

RealCap Uranium Research Report

Toro Energy Limited

Toro Energy – Strong Balance Sheet

RECOMMENDATION: BUY

TARGET PRICE: A\$0.16

Toro Energy has continued to work with The Sentient Group to place them in a position envied by many mining operators. They have reduced their financing costs, deleveraged their balance sheet and ensured they have more than sufficient cash available to enable a cautious approach to their Wiluna project commencement.

Additionally, Toro Energy has a very real opportunity to shape the future of their Canadian mining assets and will no doubt prove themselves adept at unlocking value and realising the full potential in Canada.

While the uranium market remains unsettled by news from Japan over restarts, we maintain our investment thesis that uranium demand is building from current and newly developing nuclear energy operators and that the supply shortfall continues to grow.

A uranium price rerating will enable those mining operators with quality resource assets and the ability to commence production to meet demand with a material tailwind to their equity valuations.

We believe Toro Energy stands to benefit significantly as this scenario plays out.

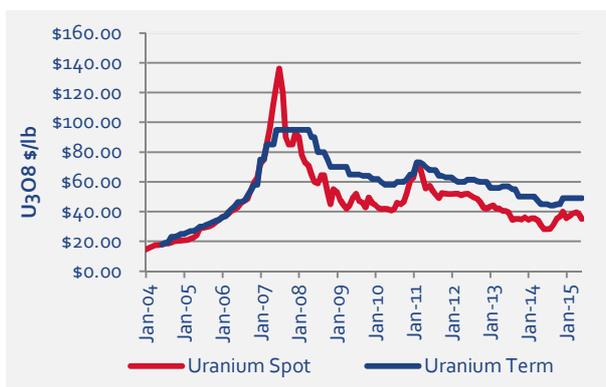
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Industry Overview

Uranium price

The Uranium spot price has held relatively steady over the first and second quarters of 2015 remaining above \$35/lb. The term price has stayed at \$49/lb, maintaining a 30-40% premium over spot.



Source: The Ux Consulting Company, LLC

Volume in both the term and spot markets has been relatively robust with 23.4 million lbs of uranium being traded on the spot market in 137 deals for 2015 up to the start of June. Ux Consulting Company reports this data. Total volume in the term market is withheld due to client confidentiality, but ten deals at term have been contracted thus far in 2015.

During 2013, 43.4 million lbs of uranium was traded at spot in 310 deals and in 2014 42.1 million lbs was traded in 294 deals. 2015, therefore, has the potential to show stronger trade volume than 2013 and 2014, and importantly, that volume is coming at a higher spot price.

The market continues to be tentative and highly attuned to the news flow out of Japan on reactor restarts. Without definitive information or timetables, the market is likely to remain cautious.

Japanese Restarts

Four years on from the Fukushima Disaster that resulted in a complete shutdown of Japan's nuclear reactor fleet, none of the remaining 48 commercial reactors have yet come back online.

Japan's Prime Minister, Shinzo Abe, has pushed for nuclear restarts, despite opinion polls showing that a majority of the public opposes them. He has warned that Japan's economic recovery will be at risk due to the enormous cost of importing coal and LNG (liquefied natural gas) to meet Japan's energy requirements in the face of the nuclear shut-down. Japan currently depends on imports for over 90% of its energy needs.

On the 22nd of April, the Kagoshima district court in south-west Japan rejected a residents' injunction against restarting two reactors at the Sendai nuclear power plant. Japan's Nuclear Regulation Authority (NRA) is currently conducting pre-service inspections of the Sendai 1 and 2 nuclear power plants. Both plants have cleared the NRA's safety examinations and are approved for restart. Documentation irregularities have been found at Sendai 1, and this has pushed back the potential restart date from early July to mid-August.

Additionally, in the face of cost pressures, some Japanese utilities are planning to sell some of their uranium stockpiles in an effort to reduce costs while they remain idle. This additional supply of uranium coming into the market is likely to put a damper on any upward price movement in the short-term.

Summary

The uranium market remains a challenging one for all participants in the nuclear fuel cycle. In terms of medium to longer-term demand, China and its ambitious nuclear expansion plans remain highly important. The Chinese government are committed to having nuclear energy play an important role in the country's energy mix, particularly in light of pollution concerns and the inability of other clean-air sources to provide base-load supply. Mixed signals and delayed restarts from Japan, as well as the potential selling down of stockpiles by Japanese utilities, create a headwind for the upward rerating in the uranium price. An upward revision is required by the uranium mining industry to catalyse their businesses. The current environment will come to an end; however, it remains a time for conservatism within the mining industry in particular.

Toro Energy Company Overview

Background

Toro Energy (ASX: TOE) is a Western Australia, Perth-based Uranium development and exploration company focussed on being a leading mid-tier global Uranium company. Toro Energy has a suite of development and exploration assets within their business structure – the key flagship project being the Wiluna Project.

Australia

The Wiluna Project is Toro Energy's primary asset situated in Western Australia. Wiluna consists of four core deposits, Centipede, Millipede, Lake Maitland and Lake Way as well as two secondary deposits, Dawson Hinkler and Nowthanna.

In addition to the Wiluna project, Toro Energy has exploration assets in the form of Theseus and Wiso Basin exploration properties.

Namibia

Toro Energy through its Namibian subsidiary Nova Energy (Namibia) (Pty) Ltd has a joint-venture stake with Deep Yellow (ASX: DYL) and a Namibian company, Sixzone Investments (Pty) Ltd. Together they participate in three exploration properties in which Toro Energy has an effective 25% stake. No significant Uranium mineralisation has been identified on the properties to date.

Canada

Toro Energy's Canadian assets comprise an equity and secured debt stake in Strateco Resources Limited. Strateco owns the Matoush Uranium project that has indicated resources of 12.33Mlbs and inferred resources of 16.44Mlbs of U₃O₈. Strateco Resources filed for court protection on the 9th of June 2015 while it attempts to refinance and continue operating. It cited that the Quebec government's refusal to grant a certificate of authorisation to proceed with the company's Matoush uranium project had placed it in an untenable position. This report will discuss the implications for Toro Energy in light of these recent developments.

Phase 1: Sentient Deal

On the 4th of November 2014, Toro Energy received a cash and asset injection from The Sentient Group, an independent private equity firm specialising in the global resources industry. The Sentient Group manages of \$2.7bn in global resource assets.

In terms of the deal, Toro Energy received A\$10m in placement proceeds (A\$7.5m reflecting tranche 1 received in December 2014 and an additional A\$2.5m as a tranche 2 payment received in June 2015). Also received were A\$10m in unitisation funds earmarked for further development of the Wiluna project.

In addition to the cash injection, Toro Energy received Sentient's Canadian-based uranium assets, namely a 19.8% equity interest in Strateco Resources Inc together with the common shares Toro Energy received C\$3m senior secured loan and C\$14.1m in a convertible note into Strateco Resources and secured over Strateco's assets, namely the Matoush Uranium Project.

Strateco Resources

Strateco Resources owns the Matoush Uranium project which as mentioned above, has indicated resources of 12.33Mlbs and inferred resources of 16.44Mlbs of U₃O₈. Strateco is however in litigation with the Quebec Government and has instituted a claim of C\$190m for damages resulting from a loss of investment in the Matoush project. This claim arises from the alleged wrongful actions of the Minister of Sustainable Development, Environment and the Fight against Climate Change.

In September of 2013, the Minister refused to grant Strateco the certificate of authorisation required to commence the advanced exploration phase of the Matoush project. The Minister alleged a "lack of social acceptability" – not a concept defined in Quebec legislation.

On the 9th of June 2015, Strateco Resources filed for protection against insolvency or a Petition for the Issuance of an Initial Order under the Companies' Creditors Arrangement Act (CCAA).

This cash flow crisis is an unfortunate turn of events for the Strateco Resources team, but in many ways, is potentially a positive occurrence for Toro Energy.

Strateco Resources faces a liquidity crisis. They have insufficient cash to meet their day-to-day operating requirements; however, their immovable mining assets remain intact. Toro Energy is the senior secured creditor for Strateco Resources, via both the loan agreement and the convertible note.

Toro Energy's Strateco Assets

Strateco Resources lists its secured debt obligations in its Petition for the Issuance of an Initial Order as follows:

Creditor	Description	Amount (C\$)
Toro Energy	Loan	3 000 000
Toro Energy	Convertible Notes	14 105 000
Strateco Employees	Secured Claims	1 184 164
Total		18 289 164

Source: *Strateco Resources Petition under CCAA - 2015*

As can be discerned from the table, the majority of the secured debt outstanding is due to Toro Energy. The Loan asset is attracting interest and matures on the 20th of December 2015. Strateco granted a first-ranking hypothec on all of the present and future immovable and movable property of Strateco Resources as a guarantee of the loan. There are also unsecured creditors, largely in the form of Revenue Quebec who are owed C\$3.7M for unpaid taxes. This debt is currently due.

The convertible notes are senior secured convertible equity notes secured by a second-ranking hypothec on of the present and future immovable and movable property of Strateco Resources. Additionally, Toro Energy has three consecutive options to extend the maturity dates of the notes for one year for a cumulative maximum of three years to the 27th of February 2019.

The secured claims by the former employees of Strateco Resources are for full and final settlement of their respective unpaid departure allocations. The payment of these employee claim amounts is

conditional on Strateco Resources receiving money from a settlement or a favourable judgment in the legal proceedings against the Quebec Government.

Toro Energy also holds an equity stake in Strateco Resources of approximately 43 million shares.

It is important to bear in mind that the acquisition of the Strateco assets had a minimal outward cash flow requirement for Toro Energy. The Strateco assets should be viewed simply as a cost of financing rather than an investment purchase. We believe Toro Energy has a real opportunity to realise upside from these assets as discussed below.

Unlocking Value from Strateco

The first reaction when encountering a distressed asset situation is typically one of gloom, however, as unfortunate as Strateco's financial position is, it presents Toro Energy with a compelling opportunity. As the primary creditor, Toro Energy has become the *de facto* owner of Strateco's uranium mining assets without the legacy of the apparently strained relationship the Strateco management team can only have had with the Quebec Government.

Toro Energy's management team have proven themselves as skilled and sensitive negotiators in navigating what can be a tricky path with various stakeholders in the uranium mining process. These include the rights of the indigenous people and the environmental and regulatory authorities.

Toro Energy is now well placed to adopt a fresh approach in Canada. If Strateco Resources are successful in their litigation against the Quebec Government, and the sentiment of the Quebec Government is positive towards the development of uranium resources in the north of the province, then Toro Energy stands to benefit as an equity participant and as a mining operator. In the event the litigation is unsuccessful, Toro Energy has an opportunity to be a "fresh face" to repair and rebuild relations with the Quebec Government. It can reinvigorate the Strateco Resources mining assets through the securing of permitting and financing as they have successfully done in Australia.

Either outcome will see Toro Energy with a far more

meaningful ability to influence and steer the Strateco Resources business and mining assets thus unlocking the real value of the uranium resource.

Phase 2: Sentient Deal

On the 11th of June 2015, Toro Energy announced a key balance sheet restructuring backed by The Sentient Group. In terms of the deal, Toro Energy will pay down the A\$12million debt facility currently held with Macquarie Bank (ASX: MQG). The impact on the Toro Energy balance sheet is examined below.

Toro Energy Balance Sheet (Including Post-Sentient Deal Estimates)

	Notes	Post-Deal Estimates	31-Dec-14
Current Assets			
Cash and cash equivalents	1	18 301 000	25 252 776
Trade and other receivables	2	134 845	134 845
Other current assets		25 306	25 306
TOTAL CURRENT ASSETS		18 461 151	25 412 927
Non-current Assets			
Available for sale investments	3	39 273	2 784 457
Loans and receivables	4	-	-
Property, plant and equipment		1 603 103	1 781 226
Exploration and evaluation assets		135 608 486	130 608 486
TOTAL NON-CURRENT ASSETS		137 250 862	135 174 169
TOTAL ASSETS		155 712 013	160 587 096
Current Liabilities			
Trade and other payables		1 351 897	1 351 897
Short-term provisions		130 905	130 905
TOTAL CURRENT LIABILITIES		1 482 802	1 482 802
Non-current Liabilities			
Borrowings	5	13 003 706	17 176 907
Long-term provisions		58 247	58 247
TOTAL NON-CURRENT LIABILITIES		13 061 953	17 235 154
TOTAL LIABILITIES		14 544 755	18 717 956
NET ASSETS		141 167 258	141 869 140
Equity			
Issued capital	6	289 017 322	286 521 554
Reserves		13 174 027	13 174 027
Accumulated losses	7	-161 971 626	-157 826 442
Balancing figure	8	947 535	
TOTAL EQUITY		141 167 258	141 167 258
Notes			
1.	Cash and cash equivalents	22 801 000	25 252 776
	Less: Macquarie Loan Payment - Working Capital	-500 000	
	Less: Macquarie Loan Payment - Unitisation Proceeds	-3 000 000	
	Less: Cash Flow for 2Q15	-1 000 000	
		18 301 000	25 252 776

2.	Full impairment of C\$3m loan	-	-
3.	Strateco: 43m shares @ mkt value	2 745 184	2 745 184
	Less: Full impairment	-2 745 184	
	Add: SeqUR	39 273	39 273
		39 273	2 784 457
4.	Full impairment of C\$14.1m loan	0	0
5.	Macquarie Debt Facility	0	12 000 000
	Less: Transaction Costs		-4 559 090
	Add: Amortised transaction costs		2 732 291
		0	10 173 201
	A\$10m unitisation deal		10 000 000
	Less: Present value discount of Unitisation Agreement		-2 882 198
	Less: Transaction costs		-114 096
	Add: Amortised transaction costs		
		7 003 706	7 003 706
	Sentient Loan Facility	6 000 000	0
	TOTAL BORROWING	13 003 706	17 176 907
6.	Ordinary shares	1 903 769 581	1 903 769 581
	Add: Sentient Issuance: Unitisation placement	31 200 000	31 250 000
	Total Ordinary Shares	1 935 019 581	1 903 769 581
	Issued Capital	286 517 322	
	Add: Sentient Issuance: Unitisation placement	2 500 000	
	Total Issued Capital	289 017 322	
7.	Accumulated Losses	-157 826 442	-157 826 442
	Less: 1Q15 loss	-1 000 000	
	Less: 2Q15 loss	-400 000	
	Less: Strateco equity impairment	-2 745 184	
		-161 971 626	-157 826 442
8.	Balancing amount due to estimates	947 535	

On examination of the balance sheet a few key items must be noted:

- Toro Energy fully impaired the Strateco loan and the Strateco convertible notes as at 31 December 2014
- Toro Energy will need to write down the value of the Strateco equity which was reflected at the closing price on balance sheet date as listed on

the Toronto Stock Exchange. This write down will create an accounting loss of approximately A\$2.7 million in this financial period

- Toro Energy has extended their debt repayment date from March 2016 to August 2018 and reduced total debt from A\$22 million (A\$10 million unitisation plus A\$12 million interest bearing from Macquarie) to A\$16 million

- Toro Energy have replaced their interest bearing debt to Macquarie of A\$12 million, due March 2016, with an interest free debt to Sentient of A\$6 million due August 2018
- The effective interest rate on the Macquarie debt was 7.6% whereas the A\$6 million facility from Sentient is interest-free. Toro Energy has therefore reduced their financing cash flow requirements substantially
- If we include the unitisation proceeds within the debt computation, then post deal, Toro Energy have deleveraged their balance sheet by 24% (Debt/Equity ratio from 12% to 9%)
- If the unitisation proceeds are excluded from the debt computation, then we see deleveraging benefits of 41% (Debt/Equity ratio from 7% to 4%)

The key takeaway from Phase 2 of the Sentient deal is a reduction in financing costs and a deleveraging of the Toro Energy balance sheet. There is also an important sentiment indicator to consider – Sentient did not have to step in as the financing partner beyond the Phase 1 deal contribution, but they have elected to do so. This provides an indication that the Sentient team is satisfied with their investment in Toro Energy. They were willing and able to provide a further capital contribution tied to the upside of Toro Energy's equity. This is another indication that the "smart money" is backing Toro Energy's medium-term vision and positioning.

Toro Energy Valuation

In a previous report, published in February 2015, we provided our methodology of a discounted cash flow (DCF) model to attach a value to the shares of Toro Energy under different future uranium market scenarios.

Importantly, only the Wiluna project was been attributed any value in the modelling process. We made various assumptions about the CapEx requirements to bring the Wiluna project to an operational state. Toro Energy's currently budgeted CapEx figure is A\$316 million. It will be spent on creating the mine infrastructure – the processing plant, power station, worker accommodation and other

vehicles and equipment required as well as provision for contingencies.

As stated previously, we continue to believe that the ultimate CapEx number will be lower than current estimates, perhaps as much as 20%.

For the purposes of our valuation, we assumed CapEx of A\$300m - A\$250m upfront and A\$50m over the life of the project. We believe we are conservative in this estimate and that the ultimate CapEx cost will be lower.

We forecast an Opex cost of approximately US\$28/lb that excludes mining royalty charges (payable to the State Government and Traditional Owners), tax, depreciation and other company administrative costs.

Toro Energy currently estimates a production output of 2Mlb's per year on average over the mine life.

The model required the following time varying inputs:

- Uranium future spot price
- USD/AUD future exchange rate
- Estimation of the blend between term and spot revenue
- Royalties payable
- Tax payable
- Non-Opex costs
- A discount rate for future cash flows
- CapEx financing structure
 - New equity issue price
 - Interest payable

Also, a factor in the model was the assumed commencement date of mining operations along with assumptions about the Wiluna project financing structure.

If the Wiluna project is financed through equity – assuming there is market appetite for such a capital raise – the new share issuance will be dilutive to existing shareholders.

We assumed Toro Energy would have the ability to finance the Wiluna Project in part through debt and part through a new equity issuance. Such a financing mechanism would be to the benefit of existing and new shareholders. Our assumed mine construction date was the end of 2016.

Given the current uranium price and market outlook we have made the following revisions to our DCF valuation model:

- Estimate the project commencement date is towards the end of 2017 rather than the end of 2016
- Estimate the mining start date is 2019 rather than 2018
- Revise the estimated new equity issuance under future uranium price scenarios

The net result of these revisions is a change in our valuation scenarios as reflected in the table below:

	Equity Issuance Price per Share	Future Uranium Spot Price	Toro Energy Valuation per Share
Prior Base Case	A\$0.15	US\$55/lb	A\$0.19
Current Base Case	A\$0.134	US\$55/lb	A\$0.16
Prior Upper Case	A\$0.26	US\$70/lb	A\$0.33
Current Upper Case	A\$0.22	US\$70/lb	A\$0.28

The revised valuation indicates a very meaningful upside potential in the share price of Toro Equity shares currently trading at A\$0.068¹.

Reiterating our DCF input assumptions, this estimate is based on the development and mining of the Wiluna Project only. No assumptions are made about the realisation of value from Toro Energy's Canadian assets. We feel that over time, Toro Energy will unlock value from its Strateco holdings. This potential revenue stream, along with the potential revenue from Toro Energy's other exploration assets will begin to be priced into the share price providing downside support and significant upside potential.

¹ As at close on 23 June 2015

Conclusions

Outlook

While sentiment in the uranium market remains cautious, future demand pressure from nuclear power utilities continues to build

The market has been awaiting the restart of the Japanese nuclear fleet as an indicator of market sentiment towards nuclear energy. Delays from Japan have dampened sentiment, but hopes remain for a 2015 restart at Sendai.

At a company-specific level, Toro Energy continues with prudent financial management and good corporate strategic decision making. It is clear that the partnership with The Sentient Group is a positive one for the company. The financing support and firepower that Sentient brings to the relationship enables Toro Energy to bolster their balance sheet and ensure the war chest is more than sufficient to see them through to mining development and production.

Risks

There are undoubtedly risks to investing in a pre-production mining company that we presented in full in a prior publication. We give a summary of the key risks below. Where possible, Toro Energy management has sought to mitigate those risks, but investors must be aware that certain risks are inherent to uranium mining.

- Financing and economic risk
- Permitting risk
- Geology and Metallurgy
- Country risk
- Liquidity risk

Investor Recommendations

We continue to hold a buy recommendation for Toro Energy and would encourage investors to build a position at current attractive price levels.

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