

RealCap Uranium Research Quarterly

Toro Energy Limited

Uranium's "Nuclear Winter"

Market commentators have since 2011 been drawing attention to the potential uranium demand-supply mismatch, calling for a price response to diminishing supply in the face of increasing planned demand. And yet, the uranium spot price is now at new lows with no sign of a supply squeeze in sight.

Uranium Spot Price (\$/lb)



Much has also been written about the slow pace of Japanese nuclear reactor restarts post-Fukushima. Over five years on from March 2011, of the 49 reactors that were operable pre-Fukushima, only 2 are currently in operation. The Institute of Energy Economics, Japan, in an "Economic and Energy Outlook of Japan through FY2017" assumes in its reference scenario that by the end of FY2016, a cumulative of 7 nuclear reactors will be restarted and by the end of FY2017, 19 units will be in operation. Assuming there are 19 nuclear power units active, the electricity generation will only amount to 42% of the pre-earthquake level generating just under 120TWh.

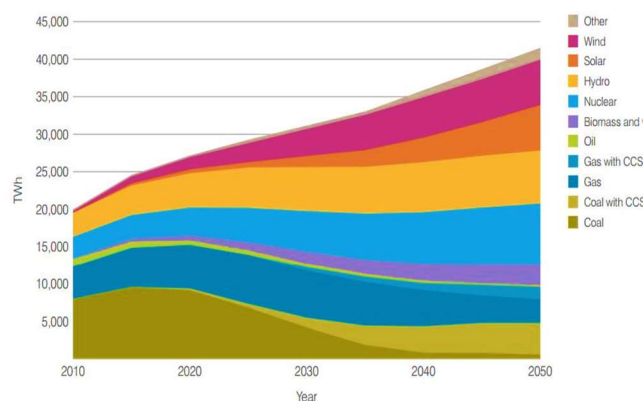
The Japanese restart environment would appear more positive going into 2017, however, it seems clear with the benefit of hindsight that Japan had sufficient uranium feedstock for all 49 of its reactors prior to Fukushima. This means that while the restarts are an important sentiment indicator for financial markets,

the restarts themselves are unlikely to account for any demand pressure.

The International Energy Agency (IEA), has published an "Energy Technology Perspectives 2015" report which describes scenarios for the global energy system to 2050. The base scenario modeled, assumes an increase of 6 degrees Celsius (6DS) in global temperatures because of global CO₂ emissions. This rapid increase in emissions and temperature is because of the projected doubling of energy demand globally. The IEA paper also describes how, with transformation across all energy sectors, a 2DS (2 degrees Celsius scenario) is achievable.

Within this 2DS model, projections for nuclear capacity are 930 GW by 2050. This represents a doubling of nuclear capacity when compared with 2014 levels. Growth in this nuclear capacity will be driven largely by non-OECD regions led by China, India, and the Middle East. Nuclear energy plays an important role in decarbonising the energy sector and has to be part of a global energy solution.

IEA 2DS for Electricity Generation



The longer-term energy outlook confirms the positive fundamentals for the uranium and nuclear energy market, but the timing remains uncertain. The Nuclear Energy Institute (NEI) which tracks statistics on nuclear power plant operation, says that as of May 2016, 30 countries were operating 444 nuclear reactors for electricity generation with 63 new nuclear plants currently under construction.

The demand for uranium fuel stock exists and is forecast to grow. Of that, there is a high level of certainty. The persistent uncertainty within the uranium spot market is because of poor financial market sentiment following the painful Japanese reactor restart process, secondary supplies of uranium feedstock which are being worked through more slowly than anticipated, as well as surplus enrichment capacity leading to underfeeding. As a result of the uncertainty, financial market participants are shying away from uranium-backed or uranium-related financial counters.

None of these conditions can continue indefinitely, and, as is the case in most commodity prices corrections, when the correction comes, it is likely to be a violent move which catches many by surprise. These factors make uranium exposure the ultimate contrarian play.

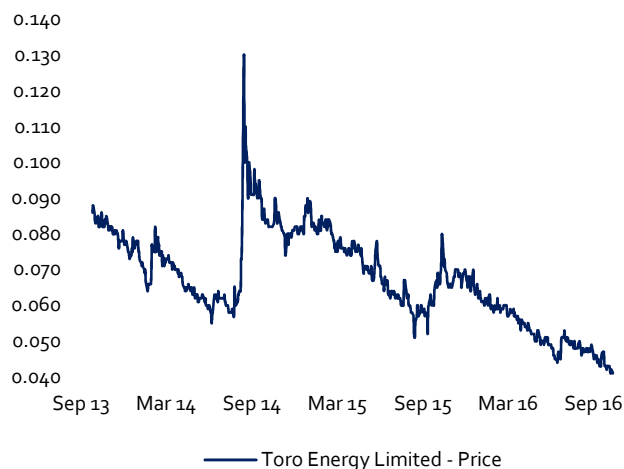
Toro Energy

Toro Energy (ASX: TOE) is a Perth-based uranium explorer and pre-production mining company. Its principle asset, The Wiluna Project located 30 km south of Wiluna in Western Australia has 84 million pounds of U₃O₈ at a 200ppm cut-off – sufficient resources to mine for 20 years.

The company has received State and Federal Environmental approvals for the Centipede and Lake Way deposits and is currently seeking approval for the Millipede and Lake Maitland deposits which together make up the Wiluna Project resource.

The Toro Energy share price has echoed the movement in the uranium spot market and continues to inch downward. The Cameco Corporation (NYSE: CCJ) Chief Executive Officer, described the recent period in a 2Q16 conference call as “the toughest quarter in the toughest market in a decade.” Company management, as well as investors, are having to remain patient which is oftentimes more challenging than being “active”.

Toro Energy Share Price (AUD)



Assessing the Peer Group

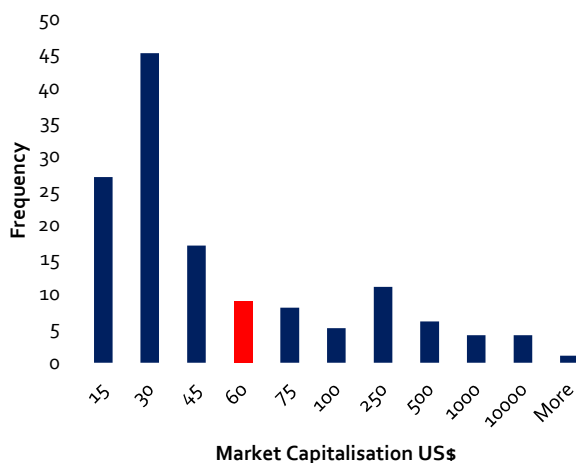
To assess the overall climate for uranium miners, a proxy index of the peer group was created. Using a universe of public companies listed on either the Canadian, American or Australian stock exchange, the following filters were applied:

- Market capitalisation above US\$10 million
- Industry classification of metals / minerals
- The use of the word “uranium” in the description of company operations

Market Capitalisation

A list of 137 companies met the filter requirements. Viewing the distribution in market capitalisation (US\$), we note that Toro Energy with a market capitalisation of US\$64 million falls in the top third of companies. This is an impressive statistic for a pre-production company that is not revenue producing. It validates the strength of the Toro Energy balance sheet and uranium resource, as well as management’s ability to attract investors.

Industry Market Capitalisation Distribution (US\$)

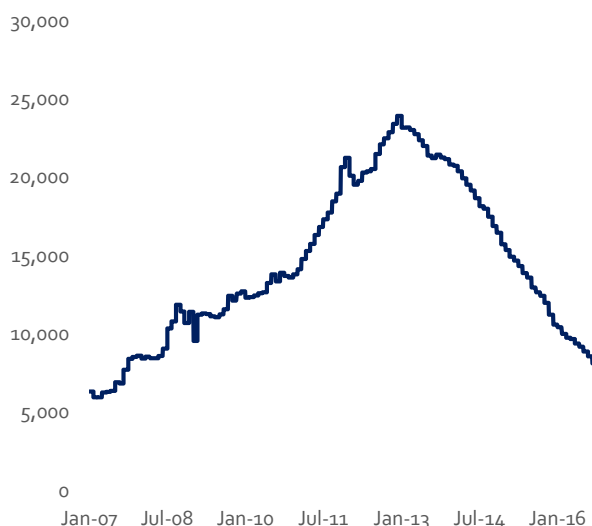


Using the constructed peer group, some interesting metrics can be observed.

Capital Expenditure

The chart below display capital expenditures for the group in US\$ on a TTM (trailing twelve month) basis.

Industry Capital Expenditures (US\$, TTM)



The marked fall in CapEx since 2013 is striking. As it became clear that there would be no immediate price recovery or restarts of the Japanese nuclear fleet, companies began to, sensibly, reduce capital expenditure. Typically, CapEx is allocated to improving mining infrastructure, commencing mining operations or conducting exploration of new potential

reserves. The supply response in the face of this clear CapEx reduction will be material. Mining companies have simply not invested in new supply pipelines. The timeframe to mining commencement is low and faces numerous regulatory challenges. Even for those uranium miners with well mapped, known resources and all the necessary permits in places, mining is not a product that can just be “turned on”. To commence operations can be a 12 to 18-month process even under ideal conditions. It is this supply reduction that must lead to a future price response.

Leverage

We can also review the leverage of the industry by examining the Debt / Equity ratio over time.

Industry Debt / Equity Ratio (%)



Leverage ratios have been increasing and are now around 60% for the constructed universe. Equity values have diminished following share price declines. There is also now a greater reliance on debt to finance operations due to falling revenues.

The red dot on the chart indicates the current leverage ratio for Toro Energy – just 13%. Again, this is a testament to a management team who have not only done all they can to fully understand their uranium resource and plan for the commencement of mining operations but who have also ensured that in this current “nuclear winter”, their capital structure is appropriately conservative.

Toro Energy Balance Sheet (A\$ millions)

	Jun '16	Jun '15	Jun '14	Jun '13	Jun '12
Assets					
Cash & Short-Term Investments	10.37	22.89	7.15	11.24	12.81
Short-Term Receivables	0.85	0.90	0.21	0.50	0.28
Other Receivables	0.84				
Total Current Assets	11.22	23.99	7.39	11.84	13.24
Property, Plant & Equipment - Net	1.00	1.45	2.11	1.48	2.06
Other Assets	89.44	133.34	128.07	88.71	83.71
Total Assets	101.71	158.82	137.56	102.04	99.02
Liabilities & Shareholders' Equity					
ST Debt & Curr. Portion LT Debt	0.00	10.96	0.00	0.00	0.00
Accounts Payable	0.14	0.53	0.24	0.76	1.85
Other Current Liabilities	0.40	0.78	0.57	0.75	1.54
Accrued Payroll	0.20	0.20	0.11	0.15	0.21
Miscellaneous Current Liabilities	0.20	0.57	0.45	0.59	1.33
Total Current Liabilities	0.54	12.26	0.81	1.50	3.40
Long-Term Debt	12.02	7.36	9.39	7.82	0.00
Provision for Risks & Charges	0.05	0.04	0.05	0.08	0.18
Total Liabilities	12.61	19.66	10.24	9.41	3.58
Common Equity	89.10	139.16	127.32	92.62	95.44
Common Stock Par/Carry Value	294.06	293.81	260.04	217.59	217.59
Retained Earnings	-208.03	-160.99	-139.19	-131.79	-125.48
Other Appropriated Reserves	3.07	6.34	6.47	6.82	3.33
Total Equity	89.10	139.16	127.32	92.62	95.44
Total Liabilities & Shareholders' Equity	101.71	158.82	137.56	102.04	99.02

Unpacking the Balance Sheet

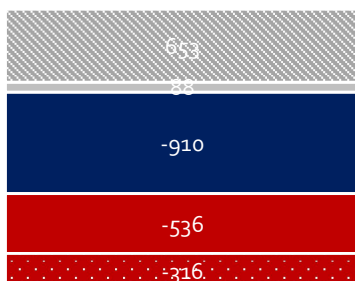
There are several balance sheet line items worth investigating on the Toro Energy Balance sheet. The key item for a pre-production mining company is its levels of cash. As at financial year end, Toro Energy had A\$10.37 million available.

Cash Flow

Their most recent quarterly cash flow report shows a net cash outflow of A\$1.02 million over the third quarter of 2016. This was attributable to the following categories as indicated in the chart below.

3Q16 Operating Cash Flows (A\$ '000)

- ▣ R&D Refunds
- ▣ Interest Received
- ▣ Administration & Corporate Costs
- ▣ Staff Costs
- ▣ Exploration & Evaluation



Toro Energy estimates their cash flows for 4Q16 to run at an outflow of A\$1.2 million. This indicates a “burn rate” of around A4 million per year. Given current cash balances of A\$9.3 million, this still provides management with sufficient reserves to see them through into 2017 as they implement their cost reduction strategy (see “Other Assets” section for further detail).

Financial Leverage

The total liabilities carried at A\$12.02 million consist of obligations to the Sentient Group which hold just over 18% of Toro Energy’s equity. This is comprised of two portions. Firstly, there is the unitisation portion which is the remaining proceeds from the A\$10 million unitisation deal currently carried at A\$8.4 million. Secondly, there is an A\$6 million loan from the Sentient Group carried at A\$3.6 million. This loan matures in August of 2018. However, given the commitment of the Sentient Group to Toro Energy and the conviction in the position, it is unlikely that this outstanding obligation will cause any financial stress for Toro Energy. Should we approach the maturity date with no firm timeline on the commencement of mining operations, it would be highly likely that Sentient would extend the terms of their loan to Toro Energy.

As a result, Toro Energy will not find themselves in the position of many others in the metals and mining sector, having to “dump assets” in order to settle loan obligations.

Other Assets

The “other assets” line item on the balance sheet, which in the case of Toro Energy refers to exploration and evaluation assets, saw a reduction from A\$133.34 million in 2015 to A\$89.44 million for the financial year ended June 2016. This change is the result of an impairment of A\$48.7 million, a non-cash transaction due to a decision to relinquish exploration tenements. 75% of this amount is for the impairment of Evaluation assets and the remaining 25% attributable to the impairment of Exploration assets.

This impairment and relinquishing of tenements assets is a part of Toro Energy’s cost reduction strategy. Those tenements that were more prospective for minerals other than uranium were sold. As well as being a cost reduction strategy, it also

speaks to the objective of Toro Energy management to focus on the core positioning as a next-to-market uranium miner, rather than a more generalist mining and minerals operation.

The expensing of these assets is seen in the retained earnings figure leading to earnings per share of negative 2.92c. If this non-cash impairment were to be stripped out of the net income line item, EPS would be a loss of 1.93c given the weighted average number of ordinary shares.

Outlook for Toro Energy

As noted in prior publications, the Toro Energy management team continue to work towards readying themselves for the commencement of mining operations conditional upon an improvement in the uranium spot price.

Uranium Resources

The results of the extensive research work conducted at Wiluna have been extremely positive, resulting in a material improvement in the uranium resource. Across the 6 deposits which make up the Wiluna Project, a 10% increase in resources brings the resource base to 84Mlbs of uranium (200 ppm cut-off) which includes 46.4Mlbs of uranium at a 500 ppm cut-off.

The research work has also indicated that the uranium deposits are contiguous which enables for an optimised and cost-effective mining process plan. Additionally, a key finding of the geological work conducted has been a determination that the uranium is predominantly clay rather than calcrete hosted. This creates significant beneficiation opportunities to enhance the grade of the uranium fed to the mill for processing. Ultimately, this results in improved project economics.

Permits & Approvals

The Western Australian EPA recommended the approval of mining at Millipede and Lake Maitland. The Western Australian Minister for the Environment is expected to make a final decision during 4Q16.

Following seven years of negotiations with the Aboriginal People at Wiluna, an agreement was reached giving the consent of the Native Title Holders to mining at Centipede/Millipede and Lake Way.

Toro Energy continues to engage with the Barwidgee People in respect of proposed mining at Lake Maitland – the tenement slated for mining commencement after mining at Centipede/Millipede.

Conclusion

All participants in the uranium mining sector undoubtedly had hoped for a price recovery over the course of 2016. Unfortunately for both investors and management teams, this appears unlikely over the remainder of the year.

We continue to have conviction in the longer-term fundamentals of the uranium market. The demand-supply dynamics will win out, but the timing of the redress is uncertain.

Like most contrarian trades, investors have to be “in it to win it”. And, with that mentality in mind, we continue to advocate an investment in Toro Energy. Not only will they survive the current environment, but they are poised to thrive in a price recovery scenario.

RealFin Capital Partners

FSP Licence No. 43784

Steve Doidge

Chief Executive Officer

Tel: +27 82 773 0173

Email: sdoidge@realcap.co.za

CONTACT US

- Email: enquiries@realcap.co.za
- Website: www.realcap.co.za

Physical Address: Office 303 Third Floor, Pam Golding on Main, Corner of Main and Summerly Road, Cape Town, South Africa, 7700

Postal Address: Suite 762, Private Bag X16, Constantia, Cape Town, South Africa, 7848

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