

Mustang Resources Ltd  
(ASX:MUS)

August 2017

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**Note:** This report is based on information provided by the company as at August 2017

Investment Profile	
Share Price as at 1 August 2017	\$0.049
Price Target	\$0.16
Ordinary Shares	535.6m
Escrow Shares	30.0m
Listed Options	61.9m
Unlisted Options	90.3m
Performance Rights	14.0m
Fully Diluted	731.8m
Market Capitalisation	\$27.7m
12 month L/H	\$0.020/\$0.105
Cash as at 30 June 2017	\$0.399 m

Board and Management	
Mr Ian Daymond: Non-Executive Chairman	
Mr Christiaan Jordaan: Managing Director	
Mr Cobus van Wyk: Non-Executive Director	
Mr Peter Spiers: Non-Executive Director	
Mr Rob Marusco: CFO/Company Secretary	
Mr Paul Allan: Senior Geologist, Montepuez Ruby Project	

Major Shareholders	
Regius Resources (Jordaan, Van Wyk)	10.56%
Lanstead Capital	7.22%
Andium Pty Ltd	5.82%
Board and Management	10.65%
Top 20	35.53%



Senior Analyst – Mark Gordon

The investment opinion in this report is current as at the date of publication. Investors and advisers should be aware that over time the circumstances of the issuer and/or product may change which may affect our investment opinion.

### BUILDING THE INVENTORY

**Site visit confirms quality of Montepuez:** Our June 2016 site visit has confirmed the potential of the Project and the activities being undertaken by Mustang Resources (ASX: MUS, "Mustang") at their Montepuez Ruby Project ("Montepuez"), located in the world class Montepuez Ruby Field in northern Mozambique.

**New bulk sampling areas delivering:** Bulk sampling and test pitting within the newly acquired 8245L licence is delivering high quality stones from this secondary deposit, reportedly with a similar quality to those from Gemfields' nearby Mugloto deposit, which has been instrumental in delivering the high value stones to Gemfields' auctions which have generated US\$280 million in revenue over the past three years.

**Plant upgrade complete:** Successfully completed upgrades to the processing plant and near completion of commissioning should result in Mustang meeting the planned 1,500tpd (550,000tpa) production target – this is using only one shift per day, and hence if required production can be significantly increased through adding extra shifts.

**Ruby markets growing:** Mustang is ideally placed to take advantage of growth in the global ruby market – this has been limited in the past by scarcity and unreliability of supply, however the discovery of Montepuez and original production by Gemfields has brought certainty into the markets, with wholesalers and producers now looking to capitalise on this, and to develop a stable, mature market similar to that set up historically by De Beers for diamonds.

**Increasing prices:** Rubies are the most valuable of the coloured gemstones (and second only to diamonds) – in 2014 the ruby market was estimated at US\$2 billion out of the total coloured gemstone market of US\$5.9 billion – increased demand has caused ruby prices to increase 63% over the past eight years.

**Only listed ruby producer:** With Gemfields now being delisted from AIM following the takeover by Brian Gilbertson's Pallinghurst Group, Mustang is the only listed ruby producer globally, and thus provides an ideal entry into this growing and exciting market.

**Graphite also delivering:** Metallurgical test work from the Caula Graphite Project ("Caula"), located to the west of Montepuez, has returned excellent results, indicating the potential to produce a high purity, large flake product potentially suitable for the premium expandable graphite and lithium-ion battery markets – the quality is equivalent or superior to a number of the other ASX-listed East African graphite players, with the grades from drilling indicating the potential for a high grade, low cost operation.

**Experienced and Committed Personnel:** Company personnel have extensive experience in Africa, particularly in Mozambique, in which directors have operated for ~13 years. In addition Paul Allen, the Senior Geologist previously worked with Gemfields at Montepuez. Insiders hold some 10.6% of Mustang, thus aligning their interests with those of other shareholders.

**Revenue from first ruby auction expected soon:** The Company expects first revenue from rubies in October 2017, with this from a planned auction of 200,000ct – work has been concentrated on developing a grading system with gemmologists being employed for this.

**Mezzanine funding in place:** Mustang has sourced A\$8.5 million in unsecured funding through a convertible note with Arena Investors LP ("Arena"), a US based investment fund with some US\$600 million under management – this will be drawn down through four tranches, and will ensure that Mustang is fully funded through the first ruby auction.

**Steady News Flow:** Ongoing activities should provide steady news flow through 2017 – the key news items will be the results of the ruby auction and the initial Mineral Resource Estimate ("MRE") at Caula, followed by the initial MRE at Montepuez.

**Valuation:** We have updated our valuation for Mustang, with this resulting in a slightly lower base case 12-month price target of \$85 million, or \$0.16/share, a 225% premium to the current price. 80% of this is based on a risked DCF valuation for a hypothetical operation, including bulk sampling, at Montepuez, with our target predicated on milestones being met, including successful results from the planned ruby auction later this year and positive bulk sampling results leading to a meaningful initial MRE at Montepuez. The lower cash position and contingent liability (-A\$1.5 million, being the funds to be drawn down less the face value) of the note are the changes to our valuation. Although the results of ongoing work at both projects and the sourcing of finance have de-risked and increased value in Mustang since our initiation, our view is that the increase in value will be crystallised with the key milestones at Montepuez and Caula, as mentioned above, being met over coming months.

## ACTIVITIES UPDATE

### OVERVIEW

- ◆ Since our May 2017 initiation report, Mustang has continued to progress site activities on its Montepuez and Caula (Balama) projects in Cabo Delgado Province in Northern Mozambique (Figure 1), with these returning significant results.
- ◆ IIR completed a two-day site visit to Montepuez in June 2017, in which all aspects of the operation were inspected.
- ◆ On the corporate side, the Company appointed Mr Peter Spiers to the Board of Directors, and has entered into the A\$10 million face value Convertible Note Deed with Arena.

**Figure 1: Mustang project locations**



Source: Mustang

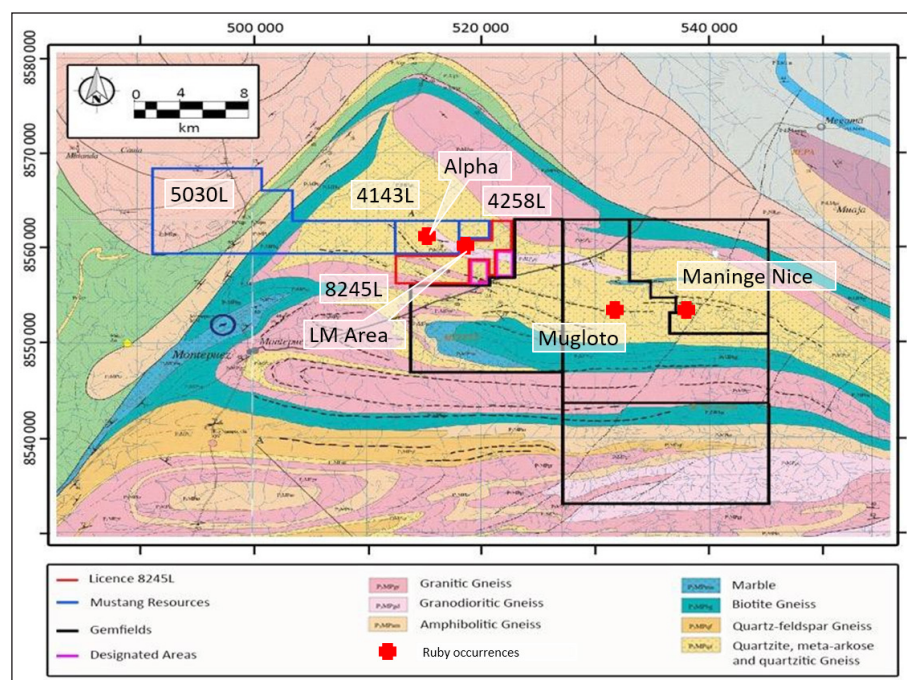
### MONTEPUEZ RUBY PROJECT - MUSTANG 52.5% TO 65%

#### Background

- ◆ Montepuez comprises four exploration tenements for 193km<sup>2</sup> – these are located some 150km west of the coastal town of Pemba (Figures 1 and 2); ownership varies between 52.5% and 65%.
- ◆ The tenements are immediately to the west of Gemfields Montepuez Project, and cover similar geology to that hosting the world's largest identified ruby deposit – Gemfields has generated revenue of US\$280 million from eight ruby auctions since June 2014, with an average price of US\$26.67/ct for all stones, and reaching US\$688.64/ct for high quality gems.
- ◆ Deposits are generally shallow (<10m), have an average thickness of 1m and are covered by soft, free dig surficial material.



Figure 2: Tenements and targets on geology



Source: Mustang

- ◆ Mustang commenced bulk sampling operations at Pit 21 in September 2016, just five months after commencement of initial fieldwork at the Project.
- ◆ This bulk sampling used a treatment plant previously used on the Company's Save River Diamond Project, also in Mozambique.
- ◆ Issues with water and clays firstly necessitated a move of the plant from its initial site at Montepuez, near Pit 21 to the Alpha Pit, and then a A\$1 million upgrade of the front-end to incorporate wet jet pumps feeding the trommel and water jetting to help break up clays – this also necessitated an upgrade of the water recycling dam to maintain a sustainable water supply.
- ◆ The plant is currently in the final stages of commissioning of the upgrades – the planned throughput is 250 tonnes per hour, with current operations based on a single seven-hour shift given a daily processing target of over 1,500 tonnes – this is 580% above throughput prior to the upgrade.
- ◆ Throughput can be significantly increased through adding additional shifts in the future.
- ◆ Activities are currently focussed on building the ruby inventory to 200,000ct from the current inventory of 132,000ct in preparation for an initial auction in October 2017 – this timing is critical in that it will give buyers time to prepare their acquisitions for Christmas and Chinese New Year, and will also be held prior to Gemfields' next auction, expected in December.
- ◆ As noted in our initiation report, all sales will be of rough rubies - a former strategy of selling some cut stones was discontinued after discussions with wholesalers given the potential for competition with rough stone customers.

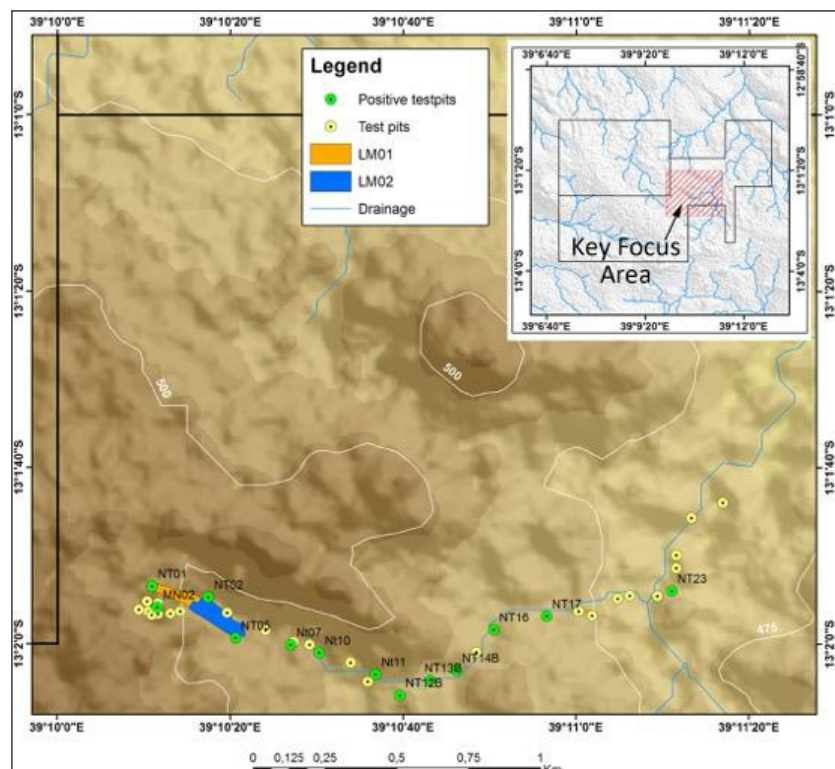
## Recent Activities and Site Visit

### Test Pits and Ruby Production

- ◆ Subsequent to our initiation note, the Company finalised acquisition of tenement 8245L, which has allowed it to commence bulk sampling in a highly prospective area, marked by a number of artisanal workings (Figures 2 and 3) over an area of secondary mineralisation considered similar to that at Gemfields' Mugloto deposit.
- ◆ Test pitting by Mustang resulted in several positive pits for some 2.2km downstream from the interpreted colluvial source (Figures 3 and 4) – discussions with Company geologists indicate that rubies in the creek downstream from the initial bulk sampling area may represent stones reworked from a main secondary colluvial deposit in the creek headwaters, which is currently being bulk sampled.
- ◆ These test pits have returned 10.7cts of rubies from 4.5 tonnes of gravel.

- ◆ During our visit shallow colluvial gravels were noted in the walls of the LM01 and LM02 bulk sampling pits.
- ◆ As reported in the June 2017 Quarterly Report, as of June 30, 2017, bulk sampling from the area had recovered 4,455ct from 5,692m<sup>3</sup> of shallow secondary material, with many of these stones being of higher quality, and classed in the special/premium categories.
- ◆ This grade of 0.8ct/m<sup>3</sup> (~0.53ct/tonne) is significantly higher than the grade of 0.11ct/tonne from the initial bulk sampling; also, reportedly the rubies are on average of higher quality.
- ◆ This has helped increase the ruby inventory to 132,000ct – a 90% increase of that held at the end of the March quarter – this has been due to treating the higher-grade areas as well as the improvements in the processing plant.
- ◆ One key aspect of preparing for the upcoming auction is developing a grading system for the Montepuez rubies – this is well underway, with the Company employing gemmologists to develop this, and using that of Gemfields as a guide.

**Figure 3: LM Area test pits and bulk sampling**



Source: Mustang

**Figure 4: LM Area test pits**



Source: IIR



**Figure 5: LM Area bulk sampling**

Source: IIR

**Plant**

- ◆ At the time of the site visit the plant was still in commissioning, however staff said that any teething issues were being solved.
- ◆ The water jetting was proving to be effective, however water delivery was impacted by issues with the water bores – these were in the process of being redrilled.
- ◆ There were some issues with sand sized material overwhelming the plant, however this was being actively managed.
- ◆ Stone sorting is carried out on site in a secure area using glove-boxes, with this being performed by skilled locals, including former artisanal miners.
- ◆ We noted good recoveries of rubies from LM Area material processed during our visit – this included a few large, high quality stones.

**Exploration**

- ◆ Exploration activities, including auger drilling and test pitting are ongoing, with this used to define potential new bulk sampling areas, and with the results to be used in the MRE.
- ◆ Exploration samples are processed on site.

**Figure 6: Plant front end**

Source: IIR

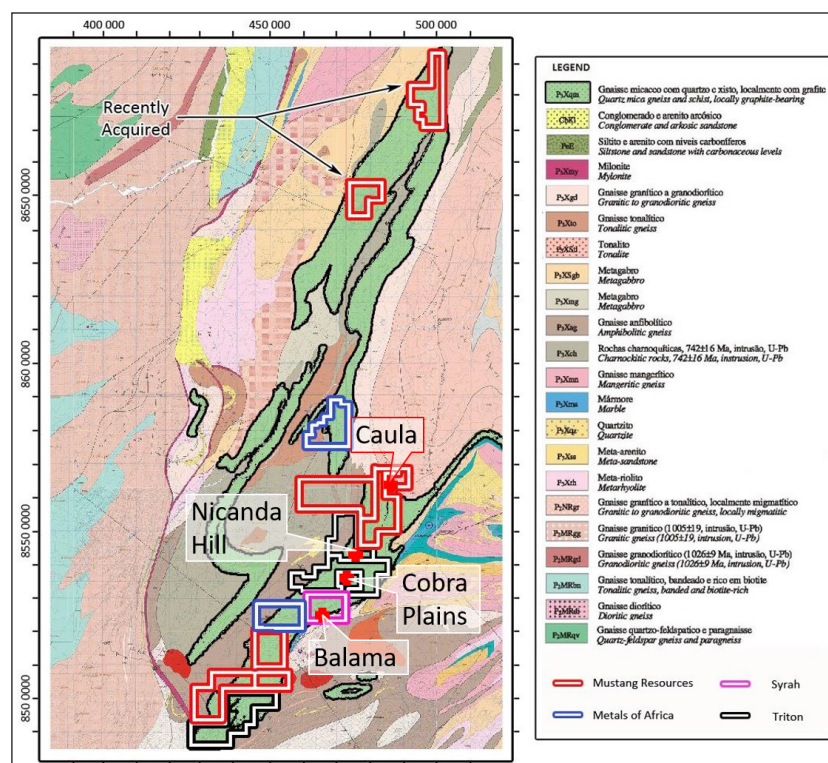


## BALAMA GRAPHITE PROJECT - MUSTANG 60% TO 95%

### Background

- ◆ The Balama Graphite Project includes seven exploration licences for 661.4km<sup>2</sup>, with the centre of the Project situated some 25km west of Montepuez.
- ◆ Balama is located along strike from major deposits of other ASX-listed companies, including Syrah Resources (ASX: SYR, Balama) and Triton Minerals (ASX: TON, Cobra Plains and Nicanda Hill)
- ◆ Work to date, including drilling has identified a number of prospects – the key is Caula, which is now referred to as the Caula Graphite Project, located in licence 6678L (Figure 7).

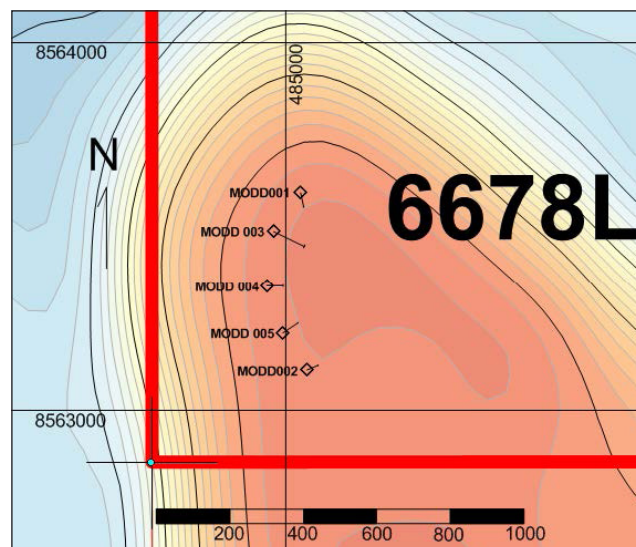
Figure 7: Balama location, prospects and geology



Source: Mustang

- ◆ Diamond drilling at Caula has identified thick intersections of high grade graphite, including 55.68m @ 15.9% TGC from 10m in hole MODD001 and 143.57m @ 15.2% TGC from 14.85m in hole MODD003 – hole positions are shown in Figure 8 – this was a follow up programme to an initial reconnaissance RC programme.

Figure 8: Caula drilling on EM image



Source: Mustang

- ◆ The mineralisation is interpreted as occurring in the hinge zone of a north plunging anticline and is associated with a strong electro-magnetic ("EM") anomaly.
- ◆ Results from the initial reconnaissance drilling were used to calculate exploration targets for two of the holes in the Balama North area:
  - MORC004, 6678L – 18.66Mt @ 13.6% TGC to 29.84Mt @ 9.7% TGC
  - MORC006, 5873L – 23.56Mt @ 6.7% TGC to 50.33Mt @ 5.1% TGC.
- ◆ Given subsequent drilling the 6678L exploration target will be superseded by an MRE expected in September 2017.

### Recent Activities

- ◆ Activities subsequent to our initiation report have included metallurgical test work, with this returning excellent results, as shown in Table 1.
- ◆ A comparison with results from other East African graphite projects is shown in Table 2.
- ◆ As shown in Table 2 these results are equivalent to, or superior to results from a number of other East African projects, and highlight the potential to produce a high purity, large flake product suitable for the expandable and lithium ion graphite sectors.
- ◆ In addition, the grades from the drilling highlight the potential to deliver a high grade resource which will have the potential to deliver a low cost operation by virtue of the high grade requiring a relatively small plant for a given graphite production.

**Table 1: Caula metallurgical test work results**

Table 1: Caula metallurgical test work results							
Graphite Product	Size Fraction	Fresh Composite			Oxide Composite		
	µm	Mass %	TGC %	TC %	Mass %	TGC %	TC %
Jumbo Flake	300	23.80%	97.9	98	13.20%	97.2	97.5
Large Flake	180	31.20%	97.26	97.46	24.60%	96.19	96.69
Medium Flake	150	9.90%	97.3	97.6	7.60%	95.9	96.5
Fine Flake	75	22.50%	96.07	96.41	43.20%	94.85	95.62

Source: Mustang

**Table 2: East African metallurgical comparison**

Table 2: East African metallurgical comparison					
Project	Company	Location	Resource/ Reserve Grade	Concentrate Grade	Jumbo + Large Flake
Caula	Mustang Resources (ASX:MUS)	Mozambique	TBC	96%	46%
Balama	Syrah Resources (ASX:SYR)	Mozambique	16.20%	95%	21%
Montepuez	Battery Minerals (ASX:BAT)	Mozambique	8.80%	96%	30%
Epanko	Kibaran Resources (ASX:KNL)	Tanzania	8.40%	96%	50%
Mahenge	Black Rock (ASX:BKT)	Tanzania	8.70%	98%	51%
Lindi	Walkabout Resources (ASX:WKT)	Tanzania	16.20%	97%	74%
Nachu	Magnis Resources (ASX:MNS)	Tanzania	5.40%	98%	66%
Namangale	Volt Resources (ASX:VRC)	Tanzania	4.90%	95%	67%

Source: Mustang, IIR

## CORPORATE

- ◆ Corporate activities have included the signing of a A\$10 million Convertible Note Deed with Arena and the appointment of Mr Peter Spiers as a non-executive director.

### Convertible Note Deed

- ◆ The Convertible Note Deed has a face value of A\$10 million, with A\$8.5 million (85%) to be drawn down in four tranches as listed below, with the notes having an 18 month term from the date of issue:
  - \$1.7 million (face value \$2 million) to be received upon signing of the Convertible Note Deed (with notes subject to conversion restrictions);
  - A\$1.7 million (face value \$2 million) (subject to shareholder approval with notes subject to conversion restrictions);

- A\$2.55 million (face value \$3 million) (subject to shareholder approval); and
- A\$2.55 million (face value \$3 million) (subject to shareholder approval).
- ◆ Other key terms include:
  - All conditions precedent for the first draw-down under the arrangement have been satisfied, although the notes issued may not be converted prior to shareholder approval expected to occur at the end of August 2017 and are also subject to a 50% conversion restriction.
  - The three remaining draw-downs are also conditional on receipt of shareholder approval of the facility and confirmation at the relevant time that no events of default under the facility have occurred and are continuing at that time.
  - The convertible notes attract interest at 1% per annum accruing on daily balances and are convertible at variable strike prices based on the lowest 1-day VWAP of the 20 trading days prior to conversion.
  - The noteholder is also entitled to two tranches of options with tranche A options exercisable at a price equal to 130% of the 30 day VWAP prior to the date of issue of tranche 1 notes, with a 3 year term equal to 60% of the value of tranche 1 & 2 notes and tranche B options (exercisable at a price equal to 130% of the closing price of Mustang's Shares on ASX prior to the date of issue of tranche 3, with a 3 year term) equal to 40% of the value of tranche 3 & 4 notes received.

### Board Appointment

- ◆ Highly experienced resource industry executive Peter Spiers has been appointed to the Mustang Board as a Non-Executive Director. Mr Spiers has more than 30 years of international experience in the resources industry spanning exploration, mine development, operations and commercial roles
- ◆ He spent 20 years with Western Mining Corporation ("WMC"), during which time he worked as a senior geologist, project manager and lastly Group Manager – Business Development prior to WMC being acquired by BHP Billiton for A\$9.2 billion.
- ◆ Following his employment with WMC, Mr Spiers was Managing Director of Orbis Gold, an ASX- listed West African gold company which was acquired for A\$170 million in 2015 by SEMAFO Inc. at a 98% bid premium. Mr Spiers is a graduate geologist from the University of Melbourne and a Member of the Australasian Institute of Mining and Metallurgy.

## UPCOMING ACTIVITIES

- ◆ Activities at Montepuez will be concentrated on ongoing bulk sampling at the LM Area, with the key target of building the ruby inventory to 200,000ct in anticipation of the October auction.
- ◆ Exploration work, including auger drilling and test pitting is also ongoing, with this aimed at discovering new bulk sampling areas, and to lead to an initial JORC-2012 compliant MRE in H1, 2018
- ◆ Work at Caula will include optimisation of the metallurgical test work, looking at improving the already good recoveries - this may also include some further drilling.
- ◆ This work, and an expected initial MRE due in September 2017 will be incorporated into a planned scoping study to follow shortly thereafter.

## RISKS

- ◆ **Exploration and sampling:** Although the Company is producing rubies and expects to receive good revenue from the sale, Montepuez is still an exploration project with the risks that exploration entails. This is somewhat mitigated by the geology and results of work to date – recovered grades are close to those that Gemfields recovered in the initial stages at Mugloto.
- ◆ **Ruby quality and value:** The Company is currently having rubies assessed for sales and marketing purposes, and until such time that is completed there will be no firm indication of value; however, comments by various parties have indicated that the rubies are broadly similar in quality to those from Gemfields' Mugloto product. The results of the upcoming auction will be critical in determining potential future value.
- ◆ **Processing:** Initial processing issues are in the process of being solved, with the upgraded plant now reportedly reaching planned capacity.

- ◆ **Illegal miners and security:** Some reports have come out about alleged security issues at Gemfields' operations, with Gemfields employing both Government and private security personnel to control illegal miners. Mustang, with their strategy of using locals as prospecting teams and paying them for stones appears to be taking a pro-active approach to managing this challenge, however there is still the possibility of losses with stones being sold to third parties by artisanal miners. We noticed no security issues on our site visit.
- ◆ **Sovereign risk:** There is always sovereign risk in operating in Africa, however recent years have seen increasing interest in Mozambique as an exploration destination (with coal and graphite playing a major role), and with the country introducing a new Mining Law in 2014. However, Africa being Africa there is always the change of unforeseen law changes, as demonstrated recently in Tanzania.
- ◆ **Costs:** Managing costs will be important depending upon the grade and quality of the rubies extracted – the current and proposed operations are however .relatively low cost, with free dig mining and industry standard processing.



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