

Ariana Resources

Update
30th October 2014

Kiziltepe Takes Multiple Steps Towards Production

We feel Ariana has taken numerous steps towards first gold production at its flagship Red Rabbit project. Kiziltepe is now 100% financed, has been granted numerous investment incentives by the Turkish Government, and has recently had its mining licence renewed to 2034 (providing mining commences within the next five years). As such, we now feel the final major hurdle ahead of construction is the receipt of permits, the timing of which is uncertain, after which the company expects to have the mine fully constructed within eight months. Accordingly, we expect first cash flow in H2'15. While cautious of the risks, our stance remains Speculative Buy.

Kiziltepe Poised To Enter Construction Phase, Subject To Permits

Kiziltepe is now is now poised to enter the construction phase, in our view, subject to certain permitting, the timing of which is uncertain. The mine is now 100% financed following an agreement with an international Turkish bank for an overall credit facility of \$33m. In addition, the Turkish Government has granted the project a number of investment incentives, including a considerable reduction in corporation tax and exemptions from other applicable duty or tax charges. We feel the support of both the Turkish Government and a local investment bank endorse the project's potential.

New Exploration Strategy

Various mineral prospects across the wider Red Rabbit project have delivered positive results recently, in our view. These are located within relatively close proximity to the proposed Kiziltepe mine site and could therefore add scale to the project. Ariana could also benefit further as it has the right to sell any resources delineated into the JV at three times cost. To date only 6% of the total vein system within the Kiziltepe region has received resource drilling, and given the numerous anomalies Ariana has identified across the region we feel there is the potential for additional resources to be identified that could add scale to the planned Kiziltepe site. However, we note that there is no guarantee any further resources will be delineated.

Valuation

Ariana is now at the final stages of permitting at its Kiziltepe project, with significant implied support for the project coming from a major Turkish bank and the Turkish Government, in our view. There is potential for further upside to the project if Ariana delineates further resources at its prospective sites which we feel have shown promising results. We have valued Ariana using a DCF of its Kiziltepe project and an EV/Resource valuation of its other resources, which combined with net cash implies value of 1.62p. We note the risks of investing in a pre-revenue exploration mining company, with any changes in our assumptions potentially having a material effect on our valuation. Share dilution could also be an issue. However, we feel Ariana is relatively de-risked given its proximity to first cash flow. Speculative Buy.

Speculative Buy

Target price 1.62p

Key data

Share price	0.95p
52 week high/low	1.35p/0.75p
Primary exchange	AIM
EPIC	AAU
Shares in issue	645.8m
Market Cap	£6.1m
Sector	Mining

Valuation

Kiziltepe NPV*	£5.4m
NAV	£7.0m
TNAV	£5.0m

* This is the value of Ariana's 51% share of profits

Share price chart



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Table: Financial overview

Year to 31st December	2010A	2011A	2012A	2013A
Revenue (£000)	0	0	0	0
Operating Loss (£000)	(447)	(1,398)	(1,080)	(1,050)
PBT (£000)	(438)	(1,347)	(1,182)	(1,334)
EPS (p)	(0.22)	(0.54)	(0.40)	(0.27)

Source: GECR and company.

Kiziltepe Poised For Cash-Flow Subject To Permitting

There have been significant developments at Ariana's flagship Red Rabbit project in Turkey, which mean that it is poised to enter the construction phase subject to certain permitting. The company expects that once final permitting has been obtained, construction of the mine should be completed within eight months. However, we note that the timing of approvals can be unpredictable.

The mine is now 100% financed following an agreement with an international Turkish bank for an overall credit facility of \$33m. In April 2014 the Kiziltepe mining licence was renewed until 2034 on the condition that mining commences within five years, which has meant that all outstanding permits could be applied for ahead of mine construction. In addition, the Turkish Government has granted the project a number of investment incentives, including a considerable reduction in corporation tax and exemptions from other applicable duty or tax charges. We feel the support of both the Turkish Government and a local investment bank endorse the project's potential while de-risking the threat of operating in an environment with political or tax uncertainty.

Financing Secured With International Turkish Bank

In July 2014 Ariana's Joint Venture company with Proccea Construction Co. secured a \$33m credit agreement, inclusive of borrowing costs, with an international Turkish investment bank that will be used to finance the Kiziltepe Gold-Silver Mine. In addition, Proccea will be required to contribute the remaining \$5m in equity to the JV to bring its equity stake up to 50%. The debt facility lasts for five years and repayments of principal plus interest commence two years after it is first drawn down, in the form of 36 monthly payments. As repayments are capped at \$33m inclusive of all capital repayments and borrowing costs, the net amount drawn down as capital is expected to be \$24m. However, this amount could rise given favourable market conditions as the amount of the total \$33m taken up by interest could reduce, or the level of drawdown could be maintained at \$24m and total repayments less than the \$33m cap. The credit profit margin is fixed throughout the life of the agreement, however the level of repayments are determined given the amount and timing of each drawdown based on market conditions at that time.

Turkish Government Provides Material Investment Incentives

The Turkish Government has granted the Kiziltepe Gold-Silver Mine a number of investment incentives following an application made by the JV to the General Directorate of Incentives and Foreign Investment at the Turkish Ministry of the Economy in 2013. These include:

- **Corporation Tax Reduction** – The JV is eligible for an 80% reduction in corporation tax up to a limit of 40% of the total capital investment. There is the potential for this to be upgraded to a 90% reduction across 50% of the investment if the JV is successful in being recognised as a strategic investment by the Government.
- **Customs Duty Exemption** – The JV has received a 100% exemption from customs duty on domestic and foreign machinery and equipment.
- **VAT Exemption** – The JV has received a 100% VAT exemption on domestic and foreign machinery and equipment.
- **Social Insurance Contributions** – The Turkish Government will pay the social insurance contributions for all mine employees for seven years.
- **Interest Repayment Support** – The Government will provide interest repayment support on any loan secured by the JV denominated in either Turkish Lira or foreign currency.

It is expected that these incentives should result in corporation tax savings of c.\$1.2m and c.\$1.0m in social insurance support, although an independent analysis is being conducted focussing specifically on these two incentives to assess the potential benefits further. We feel the award of these incentives shows that the Turkish Government is

supportive of the Kiziltepe Gold-Silver Mine and should provide material benefits for the JV and in turn Ariana.

Surface Rights Obtained at Arzu South

The JV has acquired 100% of the freehold land in the Arzu South area of the Kiziltepe site which hosts part of the open-pit mine resources. Other smaller areas of land have also been acquired in regions that will host the tailings dam and waste-rock dump materials. This has occurred following negotiations with local land owners that we feel demonstrates the relationships Ariana maintains with the local communities and also that these communities show support for the project.

High-Grade Drill Targets Identified at Kiziltepe

In May 2014 Ariana announced that it had defined drilling targets on two separate gold-silver prospects within the Kiziltepe sector of Red Rabbit known as Kizilcukur and Karakavak. At Kizilcukur in-fill composite rock-chip sampling delivered exceptional grades of 32.4g/t Au + 144g/t Ag, 8.6g/t Au + 115g/t Ag and 5.4g/t Au + 259g/t Ag and other sampling returned other high-grade samples. This prospect will be assessed by a further drilling programme to test its potential as an open-pitabile resource that could be trucked to the Kiziltepe processing plant; this prospect is c.22km (straight line) from the proposed Kiziltepe site. Sites previously identified at Karakavak, which is c.10km (straight line) from the Kiziltepe site, will also be the subject of further drilling to test its potential as a further open-pitabile resource. In total 2,000m of reverse calculation drilling will be conducted across both prospects, where the necessary forestry permits have already been obtained. If either of these prospects delivered open-pitabile or underground resources they could add further scale to the Red Rabbit Gold-Silver project.

Ariana also announced that it had discovered new anomalous mineralisation at Kepez Far West with samples delivering results up to 6.3g/t Au + 54.8g/t Ag, 5.1g/t Au + 31g/t Ag and 3.5g/t Au + 17.3g/t Ag with the mineralised zone now extending over 1.6km along strike at Kepez West and Far West. Additionally, 16km east of Kiziltepe. Ariana has collected several rock-chip samples at the Camalani prospect that have returned gold and silver mineralisation and further work is being conducted to discover the source of this material.

To date only 6% of the total vein system within the Kiziltepe region has received resource drilling and given the numerous anomalies Ariana has identified across the region we feel there is the potential for additional resources to be identified that could add scale to the planned Kiziltepe site, although we note that there is no guarantee any further resources will be delineated. However, if resources are delineated they could provide significant upside as any additional resources can be sold into the Red Rabbit JV at three times exploration cost, while Ariana would still retain 50% ownership over the resources through its stake in the JV. We feel it is significant to note that Ariana has shown a very efficient approach to exploration with an all-in discovery cost per ounce of \$22 relative to an industry average closer to \$40. We believe Ariana appears well-set to continue to explore in this cost-effective manner as it systematically tests the new targets identified.

The recent exploration has been part of Ariana's strategy to systematically sample and test all high-grade vein systems in order to assess their potential for future drilling. Ariana is currently conducting a ground-based magnetic geophysical survey over all of the primary Kiziltepe Sector tenements to assess potential areas to sample/drill in the future.

Ariana has also been developing a new geological model to help it interpret the distribution of high-grade gold-silver prospects at the Kiziltepe sector of the Red Rabbit project. It is based on the latest geological mapping of veins and associated alteration zones, combined with recent rock-chip sampling and X-Ray analyses. Accordingly, a number of the alteration zones in the area have been better characterised by analysing soil and rock samples, with the alteration zonation being similar to that in the well-mineralised areas of Kiziltepe in many cases.

The new model will now be used in an attempt to define a link between high-grade gold-silver zones, particular structural trends and clay alteration zones, and also a probable extinct volcanic centre called a caldera. The latter is a common feature of volcanic regions, associated with the localised collapse of a volcanic system following a major eruption. Similar features are seen in places containing long-lived hydrothermal systems that have given rise to extensive mineralisation that is associated with low-sulphidation and/or porphyry mineral systems, for example that at the Lihir/Ladolam gold deposit in the Pacific Rim of Fire.

A recent study of the region, which combined all previous exploration data, identified a number of trends for high-grade gold-silver prospects, including a large, near complete

circular structure approximately 6km wide. The centre of this structure hosts weak gold and molybdenum mineralisation as well as other geological features that suggest the presence of a sub-volcanic intrusion that is responsible for the mineralisation across Kiziltepe. Mapping of the quartz veins present on the outer edges of the circular feature identified two types of vein structure. Firstly, low-grade veins were identified running parallel with the edges of the circular structure. However, more significantly, regularly distributed high-grade veins were identified crosscutting the lower-grade veins trending towards the centre of the structure. Resurgent volcanic domes have also been discovered that are associated with this vein structure.

The team at Ariana is now intending to define areas within the circular structure for further analysis, and has been refining the model to enhance confidence. Accordingly, the new model should help to focus future exploration programmes and potentially improve the success rate of further exploration.

Eldorado Drilling Results

In early 2014 Ariana announced the results of the 2013 drilling programme carried out on and around the Ardala and Salinbas sections of its Eldorado JV in north-eastern Turkey, which currently hosts a 1.09Moz gold plus 4.13Moz silver resource. This programme confirmed the continuity of mineralisation between the gold-copper-molybdenum (Au-Cu-Mo) porphyry at Ardala and the gold-silver (Au-Ag) target at Salinbas. Some of the holes drilled revealed additional porphyry style mineralisation between the Ardala porphyry zone and the Salinbas zone. This campaign brought the total footprint of mineralisation that has been covered by drilling to 2.5km by 1km, and helped the company to understand the scale of mineralisation in the vicinity of the Ardala porphyry. It is also encouraging to see that in some cases, notable concentrations of base metals have been observed alongside the gold and silver mineralisation. These results are expected to reinforce the potential for an increase in the resource base at Salinbas and Ardala, and further drilling will be needed to analyse the region for additional porphyry/limestone-hosted mineralisation. We feel it is important to note that the JV project area was first identified by the Ariana team in 2007, with the discovery of the Salinbas zone made in 2009. We believe the identification of the exploration potential around Ardala and Salinbas is testament to the approach and focus taken by the Ariana team over several years. The conversion of this potential in to a +1Moz JORC resource represents a considerable exploration success.

Potential Upside Through Equity Swap

In January 2014 Ariana raised £770,000 through a placing, with c.20% of the funds raised coming from a number of directors, employees and parties related to the company, which we feel is a positive endorsement of Kiziltepe's potential. The funds are being used to analyse the Kiziltepe region further, including completion of the aforementioned magnetic geophysical survey of the area and a programme of drill-target definition. The funds will also be used to fund general working capital and for investment in the company's equity swap.

Included within the subscribers to the placing was the institutional investor, Lanstead, which subscribed for 21,111,111 new ordinary shares for total consideration of £190,000. Of these monies, Ariana intends to take £38,000 as cash for working capital purposes and the remaining £152,000 has been invested into an equity swap with Lanstead. The equity swap is set against the benchmark price of 1.2p, and is split into 24 monthly payments set against this benchmark. If Ariana's shares trade at a premium to the benchmark price then the company will receive more than 100% of the monthly payment, and if they trade at a discount then the company will receive less than 100% of the payment. The company has confirmed that no additional shares would need to be issued to Lanstead in the event of a decline in the company's share price. As consideration for the equity swap Ariana has issued a further 2,111,111 shares to Lanstead.

The equity swap provides Ariana with a facility that will allow it to benefit from any rise in its share price. There is no upper limit to the amount Ariana can receive in the event that the share price exceeds the benchmark price. As such if the company's share price does increase, this agreement has the potential to provide a good cash-flow for the company.

Valuation

We have amended our DCF valuation of the Kiziltepe Sector of the Red Rabbit project, in order to take account some changes in our assumptions. We now assume that 1.19 million tonnes of ore are mined over eight years commencing at the start of H2'15, with the mine to delivering 101Koz Au and 1.0Moz Ag for sale throughout its lifetime after recovery rates of 85.5% and 64%, respectively. We still assume that mining starts at this point because permits can be granted at any time and construction is expected to take six to eight months, which would imply the start of H2'15 based on eight months from the date of this note. We have assumed that it takes one month to mine and process the first gold, and then it takes one month to receive the cash from first gold sales, and therefore working capital will be required to fund costs until the cash flow can sustain the operation. We expect CapEx of \$25m to be required in 2014. We estimate maintenance CapEx at \$50,000 per annum run-rate, although this stops at the end of 2022 and does not run into final operations in H1'23. We have assumed a constant gold price of \$1,300/oz and a silver price of \$20/oz.

On the other side, we expect cash costs of \$600/oz (this includes a royalty rate of 4% of gold produced). We have assumed that all fixed assets are depreciated using the straight line method with no salvage value over a ten year period. All fixed assets are sold at cost less accumulated depreciation at the start of H2'23 after operations have ceased. Lastly, we have assumed a corporate tax rate of 15% on the operations in Turkey for the eight year life of mine, which approximates the reduction in corporation tax payable on the operation as a whole.

We have assumed that Ariana receives 51% (its profit share in the JV) of the cash flows from the JV in the form of dividends, paid in US dollars, on which no tax is charged due to the corporation tax paid and the effect of central costs of the PLC on the total tax charge. These are then converted into Sterling at a rate of £1 = \$1.62. We have then subtracted our estimate of cash administrative costs for the Ariana Plc of £0.50m per annum run-rate (note that this excludes any exploration expenditure as under this scenario we assume Ariana will mine only the resources currently identified). We assume no further tax is payable due to the tax already paid on the operations in Turkey and the losses Ariana will have already incurred pre-production.

We have discounted all of the after-tax cash flows using a 10% discount rate. This leads us to a NPV for the project attributable to Ariana of £5.4m or 0.84p per share. However, we note that we have assumed gold and silver prices that are higher than current prices of c.\$1,230 and c.\$17.2 but broadly in line with the DFS at Kiziltepe. This is because we feel there is potential for the gold and silver price to rise to c.\$1,300 and c.\$20 over the medium term. As such we have included a sensitivity analysis that shows how the valuation of Kiziltepe and Ariana would vary given different assumptions about the gold and silver price.

Table: DCF Model Sensitivity To Commodity Prices

Price Movement	Au/Ag Price Per Oz	Effect On Kiziltepe Valuation	Effect On Ariana Valuation
+20%	\$1,560 / \$24	1.65p	2.43p
+10%	\$1,430 / \$22	1.25p	2.03p
0%	\$1,300 / \$20	0.84p	1.62p
-10%	\$1,170 / \$18	0.44p	1.22p
-20%	\$1,040 / \$16	0.04p	0.82p

Source: GECR

We have also valued the Eldorado asset using its associated JORC resources of 581,100oz Au equivalent net to Ariana. We have constructed a peer group of junior gold miners and compared their Enterprise Value (EV) with their gold resource base. We have then applied this to the total ounces present at Eldorado to generate a value of £3.6m or c.0.56p per share. We have also applied this to Ariana's 73.5% stake in the 214,694oz Au JORC resource at Tavsan and its 27,600oz Au JORC resource at Kizilcukur & Ivrindi, which have implied value per share of c.0.15p and c.0.03p, respectively.

Table: Peer Group Analysis

Company	Primary Resource Areas	Market Cap (£)	EV	Au Resources (oz)	EV/oz (£/oz)
Conroy Gold and Natural Resources ¹ (AIM)	Ireland	4,270,000	5,262,017	1,030,000	5.11
Amara Mining ^{II} (AIM)	Ivory Coast & Sierra Leone	61,680,000	44,286,790	9,107,000	4.86
Condor Gold (AIM)	El Salvador & Nicaragua	37,440,000	36,618,361	3,427,000	10.69
KEFI Minerals (AIM)	Ethiopia & Saudi Arabia	12,280,000	11,876,000	2,100,000	5.66
Hummingbird Resources ^{II} (AIM)	Liberia	32,980,000	28,669,506	6,000,000	4.78
				Average	6.22

Source: GECR, Digital Look, Bloomberg, Company Websites, Company Annual Reports, Company Presentation

Notes: ¹ £ : € = 1.2800

^{II} £ : \$ = 1.6200

Prices as at 27/10/2014

Accordingly, when we include the net cash position at 30th June 2014 of c.£0.3m, we reach a net value for Ariana of 1.62p per share. However, we note that this valuation does not account for the scope to expand the operation at Red Rabbit beyond Kiziltepe, for which we believe there is potential. Indeed, Ariana believes they could potentially double the resources across the wider Red Rabbit project. This is given the level of exploration Ariana is conducting in the region including the prospective volcanic system recently observed. Our valuation also does not include any estimate of the value that could be added to Ariana if resource upgrades occur within the Eldorado JV or at other prospective sites, and it attributes no value to Ariana's other earlier stage exploration assets with no resources associated. In addition, the US\$20 million attributed value to the Newmont database to which Ariana holds a 10 year licence and Ariana's shareholding in Tigris Resources Limited are also not valued here.

Table: Ariana Valuation

Kiziltepe value (£)	5,449,630
Eldorado value (£)	3,613,330
Tavsan value (£)	981,215
Kizilcukur & Ivrindi value (£)	171,619
Net cash (£)	271,000
Number of shares	645,816,141
Total value (p)	1.62

Source: GECR, company reports, Digital Look

Risks

While we believe there is clear potential for Ariana to deliver returns in the near, medium and longer term, especially if extra value is delineated from prospects in the Kiziltepe region, we feel it is important to note that there still remain risks and uncertainties to the investment case:

- **Permitting Risk** – There is a risk that the necessary permits (such as a forestry permit) are not granted, or that they are not granted in a timely manner, and any delays could have a material effect on our valuation. We feel this is mitigated by the fact that the Kiziltepe JV has recently been granted a renewed mining licence for up to twenty years, and that the project is now in the final stages of permitting. In addition, we feel the Turkish Government has already shown support for the project through its award of numerous financial incentives.
- **Funding Risk** – Ariana does not yet generate any revenues, and as such the company may have to seek external financing, especially if significant delays are encountered in the permitting or construction phases of Kiziltepe. We feel this is mitigated by the fact that Kiziltepe still appears to be on track to pour first gold in H2'15. In addition, in January 2014 the company conducted a placing for £770,000 that will support working capital and exploration expenditures, and should have some level of recurring cash flow until the end of FY'15 from its equity swap.
- **Governmental Risk** – There is a risk that the Turkish Government does not remain supportive of mining in its country. We would expect the Turkish Government to remain supportive of mining given that the country is the leading gold producer in Europe¹. It has also approved a mining licence for Ariana that could last for twenty years and granted material investment incentives to the JV.
- **Key Person Risk** – There is the risk that key members of staff or management leave the company. We feel this is mitigated by the participation of a number of staff and directors in the recent funding round, which implies to us that these personnel are supportive of the company's prospects.

While this list is not exhaustive we have tried to highlight material risks that we feel stakeholders and potential stakeholders should be aware of.

Source:

¹ Turkish Gold Miners Association <http://turkishgoldminersassociation.com/turkish-gold/gold-mining-today>

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