

# HALLGARTEN & COMPANY

## Initiating Coverage

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## Golden Arrow Resources (TSX-V: GRG, FSE:GAC, OTCQB:GARWF) Strategy: LONG

Key Metrics		
Price (CAD)	\$	0.76
12-Month Target Price (CAD)	\$	1.45
Upside to Target		91%
12 mth high-low		\$0.185-\$1.48
Market Cap (CAD mn)	\$	67.0
Shares Outstanding (millions)		88.2
Fully Diluted (mns)		106.6
<b>Float</b>		<b>45%</b>

# Golden Arrow Resources

## Deconstructing Silver Standard

- + The Chinchillas deposit is shaping up to be the largest silver/zinc project likely to come to production in Argentina in the near future
- + Deal with Silver Standard lays the ground for a potential combination of the Pirquitas mine with Chinchillas making a new silver major in Latin America
- + Golden Arrow will hold 25% of the combined entity with Silver Standard holding the rest
- + There is a sizeable Zinc component in the Chinchillas deposit holding out the prospect of the mine being attractive not just for its silver component as Zinc regains investor affections
- + Changed government in late 2016 in Argentina has drastically improved investor sentiment
- ✗ Silver price is linked to sentiments on precious metals (i.e. gold) which has been less than robust lately
- ✗ Despite changes in government, investors still remain uninformed about the improvements in the local political environment

### Bulking Up for the Argentine Mining Revival

One doesn't have to have too great a memory to recall the glory days of silver both before the 2008 crash and then the resurgence thereafter (when the metal hit \$50 per oz momentarily). Back at that time one of the 800lb gorillas of the silver space was Silver Standard Resources (SSO:TSX; SSRI:NASDAQ) and it was a ubiquitous presenter in New York, constantly doing the rounds and keeping its mammoth market cap in play.

Lesser known were the vehicles of the Grosso Group which tended to focus on the Argentine scene when that was a hot area for explorers and the country was on its way to being the second largest gold producer in Latin America. Most of the competing Argentine plays have disappeared from the scene, whether by takeover or by having been scared off by the wildly swinging policy changes of the now departed Kirchner regime. However one of the constants in the junior space in Argentina has been the Grosso Group and its main vehicle at the current time is Golden Arrow Resources.

Taking advantage of the way the wind was blowing it carved out a deal with Silver Standard in last 2015 with the goal of potentially combining the mature Pirquitas mine of the large company with the evolving Chinchillas deposit held by Golden Arrow. This pooling of two projects in relatively close proximity in the north-western province of Jujuy made eminent economic sense.

As part of the original deal, Silver Standard has funded work to get Chinchillas to the point at which a production (and pooling) decision can be made. In this note we shall examine the dynamics and potential of this mooted combination.

### The Proposed Combination

In October 2015, the current main vehicle of the Grosso Group, Golden Arrow Resources, and Silver Standard entered into a business combination agreement for the joint development of Golden Arrow's Chinchillas project and "an agreement to combine the producing Pirquitas Mine and the Chinchillas project, located approximately 35 kilometres apart in Jujuy Province of Argentina, into a single new operation." The joint venture would be 75% owned by Silver Standard and 25% owned by Golden Arrow.



During the 18-month preliminary period, Silver Standard would invest up to approximately US\$12.6 million (subject to a minimum expenditure commitment of US\$4mn) at Chinchillas to advance the project and evaluate the feasibility of developing a combined mining business with its existing Pirquitas operation.

For the first six months of the Preliminary Period, Golden Arrow was tasked, on a cost recovery basis, to undertake initial pre-development activities at the Chinchillas project, including overseeing up to 17,000

meters of drilling, and will provide operational support for Silver Standard's exploration and technical teams.

In consideration for granting Silver Standard the rights to conduct pre-development activities, it agreed to pay to Golden Arrow:

- CAD\$0.5mn on signing of the transaction agreements
- CAD\$0.5mn within five business days after the shareholders of Golden Arrow approved the transaction
- CAD\$0.5mn within five business days after the earlier of the six month anniversary of the shareholder approval for the transaction and the date of election to proceed with the joint venture
- CAD\$0.5mn within five business days after the earlier of the 12 month anniversary of the shareholder approval for the transaction and the date of election to proceed with the joint venture

At any time during the Preliminary Period, Silver Standard has the sole right to elect to enter into a 75% (Silver Standard)

The ultimate goal of all this is the formation of a Newco, to be managed by Silver Standard, that shall be owned 75% by Silver Standard and 25% by a new entity to be owned by the existing shareholders of Golden Arrow (that is called for the time being "New Golden Arrow". This Newco will hold both the producing Pirquitas Mine and Chinchillas project. On formation of the joint venture, Silver Standard will make an exercise payment to Golden Arrow using a formula composed of 25% of the value of:

- Payable silver ounces sold x (average silver price minus disclosed cash costs)
- Minus capital expenditures
- Minus reclamation expenditures
- Minus Chinchillas pre-development expenditures
- Minus taxes on repatriation

It's worth noting that Silver Standard currently holds around 5% of Golden Arrow and that there is a standstill agreement that precludes the larger company from making an unwanted move on Golden Arrow. This does not necessarily mean Silver Standard can't make an (agreed) offer that is "too good to refuse".

### **The Background Music**

The two major events in the last six months have been the retreat of the silver price from over \$20 and probably more importantly the change of government in Argentina. After nearly a decade and a half of irregular iconoclastic governments in Argentina ruled most recently by the dynasts of the Kirchner family and before that the Duhalde regime the country has returned to a certain orthodoxy with the election of Mauricio Macri as President in the last quarter of 2016. While not reinserting Argentina directly into the

good books of mining investors it has certainly made thinking about the possibilities not being grounds for insanity. Amongst the measures taken so far that have enhanced the perspective for miners are:

- ✓ Lifted currency controls – devalued Peso may result in lower costs for project development
- ✓ Eliminated export taxes on concentrates and gold/silver doré
- ✓ Some import restrictions lifted – may allow better sourcing of equipment

These changes have removed the major bugbears of foreign miners operating in the country. This reopening has coincided with the Lithium boom which has placed Argentina at the centre of the action because of its ample supply of *salares* in its northwestern provinces.

### **The Grosso Group**

This grouping was founded by Joseph Grosso and is a junior mining house that currently specializes in Argentina. Besides Golden Arrow, the group also includes Argentina Lithium & Energy Corp (LIT.v) and Blue Sky Uranium (BSK.v - which we have covered in the past in our review of Argentina's uranium potential).

### **Chinchillas - Background**

The Chinchillas property is a less-well-known quantity in comparison to Pirquitas. Chinchillas was first prospected and mined in small scale in the eighteenth century by Jesuit missionaries. Remains of ancient furnaces used to melt lead and silver can still be found at site. Activity revived in 1956 when Antonio Mercado requested a concession based on the discovery of galena veins in the basement rock. In 1968, the mine was sold to a mining engineer called Pichetti who later formed the Sociedad Pirquihuasi Company together with the Pirquitas Company, and some adits and tunnels were opened for small scale production. After that point there was sporadic explorations by various parties, amongst which were Shell's mineral exploration arm and a subsidiary of Apex Silver.

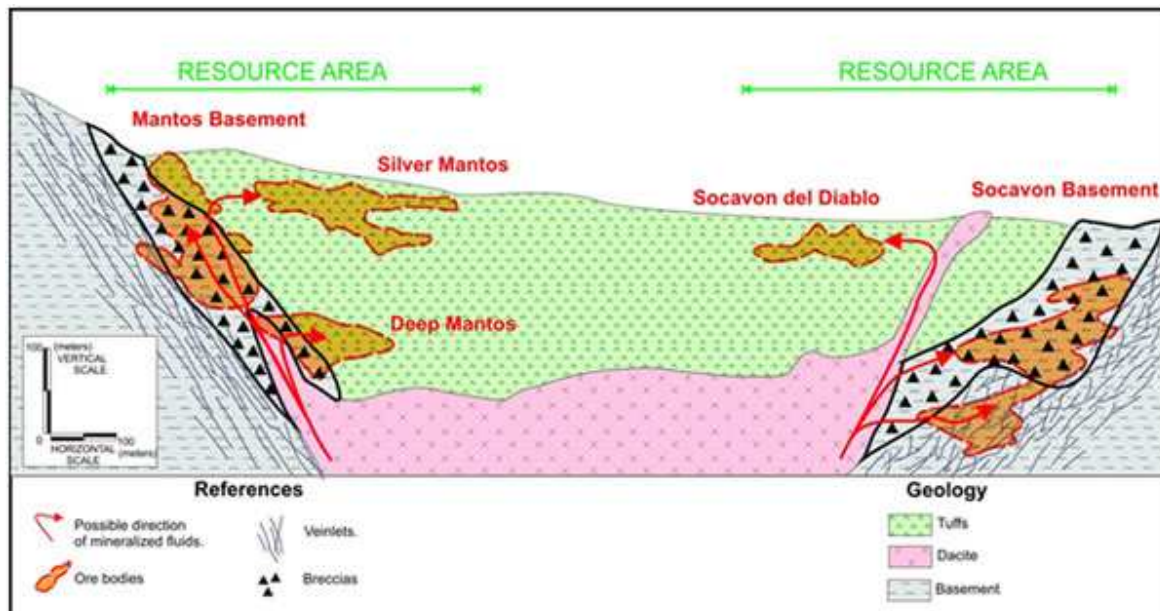
In early 2011 Golden Arrow personnel identified the Chinchillas Project as a potential advanced-stage acquisition target. Following a property tour and a review of existing data, the company completed an option agreement with the underlying land owners in August of the same year.

Golden Arrow had perceived that the near-surface mineralization provided the potential for an open-pit mining scenario, plus conventional metallurgy that has shown high recoveries of silver lead and zinc to concentrates in bench-scale testing, and access to infrastructure including highways, power and water.

### **Geology**

Chinchillas is a Tertiary Age diatreme volcanic complex that has erupted through the Paleozoic basement sediments. The resulting depression or basin shown in the cross-section below, filled with volcanic breccias and tuffs, is approximately 1.5 kilometres in diameter. Mineralization starts at surface

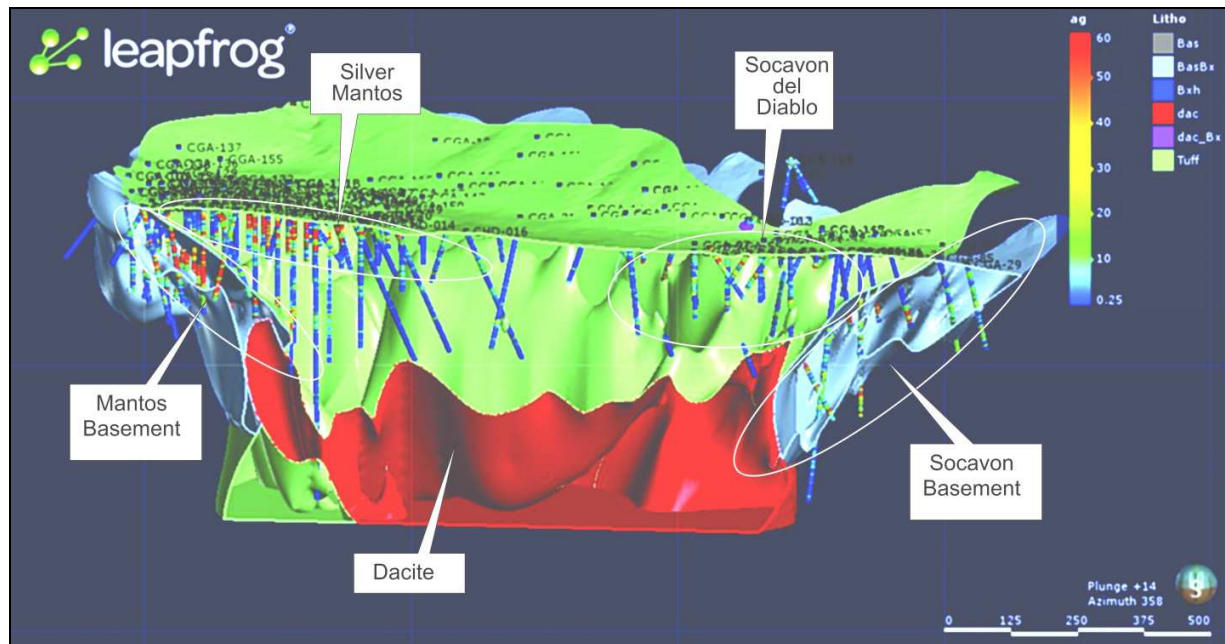
within the basin, hosted in favorable volcanic tuff units, hydrothermal breccias, and along faults and structural zones, and is present in basement sediments and metasediments, as well as across the schist-volcanic contacts.



Mineralization at Chinchillas is dominated by silver, with lesser values of lead and zinc occurring as disseminated sulphides and matrix infilling within the volcanic tuffs, and as matrix and fracture filling in breccias within the basement meta-sediments. Within the basement lithologies shears and structures are more commonly mineralized. Depth of oxidation is just a few metres within the volcanics and is insignificant within the basement rocks.

The deposit is visualized in #D in the Leapfrog model on the following page. The deposit is divided into two main areas: the Silver Mantos in the western part of the basin and the Socavon Del Diablo in the east.

Mineralization in the Silver Mantos basin is disseminated in multiple flat lying layers, or mantos, composed of strongly clay-altered volcanic tuffs and breccias. Within the Ordovician basement pelites and sandstones schists mineralization is more steeply dipping and hosted in breccias, minor small veinlets, fracture filling and mineralized structures. Mineralization is more silver and lead-rich in this zone.



On the eastern side of the basin, mineralization in the Socavon del Diablo is dominated by *manto*-style disseminated sulphides within favorable shallow dipping volcanic tuff horizons but also includes crosscutting structures, hydrothermal breccias, and some mineralized structures and breccias within the basement. Generally, mineralization is more zinc-rich in this area.

### Resource

The project hosts a resource of 100mn ounces of silver (155mn ounces in AgEq) in the Measured & Indicated categories and 44mn ounces of silver (90mn ounces AgEq) in the Inferred category.

However, it's vital to note in light of the storming Zinc price that this resource dates from April 2016 and the metals prices used for the AgEq calculation were: silver \$19/oz, lead \$1/lb, zinc \$1/lb. Zinc is nearly 30% higher now while silver is around 15% lower.

This project has a Measured and Indicated Zinc component of 401mn lbs with a further 548mn lbs Zn in the Inferred category. This is the type of stuff that gets our pulse racing.

This updated resource estimate is the result of the Chinchillas Project pre-development activities, funded by Silver Standard, which are being undertaken to evaluate the feasibility of creating a combined mining business with Silver Standard's Pirquitas mine.

<b>Chinchillas Resource Statement</b>									
	<b>Tonnes mn</b>	<b>AqEq g/t</b>	<b>Ag g/t</b>	<b>Pb %</b>	<b>Zn %</b>	<b>AgEq mn oz</b>	<b>Ag mn oz</b>	<b>Pb mn lbs</b>	<b>Zn mn lbs</b>
<b>Measured</b>									
Silver Mantos	3.6	149	115	0.56	0.38	17	13	44	30
<b>Indicated</b>									
Silver Mantos	11.9	118	72	0.63	0.64	45	28	166	168
Mantos Basement	13.6	176	125	1.16	0.27	77	55	347	81
Socavon	5	97	29	0.54	1.37	16	5	59	152
<b>Total Measured and Indicated</b>	<b>34.2</b>	<b>142</b>	<b>91</b>	<b>0.82</b>	<b>0.57</b>	<b>155</b>	<b>100</b>	<b>618</b>	<b>431</b>
<b>Inferred</b>									
Silver Mantos	4.1	115	58	0.78	0.83	15	8	71	76
Mantos Basement	1.5	107	78	0.64	0.14	5	4	22	5
Socavon	7.3	79	33	0.37	0.91	18	8	59	146
Socavon Basement	20	79	39	0.39	0.73	51	25	170	321
<b>Total Inferred</b>	<b>32.9</b>	<b>85</b>	<b>42</b>	<b>0.44</b>	<b>0.76</b>	<b>90</b>	<b>44</b>	<b>322</b>	<b>548</b>

### Recent Work

With these developments in the foreground the Silver Standard/Golden Arrow alliance has been puttering along in the background. In 2016, work completed included: a Phase VI drill program, an upgraded resource estimate, metallurgical studies, engineering studies, environmental monitoring, and community relations programs. The Environmental Report, which is the major mine permit application, was submitted to the authorities in September.

Joseph Grosso, chairman, president and CEO of Golden Arrow, went on record in December as saying "as of the end of September 2016, Silver Standard has invested approximately US\$11mn to advance the project towards pre-feasibility". He also noted that "currently at Chinchillas, there are two drills working to complete detailed geo-mechanical and hydrogeological programs in and around the designed open pit by mid-December. Exploration work is also continuing both at Chinchillas and regionally, to delineate additional potential ore feed for the proposed operation."

### Silver Standard & Pirquitas

Silver Standard is one of the companies that occupies the much reduced middle tier of the Canadian mining equities market. With a \$1.5bn market it rates neither as a major nor as a junior. Moreover it has three producing mines, Pirquitas (the subject of interest here) and the Seabee gold mine in Canada and the Marigold gold mine in Nevada.

At the time that we last focused on this company its main play was a project (not a mine) called Pirquitas in the far northern province of Jujuy in Argentina. The project eventually came into production in 2009 and has carried Silver Standard through the dark times, both for silver and for perceptions of Argentina. Now Argentina is (almost) sexy again and silver is back on centre stage.

The Pirquitas property is positioned at an elevation of 4,100 meters above sea level and is accessible by all-weather roads. The open-pit mine achieved commercial production in December 2009. Ore is crushed and treated in a gravity pre-concentrator prior to processing in a conventional mineral flotation plant. The silver and zinc concentrates produced from the plant are shipped to third party smelters.

Here is the San Miguel open-pit at Pirquitas.

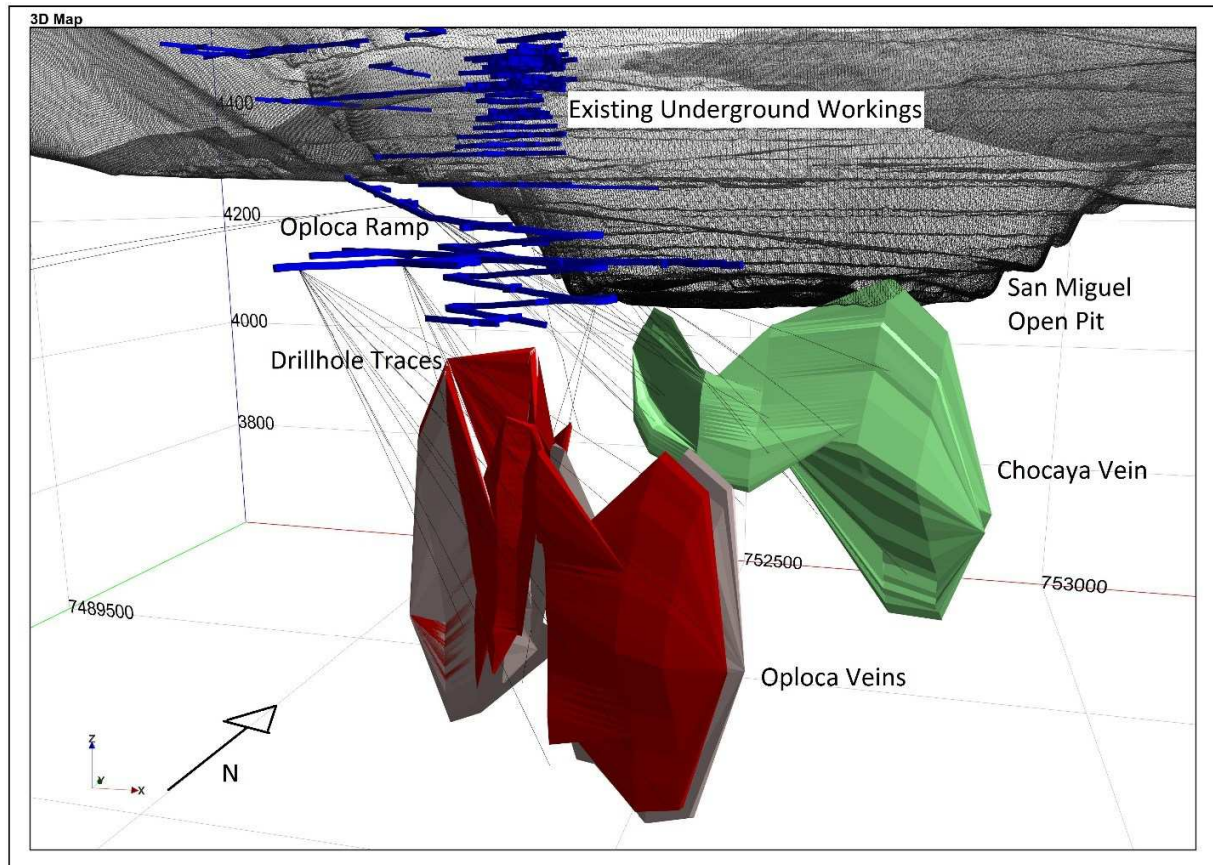


After the original mine build and start-up some further tweaking to capacity was undertaken. In early 2011, the tertiary crushing capacity at Pirquitas was upgraded with the installation of a Nordberg HP 500 cone crusher. Shortly afterwards, the ball mill was upgraded to enable it to operate at maximum capacity. As a result of those improvements the plant produced an average of 4,200 tonnes per day for an effective annual silver production capacity of 10 million ounces at average reserve grades. The flotation process at Pirquitas was pushing through 5,000 tpd in the last quarter of 2016.

The mine delivered record silver production in 2015 with 10.3mn ounces of silver and 9.4mn pounds of zinc. For 2016 the production guidance was between 8-10mn ounces of silver and up to 5mn pounds of zinc. Pirquitas though is past its peak with the open pit closing in the first quarter of 2017 after which the main focus will be stockpile processing. This make the need for a decision on Chinchillas more pressing as a production decision at the new mine will make the underground at Pirquitas more viable.

The Probable Mineral Reserves amounted to 16.5mn ounces of silver at an average grade of 220.1 g/t and 7.7mn ounces of silver in stockpiles at an average grade of 109.1 g/t as at December 31, 2015. The Indicated Mineral Resources of 53.8mn ounces of silver at an average grade of 122.4 g/t, 18.2mn ounces

of silver at an average grade of 241.1 g/t at Pirquitas Underground and 8mn ounces of silver in stockpiles at an average grade of 107.3 g/t as at December 31, 2015.



There is underground potential at Pirquitas for small-scale, high-grade ore feed from the Chocaya, Oploca and Cortaderas veins. This would augment the flow of material from Chinchillas.

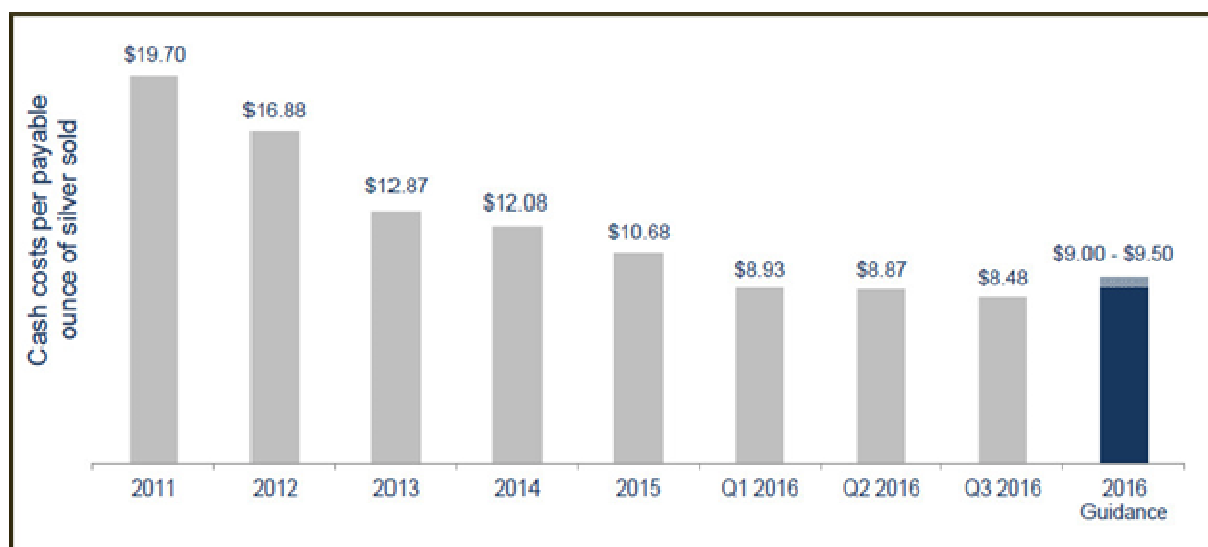
Amongst the positive drill results from 2015 drill program on the underground potential were:

- ✓ 3.16 meters at 1,436 g/t silver and 0.5% Zinc at Chocaya
- ✓ 1.93 meters at 1,890 g/t silver and 7.5% Zinc at Oploca North
- ✓ 0.83 meters at 2,670 g/t silver and 1.3% Zinc at Oploca South

The Chocaya vein is exposed in the San Miguel open pit while the Oploca North and Oploca South veins occur directly to the south of the pit. The underground drilling on these three veins was performed from the existing underground workings. All veins remain open laterally and at depth.

### The Look of the Combined Entity

The guidance for FY17 from Silver Standard talks of 4.5-5.5mn ozs of silver and a cash cost of \$13.50-16 per oz. Silver Standard reports cash costs on a per payable ounce sold basis, 2017 expected cash costs, include stockpile inventory costs of approximately \$3.50 per ounce of silver that were previously incurred. The chart below shows historic cash costs and 2016 guidance, which is \$9.00 to \$9.50 per payable ounce of silver sold.



This implies revenues from the mine of between \$80-100mn in the full year depending on the silver price staying in the \$17-19 range. Once the option is exercised GRG will receive 25% of the current production back to the time of signing of the option agreement of which the effective date is September 30, 2015. It is quite interesting to ponder that Golden Arrow is a junior that will go from zero revenue to its proportional share of substantial net revenues backdated to late 2015, without having to develop a producing mine. Then the question is with what speed the Chinchillas mine can be brought into a state to be shipping ore (the company estimates 6-9 months of pre-production) to the Pirquitas milling facility to make up for the inevitable decline in ore mined at the historic mine. There are no plans for crushing at Chinchillas at this time. Revenue flows from Pirquitas should fund the Chinchillas pre-production.

### The Rest of the Portfolio

The other project that the company has signaled is a "keeper" is Antofalla, located to the south in the mining-friendly Catamarca province. This property consists of epithermal Silver/Gold/base metals targets in silicified/brecciated zones within tuffs and dacites and is deemed to have strong similarities to Chinchillas. Golden Arrow is positioned to earn-in 100% on 8,760 hectares with low initial commitments. Some indication of the potential is given by readings such as:

- 18m @ 128 g/t Ag, 0.23 g/t Au, 0.88% Pb in historic drilling
- 14.9m @ 271 g/t Ag, 1% Pb in GRG due diligence channel sampling

High-grade Gold-Silver structures in Sediments including:

- 2m @ 9.2 Au g/t, 52 Ag g/t, 5 % Pb in historic trenches in Los Españoles Vein

In 2016 the work program here amounted to US\$200-500k to define drill targets.

With the main focus on the potential Chinchillas/Pirquitas combination the company has signaled its willingness to potentially farm out into joint ventures its attractive portfolio of other projects located in Argentina's mountain provinces. These are the:

Mogote Copper-Gold Project - 8,300 ha located in San Juan Province. This project is located within the well-known porphyry and epithermal mineral belts with deposits that include: El Indio, Pascua-Lama, Veladero, Aldebaran, Marte/Lobo and Refugio. This deposit is proximal to the Jose Maria project (held by NGEx).

Caballos Copper-Gold Project - 22,000 ha located in La Rioja Province. The company claims that there is evidence for a large buried Cu-Au porphyry system at southern extension of the Maricunga belt

Potreros Gold-Silver Project - 4,000 ha located in San Juan Province. This is an epithermal target some eight kilometres east of Barrick Gold's massive Veladero gold/silver mine which hosts reserves of 7.5mn oz gold.

### Financings

The most recent financing at Golden Arrow was in July of 2016 when the company issued 9,020,000 common shares at a price of CAD\$0.75 per share for gross proceeds of CAD\$6.765mn. Each unit consisted of one common share at \$0.75 per share and one-half share purchase warrant. Each whole warrant entitles the holder to purchase one additional share at a price of CAD\$1 per share for 18 months from the date of issue. The warrants exercise period may be accelerated if the volume weighted average price for the shares is \$1.40 or greater for 10 consecutive trading days.

### Board & Management

**Joseph Grosso**, the Chairman, CEO and a director, might be called the doyen of Argentine mining. He was one of the early pioneers of the mining sector in Argentina in 1993 when mining was opened to foreign investment, and was named Argentina's 'Mining Man of The Year' in 2005. He proved to be a



useful vector for foreign miners wanting local knowledge during the opening of the Argentine mining sector and fully formed strategic alliances and negotiated with mining industry majors such as Barrick, Teck, Newmont, Viceroy (now Yamana Gold) and Vale S.A., and government officials at all levels.

He is the founder and president of Grosso Group Management Ltd.

**Dr. David Terry** is a non-executive director and has more than 20 years of experience focused on exploration for a wide spectrum of precious and base metal deposits throughout North and South America. He has held numerous senior positions with both major and junior mining companies, including Boliden Limited, Westmin Resources Limited, Hemlo Gold Mines Inc., Cominco Limited and Gold Fields Mining Corporation. He holds a BSc and PhD from the University of Western Ontario.

**Nikolaos Cacos**, is a director and Vice President of Corporate Development with 24 years of management expertise in the mineral exploration industry. He has extensive experience in providing strategic planning to and administration of public companies. He serves as a director and officer of several publicly traded companies. He holds a Master of International Management degree from Heidelberg, Germany and a Bachelor of Science degree from the University of British Columbia.


**Dr. John B. Gammon** is a non-executive director with 40 years of experience in mineral exploration and management, including international positions with Falconbridge, Assistant Deputy Minister Mines and Minerals with the Government of Ontario and, since his retirement, as ADM as a consultant working with industry, governments and universities. In addition to Dr. Gammon's mineral exploration experience he has also spent a significant amount of time on aboriginal community and environmental issues. He has significant experience working in Latin America.

**Louis P. Salley**, is a non-executive director with over 30 years' experience as a corporate securities lawyer specializing in corporate finance matters for small cap companies, and has served as a director with a number of public companies. He was a founding partner of Salley Bowes Harwardt LLP, a Vancouver law firm, focusing on resource companies and has extensive experience with all aspects of prospectus financings, private placements, mergers and acquisitions in the public markets. Mr. Salley holds a Bachelor of Arts degree and a Bachelor of Laws degree from the University of Alberta.

**Taylor Thoen** is a non-executive director. She is the founder and creator of the longest running investment TV show in Canada, BTV - Business Television, broadcast on FOX Business News, BNN, Air Canada, and Thomson Reuters. She completed the EO - Entrepreneurial Masters Program at MIT and is the recipient of numerous awards including Canada's Top 25 Female Entrepreneur, Profit 100 Fastest Growing Company Award and Ernst & Young Entrepreneur of the Year nominee.

## Risks

The risks associated with Golden Arrow are nothing too challenging.

 Silver or Zinc price weakness

- ✖ Silver Standard desists from advancing with the transaction
- ✖ Silver Standard makes a bid for Golden Arrow
- ✖ Local difficulties with permitting or development

Price is always an issue for metals miners. Silver can be dragged up and down to varying degrees with sentiment towards gold. However Zinc has a very strong tailwind from over a decade of underinvestment that will not be willed away by sentiment but only by fresh supply and that is evidently not imminent.

Getting inside the head of Silver Standard is a difficult thing to do for investors but frankly on the basis of results one cannot see why the larger company would not want to do this deal as the work thus far, particularly the resource statement make this evidently a highly suitable “Son of Pirquitas”. Whether Silver Standard makes a predatory move or not remains to be seen.

The government of Jujuy is getting behind the Chinchillas project because frankly if it does not it risks seeing the high-paid and skilled jobs at Pirquitas disappear with that mine’s ultimate closure with nothing to replace it. Chinchillas is needed more by the provincial government than by anyone else.

## Conclusion

Supposedly J.P. Morgan was once asked how he became so wealthy and his response was “I sold too early”. The question here is whether Silver Standard “sold too early” in engineering the transaction discussed above. We think not. Production is over the hill at Pirquitas and its best chance of extending its own mine’s life and gleaning extra value out processing infrastructure at the mine is this combination. Without an extra source of feedstock, a decision on whether to shutter it will need to be made in the next two months. The obvious solution is to ramp up Chinchillas and start sending a stream of Silver (and Zinc) ore in the direction of Silver Standard’s processing facilities at Pirquitas. We are constantly asked where the next big Zinc mine is coming from and have hitherto been saying Chesapeake’s Metates project or shrugging our shoulders. However with the silver and zinc planets aligning in Jujuy the combined operation of Pirquitas and Chinchillas adds a major dark horse in the race to production.

As to which of the players to go for, the choice is between Silver Standard with 75% of the combined operation (but with a \$1.8bn market cap) or Golden Arrow with a \$66mn market and 25% of the action. While Silver Standard has two other producing mines (Marigold and Seabee, which are rather ironically both gold mines), Golden Arrow would appear to be the purer play, the cheaper stock and the better leverage to the nascent Argentine mining sector.

If the combination goes through then Golden Arrow will become THE silver major in Argentina and as such we have instituted a **Long** position in the Model Mining Portfolio Golden Arrow with 12-month target price of CAD\$1.45.

Tuesday, February 7, 2017



## Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

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