

9 April 2019

Canada

EQUITIES

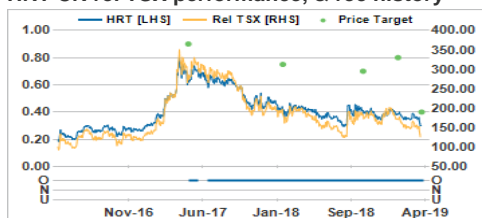
HRT CN Outperform
Price (at 20:50, 08 Apr 2019 GMT) C\$0.30

| | | |
|---|-------|-----------|
| Valuation | C\$ | 0.54 |
| - DCF (WACC 5.0%, beta 1.2, ERP 7.0%, RFR 4.0%) | | |
| 12-month target | C\$ | 0.40 |
| 12-month TSR | % | +33.3 |
| Volatility Index | | High |
| GICS sector | | Materials |
| Market cap | C\$m | 180 |
| Market cap | US\$m | 135 |
| 30-day avg turnover | C\$m | 0.2 |
| Number shares on issue | m | 600.2 |

Investment fundamentals

| Year end 31 Dec | | 2018A | 2019E | 2020E | 2021E |
|------------------|-----|--------|-------|-------|-------|
| Revenue | m | 0.0 | 71.1 | 124.1 | 126.1 |
| EBITDA | m | -32.5 | 26.8 | 61.7 | 64.2 |
| Recurring profit | m | -32.7 | 20.5 | 53.4 | 57.2 |
| Reported profit | m | -39.9 | 20.5 | 53.4 | 57.2 |
| Gross cashflow | m | -32.4 | 20.5 | 53.4 | 57.2 |
| CFPS | C\$ | -0.06 | 0.03 | 0.09 | 0.10 |
| CFPS growth | % | -875.9 | nmf | 160.7 | 7.2 |
| PGCFPS | x | nmf | 8.8 | 3.4 | 3.1 |
| EPS rec | C\$ | -0.06 | 0.03 | 0.09 | 0.10 |
| EPS rec growth | % | -306.7 | nmf | 160.7 | 7.2 |
| PER rec | x | nmf | 8.8 | 3.4 | 3.1 |
| Total DPS | C\$ | 0.00 | 0.00 | 0.00 | 0.00 |
| Total div yield | % | 0.0 | 0.0 | 0.0 | 0.0 |
| ROA | % | -25.1 | 18.5 | 33.6 | 28.5 |
| ROE | % | -51.7 | 72.6 | 84.0 | 48.1 |
| EV/EBITDA | x | -7.5 | 9.1 | 3.9 | 3.8 |
| Net debt/equity | % | 326.3 | 207.9 | 42.4 | 0.7 |
| P/BV | x | 9.2 | 4.9 | 2.0 | 1.2 |

HRT CN rel TSX performance, & rec history



Note: Recommendation timeline - if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.

Source: FactSet, Macquarie Research, April 2019
(all figures in CAD unless noted)

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Harte Gold (HRT CN)

FS in hand, expectations reset - target down

Key points

- ▶ HRT underpins the Sugar Zone mine complex with a FS - the asset is in ramp-up mode.
- ▶ Target down to C\$0.40 (was C\$0.80) as we lower expectations for margin and highlight balance sheet concerns (again).
- ▶ Plenty of upside not in our model if the cost structure can be achieved, resource conversion is solid and higher grade zones are drilled-off.

Event

- HRT, before market on Apr/8th, reported the results of its FS for its ~80kozpa Sugar Zone mine, NW Ontario, Canada.

Impact

- **Model updated for -C\$0.27 NAVPS impact, target reduced to C\$0.40 (was C\$0.80).** We have amended our model on various fronts (Fig 1) and highlight the following key changes/assumptions: i) improved overall head grade of 6.8g/tAu (was 6.2g/tAu – includes 38% dilution as per the FS); ii) increased (+20%) opex based on expected operating costs for narrow ~2m average mining widths – average LOM mining cost of ~C\$110/t vs FS at C\$95; iii) deferral of mill expansion to 2023 (was 2020 – FS assumes no mill expansion with 800tpd steady state production). Given ramp-up teething issues (and balance sheet issues), we have also reduced our P/NAV and P/CF target multiples by 10% & 20% respectively.
- **Near term funding gap reduced through grade improvement and FS deferral (?) of expansion plans beyond 800tpd (vs May/18 PEA at 1,400tpd).** We have reduced our estimated near term funding need to \$35m in 2Q19 (was ~\$40m in 2019/2020 [LINKI](#)) with the proceeds going towards repayment of the Appian bridge (due in May/19), addressing the payables build up and short-medium term working capital requirements [LINKI](#).
- **Opportunities and upside to our target** that are not in our model (p2) including: i) inferred resources at 5.9g/t converting at a high ratio to +7g/tAu; ii) mining costs meet the FS estimates at C\$100/t, and; iii) strong exploration upside for new higher grade discoveries or expansions of zones.

Earnings and target price revision

- 2019/20 EPS now 3c/9c (was -1c/8c). Target reduced to C\$0.40 (was C\$0.80) via model changes & lower target multiples - P/NAV to 0.85x (was 0.95x) & P/CF to 8x (was 10x).

Price catalyst

- 12-month price target: C\$0.40 based on a Sum of Parts methodology.
- Catalyst: 1Q19 production & financials; Refinance package (2Q19).

Action and recommendation

- We have become cautious on HRT given the recent YE18 financials that highlighted covenants being breached along with the FS that we still see execution risk with. We maintain our Outperform, however, we have significantly reduced our target to C\$0.40 (was C\$0.80).

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Analysis

We have reviewed the FS results that were in the HRT's news release and updated our model after analysing the new LOM plan and discussing the study with VP Operations Roger Emdin (see Fig 1 for the PEA vs FS vs Macquarie previous vs Macquarie revised). Note that while we have been more conservative on the cost structure, we are very constructive that the mine will be able to expand to 1200tpd by 2023 (not in the FS but in the PEA) that puts it on a trajectory to produce +75kozpaAu. We have highlighted our key concerns along with key opportunities/upside below.

Concerns

- ⇒ **Balance sheet is stressed.** There could be a dilutive debt refinancing with additional covenants that could add to the existing financial encumbrances. We highlight that HRT had C\$101m of current debt vs C\$12m of current assets as of Dec/31st 2018 and was in breach of several operational and financial Sprott covenants [\[LINK\]](#).
- ⇒ **Execution risk.** The Sugar mine complex is in ramp-up mode and has had a number of challenges in reaching commercial production at 525tpd. One of these challenges has been a severe NW Ontario weather with high rainfall in 4Q18 and prolonged freezing temperatures in 1Q19 – this has negatively impacted the ramp-up. Another challenge has been equipment availability (specialized narrow vein mining equipment teething issues) due to contractor ramp up issues and delays in acquiring long-lead electrical items to properly establish underground electrical infrastructure. We do not have a good understanding yet of how the mine is reconciling to the block model or how well the mill is performing.
- ⇒ **Retaining skilled Labour.** As more gold mines in Canada are being built or expanding, there has been generally a crunch on the ability to retain skilled miners and mining engineers for out-of-town operations (vs Timmins, Val d'Or). We will closely monitor HRT's ability to retain personnel.

Opportunities / Upside

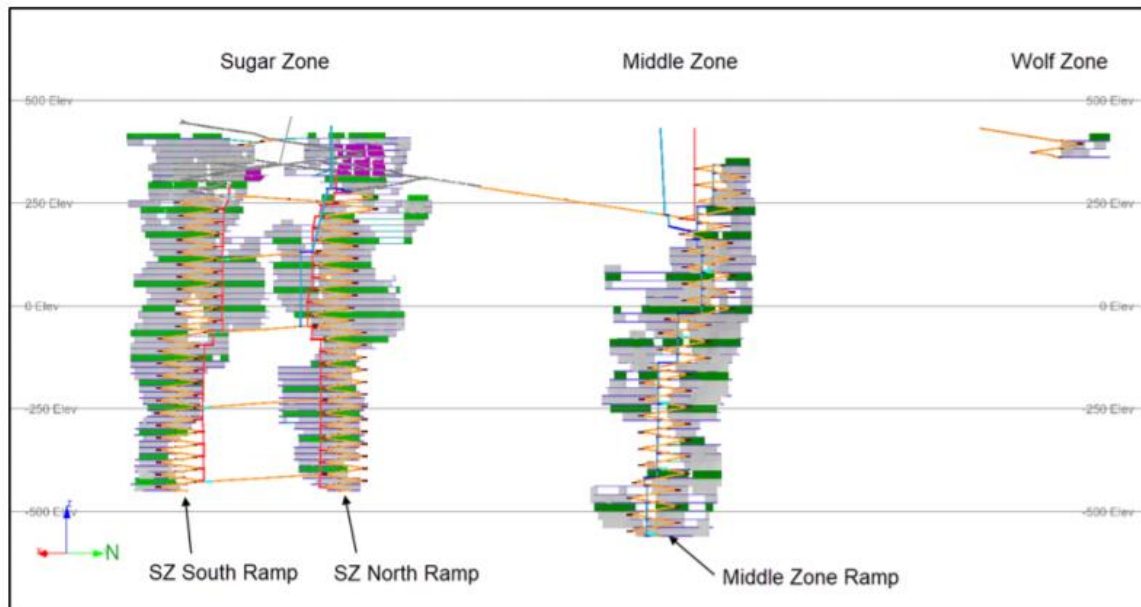
- ⇒ **High conversion rate of inferred to indicated resources along with a grade increase.** We think there is a high probability that the inferred will largely convert to indicated and at higher grades (the reserve grade of ~7g/tAu). Impact – +C\$0.03 NAVPS.
- ⇒ **We continue to see strong exploration upside for new higher grade discoveries, at the Sugar Zone complex – we highlight that for every 1g/tAu increase in average grade there is a +C\$0.10 NAVPS impact.**
- ⇒ **Reduce mining costs** via the use of loose rock backfill in secondary stopes above the sill pillar (lowest mining block level). Loose rockfill is typically cheaper to place, requires no curing time and reduces waste haulage costs to the surface. If HRT can implement operational excellence initiatives, and lower mining dilution (through prudent blasting practices) to meet the FS mining cost estimate of C\$100/t then there is +C\$0.03 NAVPS upside;
- ⇒ **New discoveries and expanding existing zones** – HRT has been very successful at expanding the Sugar and Middle Zone to depth – this was a core aspect of our investment thesis when we initiated coverage [\[LINK\]](#).

Fig 1 Sugar Zone model summary and comparison of the May/2018 PEA, Apr/19 FS and Macquarie Model. We assume an expansion to 1,200tpd in 2023 via an additional ball mill and secondary crusher (assumed \$30m capex in 2022) – economies of scale drive lower processing and G&A costs. We also assume a 25% conversion of indicated and inferred resources with 38% mining dilution applied.

| | | PEA | Macquarie | | Macquarie | |
|--------------------------------------|-------------|---------|-----------|---------|-----------|-----------------|
| | | | Previous | FS | Current | % Change (Macq) |
| Average Gold Price | (US\$/oz) | \$1,250 | \$1,295 | \$1,300 | \$1,295 | 0% |
| Average FX Rate (CAD:USD) | | 0.80 | 0.73 | 0.77 | 0.73 | 0% |
| LOM Tonnes Mined/Milled | (000s t) | 4,539 | 5,405 | 3,879 | 4,823 | -11% |
| Avg Processing Rate (2021+) | (tpd) | 1,400 | 1,177 | 783 | 1,143 | -3% |
| Diluted Average Head Grade | (g/tAu) | 6.5 | 6.2 | 7.1 | 6.8 | 10% |
| Gold Recovery | (%) | 95% | 95% | 95% | 95% | 0% |
| Mine Life | (years) | 12 | 12 | 14 | 14 | 17% |
| Total Gold Ounces Recovered | (kozAu) | 904 | 904 | 843 | 994 | 10% |
| Average Annual Gold Production (LOM) | (kozAupa) | 81 | 75 | 61 | 76 | 2% |
| Sustaining Capital (LOM) | | | | | | |
| Sustaining Capital | (C\$m) | \$200 | \$193 | \$223 | \$235 | 22% |
| Expansion Capital | | | | | | |
| Expansion Capital | (C\$m) | \$23 | \$28 | \$0 | \$30 | 9% |
| Unit Operating Costs | | | | | | |
| Mining | (C\$/t) | \$91 | \$95 | \$100 | \$111 | 17% |
| Processing | (C\$/t) | \$29 | \$31 | \$34 | \$29 | -4% |
| G&A | (C\$/t) | \$8 | \$13 | \$33 | \$27 | 105% |
| Total | (C\$/t) | \$128 | \$139 | \$167 | \$168 | 21% |
| LOM Average Cash Costs | | | | | | |
| LOM Average Cash Costs | (US\$/ozAu) | \$507 | \$583 | \$648 | \$630 | 8% |
| LOM All-in Sustaina Costs | | | | | | |
| LOM All-in Sustaina Costs | (US\$/ozAu) | \$708 | \$733 | \$851 | \$816 | 11% |
| After-tax NPV5% | | | | | | |
| After-tax NPV5% | (C\$m) | \$244 | \$413 | \$270 | \$240 | -42% |

Source: Company reports, Macquarie Research, April 2019.

Fig 2 Mine Long Section (viewing East). We believe that once access is established to both the Sugar Zone North and the Middle Zone, the mine will likely be able to support a 1,200tpd mining rate based on: i) multiple development headings; ii) multiple mining blocks, and iii) segregation of working areas for efficient development & production cycles. We estimate that concurrently mining 4-5 stopes (assuming 200-300tpd per stope) will allow HRT to achieve an expanded 1,200tpd mining rate.



Source: Company reports, Macquarie Research, April 2019.

Harte Gold (HRT CN, Outperform, Target price: C\$0.40)

| Income Statement | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
|---------------------|-------------|------------|------------|-------------|-----------|-----------|
| Total revenue | C\$m | 0 | 0 | 0 | 71 | 124 |
| Operating expenses | C\$m | 0 | 0 | 0 | 47 | 65 |
| Operating margin | C\$m | 0 | 0 | 0 | 24 | 59 |
| Depreciation | C\$m | 0 | 0 | 0 | 0 | 0 |
| Exploration | C\$m | 0 | 0 | 29 | 5 | 5 |
| EBT | C\$m | (3) | (2) | (40) | 20 | 53 |
| Total tax | C\$m | 0 | 0 | 0 | 0 | 0 |
| Net Income | C\$m | (3) | (2) | (40) | 20 | 53 |
| Adjusted EBITDA | C\$m | (3) | (7) | (32) | 27 | 62 |
| Adjusted Net Income | C\$m | (3) | (6) | (33) | 20 | 53 |
| Adj. EPS FD | C\$ | (0.01) | (0.01) | (0.06) | 0.03 | 0.09 |

| Cash Flow Statement | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
|---------------------------|-------------|---------------|---------------|---------------|-------------|-------------|
| Cash flow from Operations | C\$m | (2) | (1) | (38) | 20 | 53 |
| Cash flow from investing | C\$m | (7) | (52) | (67) | (30) | (15) |
| Cash flow from financing | C\$m | 36 | 50 | 88 | 18 | (14) |
| Net change in cash | C\$m | 27 | (2) | (17) | 8 | 24 |
| CFPS FD | C\$m | (0.01) | (0.01) | (0.06) | 0.03 | 0.09 |

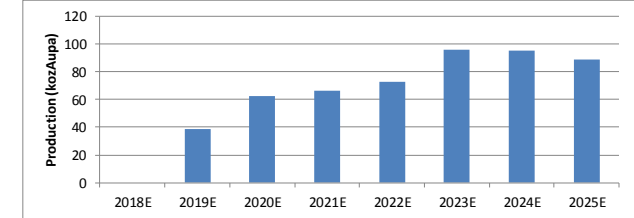
| Balance Sheet | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
|----------------------|------|------|------|-------|-------|-------|
| Cash and equivalents | C\$m | 27 | 25 | 7 | 15 | 40 |
| Working Capital | C\$m | 15 | 6 | (89) | (24) | 0 |
| Debt | C\$m | 2 | 1 | 71 | 92 | 78 |
| Total S/H equity | C\$m | 57 | 107 | 20 | 37 | 90 |
| Enterprise Value | C\$m | 126 | 127 | 215 | 228 | 189 |

| Price assumptions | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
|------------------------|--------------|----------|----------|----------|------------|------------|
| Gold | US\$/oz | 1,248 | 1,257 | 1,269 | 1,319 | 1,431 |
| Silver | US\$/oz | 17.11 | 17.05 | 15.71 | 16.13 | 17.69 |
| USD/CAD | x | 1.31 | 1.28 | 1.31 | 1.39 | 1.40 |
| Production | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
| Sugar (100%) | 000oz | 0 | 0 | 0 | 39 | 62 |
| Total Gold Prod | 000oz | 0 | 0 | 0 | 39 | 62 |
| Gold cash costs | US\$ | 0 | 0 | 0 | 826 | 694 |

| Valuation (Macq Deck) | Unit | 2016 | 2017 | 2018E | 2019E | 2020E |
|-----------------------|------|------|------|-------|-------|-------|
| P/E | x | NMF | NMF | NMF | 6.1 | 2.3 |
| P/CF | x | NMF | NMF | NMF | 6.1 | 2.3 |
| EV/EBITDA | x | NMF | NMF | NMF | 3.6 | 1.6 |
| P/NAV | x | 0.51 | | | | |

| NAV Breakdown (5% discount, based on Macquarie price deck) | US\$m | US\$ / Sh | C\$ / Sh | % Total |
|--|-------------|---------------|---------------|-------------|
| Gold Operations (DCF) | | | | |
| Sugar Zone | 193 | 0.32 | 0.43 | 62% |
| Other Mining Assets (Comparative analysis) | | | | |
| Sugar Zone Option Value Resources - 450koz (\$125 EV/oz) | 56 | 0.09 | 0.13 | 18% |
| Middle Zone Option Value Resources - 250koz (\$100 EV/oz) | 25 | 0.04 | 0.06 | 8% |
| Sugar Land Package (82000ha @ \$1200/ha) - 50% Prospective | 37 | 0.06 | 0.08 | 12% |
| Total Mineral Asset NAV | 311 | 0.52 | 0.69 | 100% |
| Corporate Adjustments | | | | |
| Net working capital | 11 | 0.02 | 0.03 | |
| Long term debt (includes future financing) | (69) | (0) | (0.15) | |
| Cash from future equity financing | 0 | 0.00 | 0.00 | |
| Total Non-Operating NAV | (57) | (0.10) | (0.13) | |
| NET ASSET VALUE | 254 | 0.42 | 0.56 | |
| Operating multiple | | 0.85x | | |

Production profile



Source: Company data, Macquarie Research, April 2019

Important disclosures:

| Recommendation definitions | Volatility index definition* | Financial definitions |
|--|---|---|
| <p>Macquarie – Asia, USA, Canada, Europe and Mazi Macquarie (SA): Outperform – expected return >10% Neutral – expected return from -10% to +10% Underperform – expected return <-10%</p> <p>Macquarie - Australia/New Zealand Outperform – expected return >10% Neutral – expected return from 0% to 10% Underperform – expected return <0%</p> <p>Note: expected return is reflective of a Medium Volatility stock and should be assumed to adjust proportionately with volatility risk</p> | <p>This is calculated from the volatility of historical price movements.</p> <p>Very high–highest risk – Stock should be expected to move up or down 60–100% in a year – investors should be aware this stock is highly speculative.</p> <p>High – stock should be expected to move up or down at least 40–60% in a year – investors should be aware this stock could be speculative.</p> <p>Medium – stock should be expected to move up or down at least 30–40% in a year.</p> <p>Low–medium – stock should be expected to move up or down at least 25–30% in a year.</p> <p>Low – stock should be expected to move up or down at least 15–25% in a year. * Applicable to select stocks in Asia/Australia/NZ/Canada</p> <p>Recommendations – 12 months Note: Quant recommendations may differ from Fundamental Analyst recommendations</p> | <p>All "Adjusted" data items have had the following adjustments made: Added back: goodwill amortisation, provision for catastrophe reserves, IFRS derivatives & hedging, IFRS impairments & IFRS interest expense Excluded: non recurring items, asset revals, property revals, appraisal value uplift, preference dividends & minority interests</p> <p>EPS = adjusted net profit / efpowa* ROA = adjusted ebit / average total assets ROA Banks/Insurance = adjusted net profit /average total assets ROE = adjusted net profit / average shareholders funds Gross cashflow = adjusted net profit + depreciation *equivalent fully paid ordinary weighted average number of shares</p> <p>All Reported numbers for Australian/NZ listed stocks are modelled under IFRS (International Financial Reporting Standards).</p> |

| Recommendation proportions – For quarter ending 31 March 2019 | | | | | | | |
|---|--------|--------|--------|--------|--------|--------|---|
| | AU/NZ | Asia | RSA | USA | CA | EUR | |
| Outperform | 48.45% | 56.50% | 47.06% | 51.94% | 68.53% | 51.76% | (for global coverage by Macquarie, 3.69% of stocks followed are investment banking clients) |
| Neutral | 35.27% | 30.15% | 32.94% | 42.78% | 24.48% | 38.19% | (for global coverage by Macquarie, 2.76% of stocks followed are investment banking clients) |
| Underperform | 16.28% | 13.35% | 20.00% | 5.28% | 6.99% | 10.05% | (for global coverage by Macquarie, 0.89% of stocks followed are investment banking clients) |

HRT CN vs TSX, & rec history



(all figures in CAD currency unless noted)

Note: Recommendation timeline – if not a continuous line, then there was no Macquarie coverage at the time or there was an embargo period.
 Source: FactSet, Macquarie Research, April 2019

12-month target price methodology

HRT CN: C\$0.40 based on a Sum of Parts methodology

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| Date | Stock Code (BBG code) | Recommendation | Target Price |
|-------------|-----------------------|----------------|--------------|
| 28-Jan-2019 | HRT CN | Outperform | C\$.80 |
| 15-Oct-2018 | HRT CN | Outperform | C\$.70 |
| 16-Feb-2018 | HRT CN | Outperform | C\$.75 |
| 08-May-2017 | HRT CN | Outperform | C\$.90 |

Target price risk disclosures:

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