

True North Gems

Funded through to production

True North Gems (TGX) has secured C\$5.3m via a share subscription agreement with Greenlandic private equity/venture capital firm Greenland Venture (GV). This financing effectively completes Aappaluttoq's mine construction financing, paving the way to first production (expected Q415). A key near-term catalyst remains – sales agreements for Aappaluttoq's ruby/pink sapphire output – the first of which are expected by year end.

Year end	Revenue (C\$m)	PBT* (C\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/13	0.0	(1.7)	(0.7)	0.0	N/A	N/A
12/14	0.0	(1.4)	(0.5)	0.0	N/A	N/A
12/15e	5.0	0.2	0.0	0.0	N/A	N/A
12/16e	45.9	31.7	6.6	0.0	2.0	N/A

Note: *PBT and EPS are normalised, excluding intangible amortisation, exceptional items and share-based payments.

Repurchase option can retain 70% ownership for TGX

The share subscription agreement applies to A shares of True North Gem's operating subsidiary True North Gems Greenland (TNGG) and dilutes True North's eventual ownership of Aappaluttoq (assuming LNSG secures its remaining 20% earn-in by completing mine construction) to 65.39% (previously 73%). A three-year repurchase option is included in the share subscription agreement allowing True North to retain up to 70% ownership.

Sale agreements being finalised

The PFS details a currently defined nine-year mine life (although deposits 2 and 3 have already been identified as extending this), extracting variably sized and distributed quantities of rubies and pink sapphires. Sales agreements are still being finalised with offtake partners for specific parcels of stones. We have downgraded our FY15 revenue assumption by a material 54%, from C\$10.9m to C\$5.0m to reflect uncertainty over FY15 offtake. We expect sale agreements to conclude in Q415.

Base case valuation slightly reduced, at C\$0.38

Our base case valuation uses True North's 18 March 2015 PFS on the Aappaluttoq deposit. We adjust our previous C\$0.41 per share base valuation for True North's FY14 and H115 financial results, the Halman Aldubi Provident and Pension Fund C\$1m warrant exercise of 3 June 2015 and the share subscription agreement. Our C\$/US\$ forex rate moves from 1.28 to 1.33. We treat the US\$18m capital leasing arrangement with LNS as an investment in True North's operating subsidiary TNGG in the form of an asset treated as a minority. Even with this marked change in our FY15 revenue assumption, our value of True North's eventual 65.39% (previously 73%) interest in Aappaluttoq is still C\$0.38 per share (using a 10% discount rate). Further demonstrating the strength of the project, cancelling FY15 revenue entirely would only cut our C\$0.38 valuation by 2.6% to C\$0.37 per share.

Mine financing completed

Metals & mining

6 October 2015

Price **C\$0.13**

Market cap **C\$40m**

C\$:US\$1.33

Net cash (C\$m) at 30 June 2015 0.2

Shares in issue 306.1m

Free float 88%

Code TGX

Primary exchange TSX-V

Secondary exchange N/A

Share price performance



% 1m 3m 12m

Abs (3.9) (3.9) 13.6

Rel (local) (4.4) 4.2 24.0

52-week high/low C\$0.19 C\$0.09

Business description

True North Gems is developing its 85.4%-owned (65% on completion of the mine by its JV partner LNSG) and exploitation (mining) permitted Aappaluttoq ruby and pink sapphire mine in Greenland.

Next events

Sales agreements By end 2015

Production start-up Q415

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Mine financed via sale of only 34% of project

True North Gems has successfully financed the construction of the Aappaluttoq mine project via a mixture of debt, equity and a capital leasing agreement over the majority of Aappaluttoq's construction and equipment. The following summary details the total C\$38m financing package now secured to develop the Aappaluttoq mine. True North Gems (the listed entity) has the ticker TGX, and its operating subsidiary True North Gems Greenland is abbreviated to TNGG.

In a series of moves announced in August 2013, September 2014 and August 2015, True North Gems has now funded around C\$42m, covering Aappaluttoq's capital costs of C\$38m plus additional working capital.

Announced in 2013 and 2014: 27% JV partner funds C\$26m of C\$38m total capex

During 2013 and 2014 True North Gems sold a total of 27% of its operating subsidiary TNGG (True North Gems Greenland is the operating subsidiary that owns Aappaluttoq) to its JV partner LNSG (LNS Greenland A/S and LNS Denmark ApS) for a total of C\$26m. LNSG will fully realise its interest when it completes mine construction, expected by early Q415.

Of the C\$26m, C\$23m relates to the 13 August 2013 agreement with LNSG, whereby it earns in to 20% of the Aappaluttoq project. Of the C\$23m funding package, C\$18m is subject to a capital lease agreement with True North over equipment for Aappaluttoq with the remaining C\$5m used for direct project capital expenditures. We treat the US\$18m capital leasing arrangement with LNSG as an investment into True North's operating subsidiary TNGG in the form of an asset treated as a minority.

The remainder of the C\$26m comprised a C\$3m investment made by LNSG via a purchase of 7% of TNGG shares. This was part of a separate financing package signed with LNSG announced 11 September 2014 taking LNSG's potential eventual stake to 27%.

JV partner capital loan of C\$5m paid off over LOM

A further C\$5m capital loan was provided to TNGG by LNSG in the 11 September 2014 financing package, to be used for capital and construction costs. We include this in our financial model, with repayment spread across nine years, bearing interest at 8%.

True North Gems equity portion comprises issuance of C\$3m

The True North Gems (ie listed parent entity) equity portion of Aappaluttoq's mine financing was only C\$3m, via the issue of 28.6m True North Gem's (TGX) shares to LNS (announced 11 September 2014).

August 2015: GV share subscription for c 7% interest in TNGG

On 28 August 2015, the remaining C\$4m capital requirement to meet the C\$38m total capex requirement was secured via a C\$5.3m share subscription in TNGG with Greenland Venture (GV).

In tandem with the subscription, True North has a three-year repurchase option to retain up to 70% ownership. To achieve this True North would be required to repurchase 50% (3.5% of the 7%) of the subscribed shares. The base repurchase share price is C\$0.93, to which an additional C\$0.46 a share is added if the option is exercised before its first anniversary. If exercised between one and two years, or after the second anniversary, additional per share premiums of C\$1.15 and C\$2.19 are to be paid on top of the base (C\$0.93) repurchase price, respectively. This agreement also

includes a small US\$1.17m loan to True North, repaid over 22 months bearing interest at 2% per month.

Valuation – base case C\$0.38 per share (little changed)

We have adjusted our previous C\$0.41 per share base valuation for True North's FY14 and H115 financial results, the Halman Aldubi Provident and Pension Fund C\$1m warrant exercise of 3 June 2015 and the share subscription agreement. Our C\$/US\$ forex rate moves from 1.28 to 1.33. We treat the US\$18m capital leasing arrangement with LNSG as an investment into True North's operating subsidiary TNGG, in the form of an asset treated as a minority

Previously, our understanding from management was that there would be a shortfall in working capital and capex that was due to be met via an additional C\$10m loan. We had included this in our financial model underpinning our previous C\$0.41 base case valuation. We had modelled a two-year repayment holiday, followed by a five-year repayment period (ie from 2017 to 2023 inclusive), with the loan bearing interest at 9%. This assumption is no longer valid and True North has instead met the requirement via the C\$5.3m share subscription agreement and US\$1.17m (C\$1.6m) loan with GV.

Due to the share repurchase agreement, True North will have sold between 3.5% and 7% (depending on whether True North executes its 3.5% repurchase option) of its outstanding share capital to Greenland Venture.

Project execution and marketing remain key risks

There remains uncertainty surrounding the FY15 revenue figure due to a lack of concrete sales agreements for Aappaluttoq stones. We have confidence in the abilities of both True North's CEO and newly appointed head of marketing (Hayley Henning) to secure such agreements (a number of buyers are lined up and terms are being finalised) and note that adjusting our FY15 revenue figure by increments of C\$5m changes our base case valuation by only C\$0.01 or 2.5%.

Sensitivity to change in FY15 revenue figure

The following sensitivity analysis is provided to demonstrate the change in our valuation for differing FY15 revenue amounts. We await True North's announcements of sales contracts for its stones to further de-risk our valuation of True North's shares. The ruby price used to underpin our valuation is US\$7/ct (average) and is a result of a third-party assessment of Aappaluttoq stones. This price remains conservative in view of Gemfields' (the only other major publically listed producer of rubies) recent maiden reserve estimate for its Montepuez ruby deposit. The reserve estimate detailed an economic analysis of the deposit using US\$1.30/ct and US\$389/ct for low and higher-quality rubies and corundum, respectively. True North's US\$7/ct average price estimate for its stones is at least comparable to the lower end of Gemfields' assessment of Montepuez stones, however different the two projects are in terms of geology. Further, Gemfields' stone values are for ruby and corundum only and cannot reflect or imply any value for Aappaluttoq's pink sapphires, which have no equivalent on the current gemstone market.

Exhibit 1: Sensitivity to percentage change in LOM net revenue

% change in annual net revenue over LOM	-20	-10	0	10	20	30
DDF (C\$)	0.27	0.33	0.38	0.44	0.49	0.55

Source: Edison Investment Research

As can be seen from both Exhibit 1, changing net revenue over life of mine by 10% results in a 12.5% change in our DDF valuation, and eliminating FY15 revenue entirely, reduces our base case C\$0.38 valuation by 2.6% to C\$0.37. The very rapid pace of construction on site following True

North's receipt of its mining licence (announced 3 March 2014) will likely mean that first production will occur before sales agreements have been announced to the market.

Exhibit 2: Sensitivity to changes in discount rate applied						
Sensitivity to discount rate (%)	0	5	10	15	20	39
DDF (C\$)	0.66	0.50	0.38	0.30	0.24	0.13

Source: Edison Investment Research

True North's share price (at 23 September 2015) implies the market is applying a 39% discount rate relative to the 10% used in our base case.

True North's H115 accounts showed cash at end June 2015 of C\$0.2m. This figure does not reflect the C\$5.3m secured via the Greenland Venture share subscription in TNGG. However, we have now included this Greenland Venture agreement and all other financing arrangements between True North and LNSG in our model.

If no revenue is secured by end FY15 we would expect LNSG to carry the cost of mining Aappaluttoq and inventories building until ruby and pink sapphire sales commence.

Final construction phase underway

True North announced 30 September that its JV partner LNSG has commenced the concrete pour at the Aappaluttoq processing plant. The processing plant, or the corundum and gemstone recovery facility, is pivotal to the mines construction. True North states that production is still on track for Q415.

A summary of key infrastructure developments undertaken and managed by True North's JV partner LNSG are:

- the pouring of the concrete floor and the raising of the structural steel at the workshop. Installation of the wall and ceiling panels is underway;
- all external cladding has been installed at the camp, with all buildings now fully insulated, allowing the carpentry crews to assist in fitting out the workshop area;
- the lowering of the northern lake has been successful and enabled the construction of a work trail from the process plant building to the secured main pit area;
- installation of full site security measures is now underway;
- installation and permitting of the main explosives depot – allowing the temporary facility at the outer port to be decommissioned;
- further construction work at the outer port; and
- all required permits for the camp have been granted, allowing full operational status.

Further, geological teams are onsite to assess the second drainage channel near the pit. Once this is completed the southern lake will be lowered and allow further access to the mining areas.

For a photo gallery of developments at Aappaluttoq, please visit True North's website at www.truenorthgems.com.

Exhibit 3: Financial summary

	C\$000s	2013	2014	2015e	2016e
December		IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue		0	0	5,000	45,854
Cost of Sales		0	0	(1,749)	(7,825)
Gross Profit		0	0	3,251	38,029
EBITDA		(1,593)	(1,222)	167	34,955
Operating Profit (before amort. and except.)		(1,593)	(1,222)	167	32,658
Intangible Amortisation		0	0	0	0
Exceptionals		0	0	0	0
Other		0	0	0	0
Operating Profit		(1,593)	(1,222)	167	32,658
Net Interest		(57)	(149)	10	(910)
Profit Before Tax (norm)		(1,650)	(1,371)	176	31,748
Profit Before Tax (FRS 3)		(1,650)	(1,371)	176	31,748
Tax		0	0	0	(841)
Profit After Tax (norm)		(1,650)	(1,371)	176	30,907
Profit After Tax (FRS 3)		(1,650)	(1,371)	176	30,907
Average Number of Shares Outstanding (m)		233.7	295.8	305.6	305.6
EPS - normalised (c)		(0.7)	(0.5)	0.0	6.6
EPS - normalised and fully diluted (c)		(0.7)	(0.5)	0.0	6.6
EPS - (IFRS) (c)		(0.7)	(0.5)	0.0	6.6
Dividend per share (c)		0.0	0.0	0.0	0.0
Gross Margin (%)		N/A	N/A	65.0	82.9
EBITDA Margin (%)		N/A	N/A	3.3	76.2
Operating Margin (before GW and except.) (%)		N/A	N/A	3.3	71.2
BALANCE SHEET					
Fixed Assets		24,467	27,988	70,614	65,883
Intangible Assets		0	0	0	0
Tangible Assets		24,467	27,988	70,614	65,883
Investments		0	0	0	0
Current Assets		729	2,343	3,455	30,561
Stocks		0	0	671	643
Debtors		18	35	2,466	3,769
Cash		271	1,989	0	25,830
Other		440	319	319	319
Current Liabilities		(1,390)	(1,346)	(5,609)	(1,356)
Creditors		(1,390)	(715)	(226)	(725)
Short term borrowings		0	(631)	(5,384)	(631)
Long Term Liabilities		(1,113)	(1,160)	(6,278)	(4,980)
Long term borrowings		(894)	(877)	(5,995)	(4,697)
Other long term liabilities		(219)	(283)	(283)	(283)
Net Assets		22,694	27,825	62,182	90,107
CASH FLOW					
Operating Cash Flow		(1,423)	(1,800)	(1,195)	34,179
Net Interest		(57)	(149)	10	(910)
Tax		0	0	0	(841)
Capex		(2,091)	(2,913)	(21,000)	(548)
Acquisitions/disposals		50	0	0	0
Financing		3,786	5,945	10,326	0
Dividends		0	0	0	0
Net Cash Flow		265	1,083	(11,860)	31,880
Opening net debt/(cash)		9	623	(481)	11,379
HP finance leases initiated		0	0	0	0
Other		(879)	21	0	0
Closing net debt/(cash)		623	(481)	11,379	(20,501)

Source: Company accounts and Edison Investment Research. Note: Edison forecasts presented as if LNSG's 20% earn-in to TNGG is fully realised.

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