Monday, July 6, 2015

HALLGARTEN & COMPANY

Initiating Coverage

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Tango Mining (TGV.v)

Strategy: Long

Key Metrics			
Price (CAD)	$ 0.025		
12-Month Target Price (CAD)	$ 0.12		
Upside to Target	380%		
High-low (12 mth)	$0.02 - $0.06		
Market Cap (CAD mn)	$ 3.84		
Shares Outstanding (millions)	153.4		
(fully diluted)	167.5		
	2014	**2015e**	**2016e**
Consensus EPS		n/a	n/a
Hallgarten EPS		$0.008	$0.013
Actual EPS	($0.01)		
P/E	n/a	3.23	1.88
Dividend	$ -	$ -	$ 0.005
Yield	0.0%	0.0%	20.0%

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Tango Mining

Switching from a Latin to an African Beat

- + Focusing on diamonds and coal with only producing properties or those with near-term production under consideration
- + The reactivating of the Oena alluvial diamond mine on the Orange River is going apace with the first diamonds having been produced
- + Cashflow and current operations underpinned by four producing coal mines in South Africa
- × Investors remain wary of South Africa but that is largely due to labour relations problems and energy supply issues

New Diamond Player in the Making

Producing diamonds companies are an even rarer commodity than the gems they seek. Occasionally there are surges in the number of explorers in the space, but this is usually triggered off by some new diamondiferous region being identified. Tango is different in that it has joined the ranks of producers in one of the world's most well-documented diamond mining provinces.

From the company name one would have thought a Latin flavour to the Tango's projects and one would not be wrong as, until October of 2014, the company was solely devoted to a gold exploration project in Nicaragua. However a transformative deal in the last quarter of 2014 resulted in the company acquiring African Star Minerals which brought with it a mix of assets heavily biased towards southern Africa, in particular a set of producing coal assets and an alluvial diamond field that has been productive in recent memory.

The object of this note is to deal with these new acquisitions, particularly as they pertain to precious gems.

Nicaragua – JV in Prospect

It is probably best to deal first with the Latin American asset, if only because it is likely to be JVed out of the picture and become a minor footnote, at least until a JV partner makes meaningfully headway with it. Tango holds a 100% interest in the 2,088 hectare El Santo concession. El Santo is located in central Nicaragua south of B2Gold's La Libertad mine and mill complex that is projected to produce approximately 135,000 to 145,000 ounces of gold in 2015. El Santo is thought by Tango to host several east-west trending, low sulphidation, epithermal quartz vein systems similar to those found on the La Libertad concession. Tango has filed an environmental impact assessment with respect to El Santo and is engaged in discussions to JV out this project and focus its attentions on Africa in the future.

The African Star Minerals Deal

The transformation of Tango from a Latin American mining into one with an African bias began in October of 2014 when the company entered into merger agreement which involved the listed entity acquiring a 51% interest in African Star Minerals Group, which: (i) held a 100% interest in the Oena Diamond Project, a past producing alluvial diamond property covering 8,800 hectares located in the Northern Cape Province, South Africa; and (ii) had four toll treatment contracts in respect of four producing collieries located within the Ogies and Highveld coalfields, Mpumalanga Province and Kliprivier coalfield, KwaZulu-Natal Province.

The shareholders of African Star received shares of Tango in the merger with Tango issuing them 49mn shares (at a deemed price of $0.05).

There were no underlying royalties in respect of Oena, however, each of the four private companies comprising African Star qualify as being “BEE Compliant”, namely, that they are in compliance with South Africa’s Black Economic Empowerment rules. The 51% held by Tango is matched with the 49% empowerment equity holdings by BEE individuals. Tango have a pre-emptive right on the 49% should it become available for sale.

To ensure a managed market in Tango stock issued for the transaction, African Star agreed to:

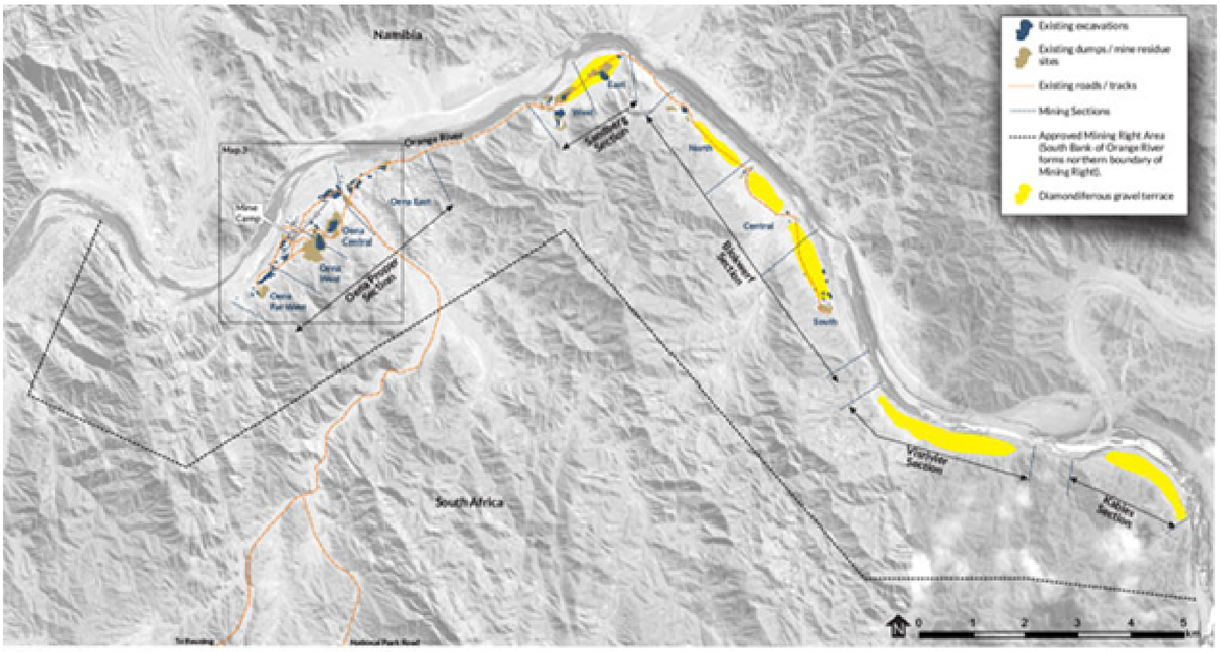
- restrict the number of Payment Shares tradable on any given day
- impose a thirty-month escrow period, whereby 10% of the Payment Shares would be free trading (subject to a regulatory four month hold period) at closing, and subsequently thereafter, 18% would be released at each six-month interval over the 30 months

The Section 11 (1) Ministerial approval required under the Mineral and Petroleum Resources Development Act, 2002, Republic of South Africa was granted on 24 April 2015 that allowed for the completion of the transfer of the mining right and controlling interest in African Star to Tango on the 18 June 2015..

Oena

The Oena Project consists of one New Order Mining Lease located on the lower Orange River, Northern

Cape Province, South Africa. The New Order Mining Lease (MPT24/2014MR) was granted in 2009, is valid until April 2015. The license renewal has been submitted to the DMR and receipt confirmed 27 January 2015 for a further extension for 30 years to 2045. Oena is 8,800 hectares in size and covers a 4.8 kilometre wide strip along a 15 km length of the Orange River.



Claim Boundary and Section location map

Ownership

The original Oena Mining Licence (ML 7/92) was issued in 1992 to Kuboes Diamante (Proprietary) Limited and then was converted to the current New Order Mining Lease in 2009. African Star Minerals acquired 100% of Kuboes in 2013. The beneficial interests in turn from African Star have been transferred to Tango and they are in receipt of the Section 11 Ministerial approval of the transfer of mining rights and consent for change of control in terms of the Mineral and Petroleum Resources Development Act. The Black Empowerment (BEE) part of the ownership is vested (with a 26% stake in a free carry) and there is 23% in a trust that could eventually be distributed to local organisations in the general vicinity of the project.

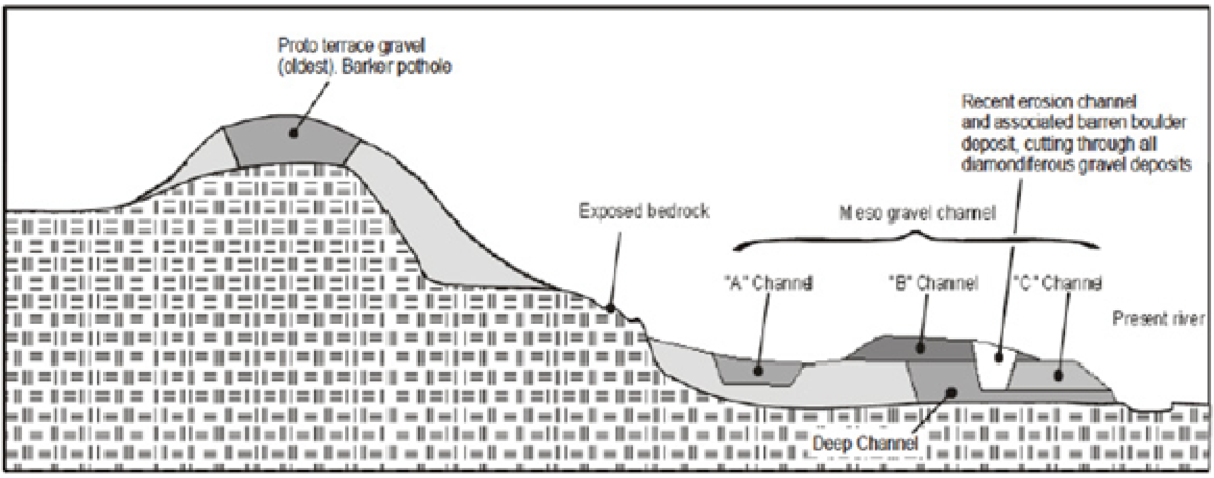
Geology and Deposit Type

The Oena deposit is located within a well- established alluvial diamond mining province 50 km upstream of Namdeb's Auchas and Daberas alluvial diamond mines, located on the Namibian (i.e. north) bank of the Orange River, and 15 km and 60 km upstream of Trans Hex's Reuning and Baken alluvial diamond mines, respectively, located on the South African (i.e. south) bank of the Orange River.

Two separate and distinctly different aged diamondiferous-bearing paleochannel gravels are present on the Oena property. These are:

- Proto-terraces (dated as Miocene: 17–19 million years ago) are higher-level and are located greater than 40m above the current Orange River level.
- Meso-terraces (dated as Pliocece and Pleistocene and are 2-5 million years ago) which are lower-level and are located between 10m to 12m above the current Orange River level.

There are five meso-terraces on the Oena property including the Oena, Sandberg, Blokwerf, Fishriver and Kabies Sections. Most of the historical exploration has been concentrated on the Oena and Sandberg Sections and none has been completed at the Fishriver and Kabies Sections.



Schematic section of Property meso- and proto-terrace paleochannel gravels

Past Production

The Oena deposit has seen various forms of exploration and mining activities that started in 1992 with work by independent mining companies who mined the proto-terraces at the Oena Section until 1995, producing some 30,000 carats with an average stone size of some 2 carats. The largest stone recovered was 79 carats.

Between 1995 and 2000 various contractors were employed to test mine the property. Small pits, trenches and bulk sample pits were excavated and treated through a conventional pan plant. The results of this test mining are not known. Between 2000 and January 2006 systematic drilling was focused on the meso-terraces and a bulk-sampling program. Between February 2006 and August 2007 trial mining was performed with results documented in daily mining and plant treatment reports. These results were used to measure average diamond sizes and expected grades in basal and suspended gravels over the Oena meso-terraces.

The systematic drilling results have been used in sections and volumes of gravel, both suspended and basal have been estimated using a polygonal block method. The historical bulk sampling and trial mining results have been used to estimate average grades for the gravel remaining at Oena:

Oena Metrics

	Bulk Sampling	Trial Mining
	Jan 2002 to Jan 2006	Feb 2006 to Aug 2007
Average pricing USD/Ct	$1,503	$1,790
Carats recovered	4,768 cts	741 cts
Metric tonnes treated	1,153,818	459,677
Grade recovered	0.41	0.16
(carats per hundred metric tonnes ("cpht") of material mined and processed)		
Number of stones recovered	3,253	609
Average stone size	1.47 cts	1.22 cts

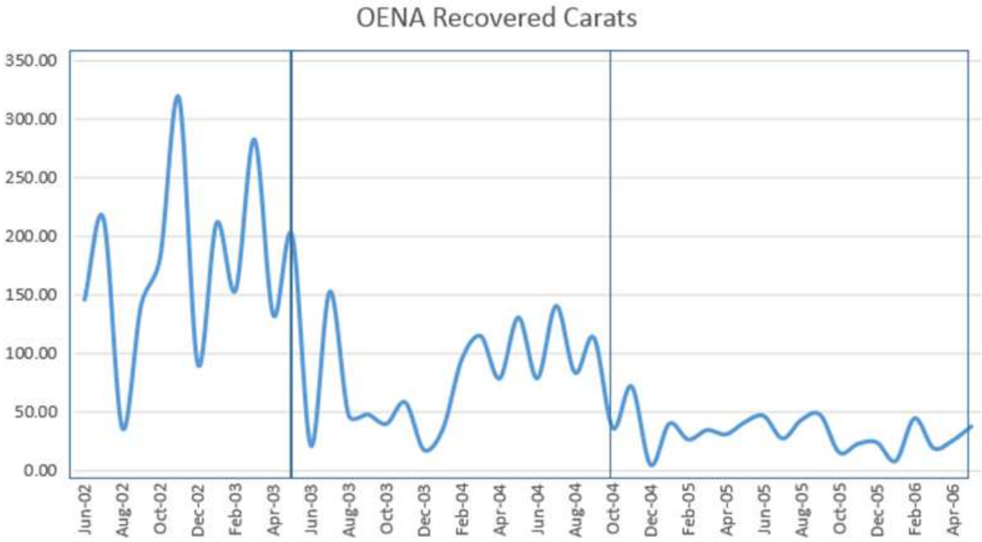
The past operations of the mine were a litany of misery that Tango intends to avoid this time around. As can be noted in the table below, carats recovered and grade sagged badly even as prices in USD terms were strengthening healthily.

HISTORICAL MINING STATS – OENA		2002	2003	2004	2005	2006
Pricing	USD/crt	855	852	1050	1198	1503
Carats recovered	crt	923	1989	903	677	374
Tons treated	Tons	161,930	473,571	188,125	135,400	194,792
Grade recovered	cpht	0.57	0.42	0.48	0.5	0.192
Average stone size	crt/st.	1.93	1.44	1.23	1.36	1.39

It should be noted that the exchange rate in 2006 (for example) was 6.5 Rand to the USD compared to 11.93 Rand to the USD currently.

Firestone placed the mine on care and maintenance as a result of this decline in production, and its divestment of alluvial projects in the wake of the 2008 global financial crisis. However, beyond this there was also a lack of sufficient capex (with some relatively simple "quick fixes" not being applied) as well as Firestone switching its focus to developing its BK11 property and the Bontekoe Tolling agreement with DBCM.

Problems extended beyond macro issues though with a key factor being the significant level of thefts of diamonds considering that 47% of 2002/2003 production was greater than 5 carats per stone.



Firestone production maintained 36 staff and mining operations focused on fresh feed. During the final phase from October 2004, the site was managed by a skilled earthmoving individual (rather than a production focused person) following the dismissal of mine managers in Phase A & B.

In the final phase the plant was placed on care & maintenance with most work done on rehabilitation but still there was some limited throughput to finance rehabilitation activities hence the low volumes post-October 2004.

Mine Reactivation

The easy pickings in any mining operations these days tend to be stockpiled material. Past operational inefficiencies at Oena suggest that grade in coarse residue (tailings) and oversize material is available to mine at low cost and is commercially viable. Therefore there are diamonds sitting on a stockpile of over 349,000 tonnes which the management at Tango believes run at grades of over 6 cpht.

In addition there are several other stockpiles on the site that the company plans on deploying one of the mobile bulk sample plants to test them. It is expected that the main pile is shovel-ready and that processing shall begin as soon as the minor refurbishments to the plant are completed.

An NI43-101 report, dated October 2014 was prepared by Peter Walker of VP3 GeoServices.

Oena - Inferred Resource

	Volume m3	**Grade**
Blocks 2-6	1,075,000	0.295 cpht

In addition to this historical Inferred Resource, systematic Reverse Circulation drilling of the Sandberg terrace was completed and showed an estimated 4.5mn to 5.75mn cubic metres of basal and suspended gravel and was shown by two bulk samples to be diamondiferous, however, these sample volumes are too small to estimate diamond grades at a sufficiently predictable level of accuracy.

Planned capital expenditure in 2015 is CAD$729,000, with those funds being deployed on plant equipment, operational readiness and infrastructure development costs.

In March the company reported the successful mobilization of mining contractor earthmoving equipment to support a total of 1.59 million tpa throughput capacity. The first 24,421 tonnes has been excavated, of which 3,390 run-of-mine tonnes have been processed through the commissioned rotary plant and recovery system. The newly acquired high volume Bourevestnik X-ray recovery equipment, to be commissioned in the latter half of this year, will allow for increased recovery efficiencies and product insurance and protection. Production was commenced the 21st of June 2015, and the 11.5 carat diamond pictured at the right was recovered on the 29th of June.

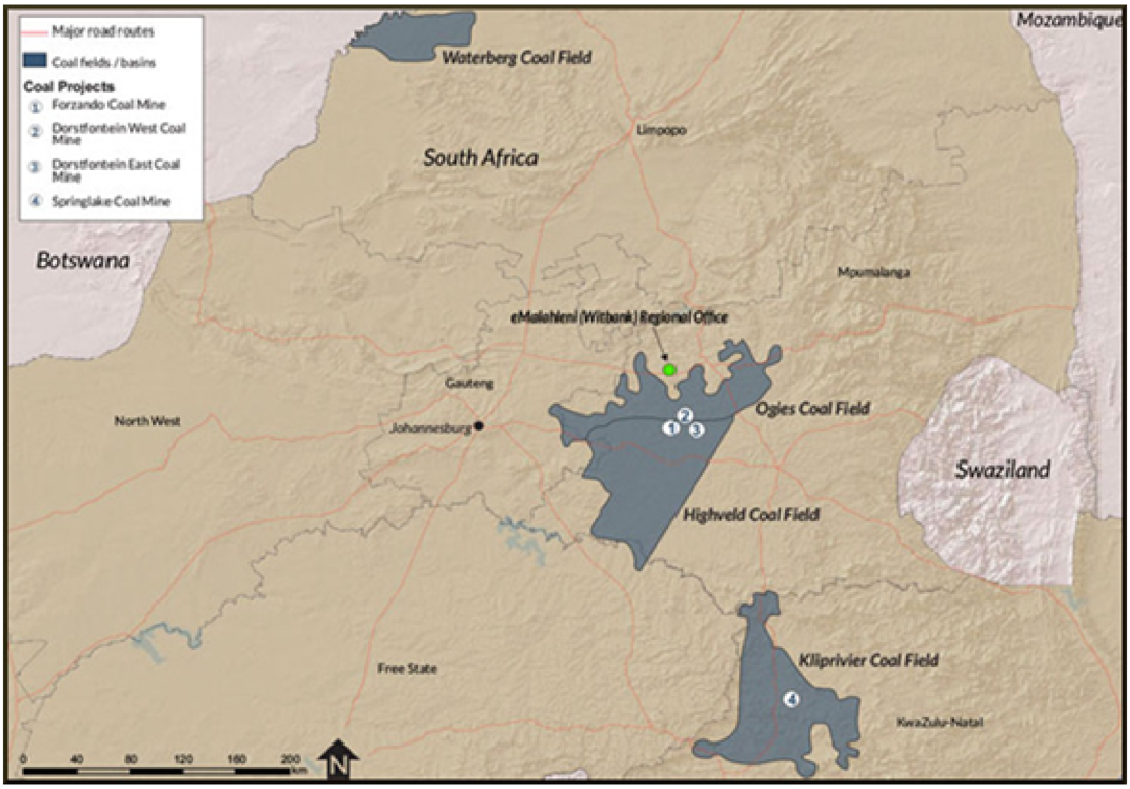
An initial 12,215 ton bulk sample in June 2015, produced an average stone size of 3.03 cts per stone and this was achieved using the less efficient rotatory pan plant during the initial startup period phase. The actual grade was 0.298 cpht. This looks promising considering the benchmark 0.12 cpht and 1.39 cts per stone declared in the NI43-101. Management considers tonnage throughput is therefore deemed to be as the critical component to successfully operate Oena.

The Coal Mining Assets

Most mining companies these days would kill to have cashflow and yet few consider the strategy of having assets that generate revenues in the short term even if those assets are not want one wants to hang one's hat on for the long term.

In the case of Tango, the cash cow is the coal assets that it picked up with the African Star deal. While coal is not fashionable these days, the production of Tango's mines benefits from having medium term offtake agreements with buyers of substance.

Tango has four thermal coal, metallurgical and processing plant and engineering contracts. The four projects are located within the Ogies and Highveld coalfields, Mpumalanga Province and Kliprivier coalfield, KwaZulu-Natal Province, in the eastern part of South Africa.



These assets are:

- Dorstfontein East Coal Mine. This is a multi-seam mine where the raw coal is beneficiated through a 300,000 tpm wash plant producing washed coal for the export market.
- Dorstfontein West Coal Mine. This is a multi-seam mine where the raw coal is beneficiated through a 150,000 tpm month wash plant producing washed coal for the export market and inland market.
- Forzando Coal Mine. This is a multi-seam mine where the raw coal is beneficiated through a 300,000 tpm month wash plant producing washed coal for the export market and inland market.
- Springlake Coal Mine. This is a multi-seam mine where the raw coal is beneficiated in a 250t/hr wash plant, producing low volatile coal for both the inland metallurgical and export markets.

The operations currently employ some 285 personnel in both the skilled and unskilled labor categories.

These mines process 6.5 million tonnes per annum. The company has 19.5 million tonnes contracted for sale over next three years, with clientele that include Total (SA) and Glencore. The contracts for the processing have been systematically renewed for the past 17 years. While renewal cannot always be guaranteed, this longevity of the relationship has brought stability to the company's earnings flow and planning.

The coal division generated US$D17m in revenue in 2013, and US$19m in revenue in 2014. The minimum tonnage the venture processes on contract means it will make a minimum of US$12m per annum regardless of the coal price or market.

The revenue forecast from management for 1Q15 (ending November 2014) is CAD$2.133mn and CAD$11.98mn for the financial year ending August 2015.

Our model for earnings for this division are:

Coal Division Earnings Model	FY17	FY16	FY15	1H15
Revenue	15.39	15.08	14.64	6.841
Operating Profit	1.45	1.56	1.47	0.693
Pre-tax	1.45	1.56	1.47	0.693
Tax	0.435	0.468	0.441	0.194
Post-tax	1.015	1.092	1.029	0.499

Our estimates are nothing exceptional but they do provide funds in the short-term that cover the bulk of fixed overheads.

Financing Initiatives

In mid-May, Tango announced that it had arranged an offtake agreement with ATC Enterprises DMCC and, in consideration, ATC had agreed to purchase from Tango a US$500,000 unsecured one-year convertible note.

ATC is a private, Dubai-based, trading company. The ATC team has over 25 years' experience in trading diamonds and has been active for 10 years. Currently, 1 in 4 rough diamonds from Africa are traded through Dubai and it has become one of the largest and most favoured destinations for purchasing rough diamonds. All diamonds traded by ATC are fully certified under the Kimberley Process Certification Scheme.

The Unsecured Note will be a one year non-transferrable convertible note in the principal amount of US$500,000, bearing interest at a rate of 10% per annum. ATC has the option at maturity, at its discretion, to be repaid all or a portion of the principal amount by the issuance of common shares of Tango at a value of CAD $0.05 per share, interest is repayable in cash or shares with pricing fixed at the day of conversion.

The Offtake Right shall become effective on the date of issuance of the Unsecured Note and shall expire on the later of:

(i) twelve months after the date that ATC takes delivery of the first diamond
(ii) the date that ATC has received a minimum of 2,000 carats.

An independent valuator appointed by Tango shall determine the price of diamonds produced from Oena and ATC shall be entitled to a fee payable in cash equal to 10% of the gross sale proceeds.

For investors used to offtakes in the specialty and base metals sectors this seems like a sensible and familiar arrangement.

Over and beyond the unsecured convertible note, the company also indicated that it is organizing the issuance of Secured Convertible Notes for gross proceeds of up to CAD$2.5 mn. These will be:

- two-year non-transferrable convertible secured notes
- interest at a rate of 12% per annum

The principal and accrued & unpaid interest shall be paid at maturity, except that the holder may elect a conversion option and be paid in common shares of Tango at a value of CAD five cents per common share. The Secured Notes shall be secured on a pro-rata basis using a formula per subscription amount against Tango's right, title, and 51% interest in and to African Star Minerals.

The Unsecured Note and Secured Notes and the underlying common shares issuable upon conversion of each, shall be subject to a four-month hold period from the date of issuance.

While more money than the company currently requires for developing Oena and the coal areas, the Secured Notes will give the company to build opportunistically upon its current strengths. The company has made no secret of its desire to accumulate diamond producing assets, particularly those that are poorly managed or shuttered and turn them around.

The Earnings Model

The model on the following page shows our estimates for the next three fiscal years. There should be no appreciable revenues from Oena in FY15 so that operation's financial contribution only kicks in from FY2016. The operations at Oena, if the planned efficiencies can be achieved, should be a rising revenue source with a good margin in the following fiscal years. In the first year at least the workover of stockpiles will have lower opex for each carat produced.

Economics have been enhanced by the prolonged weakness of the Rand against the USD. It should be noted that the exchange rate in 2006 (for example) was 6.5 Rand to the USD compared to 12 Rand to the USD currently.

Tango Mining
FY ending August - millions of CAD

	FY17e	FY16e	FY15e	2Q15	1Q15	FY14	4Q14	3Q14	2Q14	1Q14	FY13
Total Revenue	21.09	19.38	14.64	3.463	3.38	0.00	0.00	0.00	0.00	0.00	0.00
Coal Assets	15.39	15.08	14.64	3.463	3.38						
Oena	5.70	4.30									
Cost of Revenue, Total	11.85	11.50	8.25	2.838	1.04	-	-	-	-	-	-
Gross Profit	9.24	7.88	6.39	0.625	2.34	-	-	-	-	-	-
Selling/General/Admin	2.23	2.10	3.34	0.37	2.28	1.19	0.22	0.26	0.26	0.44	1.50
Exploration	0.13	0.10	0.023	0.005	0.01	0.09	-0.01	0.00	-0.01	0.11	0.93
Depreciation/Amortisation	0.50	0.50	0.13	0.048	0.056	0.02	0.00	0.00	0.01	0.00	0.02
Other Operating Expenses					0.26	-	-	-	-	-	-0.06
Total Operating Expense	14.71	14.20	11.743	3.261	3.65	1.31	0.22	0.26	0.26	0.56	2.39
Operating Income	6.38	5.18	2.90	0.19	-0.27	-1.31	-0.22	-0.26	-0.26	-0.56	-2.39
Financing Costs	0.23	0.18	0.02	0.005							
Income Before Tax	6.15	5.00	2.88	0.184	-0.26	-1.36	-0.24	-0.27	-0.26	-0.59	-2.66
Tax	1.60	1.30	0.75	-0.19	0.00	0.00	0.00	0.00	0.00	0.00	0.00
Income After Tax	4.55	3.70	2.13	-0.01	-0.26	-1.36	-0.24	-0.27	-0.26	-0.59	-2.66
Minority Interest	2.09	1.70	0.98	0.24	-0.06	-	-	-	-	-	-
Net Income After Minorities	2.46	2.00	1.15	-0.01	-0.32	-1.36	-0.24	-0.27	-0.26	-0.59	-2.66
Weighted Average Shares	151.00	150.00	148.80	149.26	148.18	95.33	98.49	98.45	98.45	59.12	59.12
EPS	0.016	0.013	0.008	0.000	-0.002	-0.01	0.00	0.00	0.00	-0.01	-0.05

We are opting towards not projecting a meaningful rise in shares on issue at this point as Oena's initial work is funded out of the coal division's cashflow and the financing that shall be discussed further on. A stock rollback would be welcome.

The company at these modest earnings projections is currently trading on a P/E of between one and two times FY16 and FY17 earnings, a truly stunningly low valuation for a company with such a sound core earnings stream from coal and further income (Oena) coming on-stream.

Management

The team is led by **Terry Tucker, P.Geo**, who holds the Executive Chairman position. He is a geologist with 26 years' experience in mineral exploration and development projects. Prior to 2011, he was the CEO and Director of Nyota Minerals (AIM, ASX: NYO) focused on an advanced stage gold project in Ethiopia. He was also President, CEO and Director of TSX-listed StrataGold, which advanced the development of two gold projects in Guyana and Canada before the company's acquisition by Victoria Gold Corp (TSX-V: VIT) in June 2009. Previously he was responsible for a number of exploration projects in northern Canada, including the discovery of the Wolverine gold-rich massive sulphide deposit.

The CEO is **Marco Möller** who has over 20 years' experience in the Southern African mining, energy markets and the export manufacturing and engineering sectors, which includes CEO of African Star. Mr. Möller was also founder and Executive Managing Director of AFRICO Engineering and JOSS Steelworks and was group financial controller of Firestone Diamonds PLC, where he was part of the key management team responsible for developing various alluvial and kimberlitic assets from early exploration through to production status. He holds an MBA from UCT, a B.Com postgraduate degree at the University of South Africa and has completed the South African Institute of Chartered Accountants training program with PriceWaterhouse Coopers.

Antonio Ponte is a Swiss-based financier with 25 years of asset management and mining corporate finance experience, operating principally in Switzerland and Europe. He is the Chairman and Founder of Raifin SA, a European mining finance consultancy, and has held positions at UBS Switzerland, Citibank Switzerland and other private banking institutions. He has been a director and consultant to a number of TSXV companies for more than five years.

Kevin Gallagher has over 40 years' experience in the mining and metallurgical process engineering industry and was founder and is Executive Managing Director of the Kwena Mining Group (part of African Star). His operational experience includes 14 years as metallurgical supervisor at various coal, gold and platinum plants which includes Harmony Gold, Rand Mines Group & Rio Tinto. He is a member of the South African Coal Processing Society, a member of the Mine Metallurgical Managers Association, holds a Diploma (Hon) Mineral, Processing & Extractive Metallurgy from the School of Mines Rhodesia.

Since 2003, **Ian Mann,** Non-Executive Director, has been the President of Meridian Fund Managers Ltd, a fund manager primarily investing in mining and oil and gas companies. Prior to that, he held senior management and partner positions with several Bermuda companies. Since 1997, he has served as a non-executive director of a number of Canadian exchange listed mining companies, three of which have now merged into other entities. He holds an Honours Business Administration degree from The University of Western Ontario.

Marc Bamber, Non-Executive Director previously worked as a natural resources hedge fund manager with RAB Capital Plc. Mr. Bamber possesses an understanding of the natural resources investment sector including its many risks and opportunities. He also has extensive experience at Board level with good knowledge of the UK, European and Canadian markets as an independent company director and consultant to small and mid cap natural resources companies including Fission Energy Corp (sold to Denison Mines Corp); Fission Uranium Corp and Fission 3 Corp..

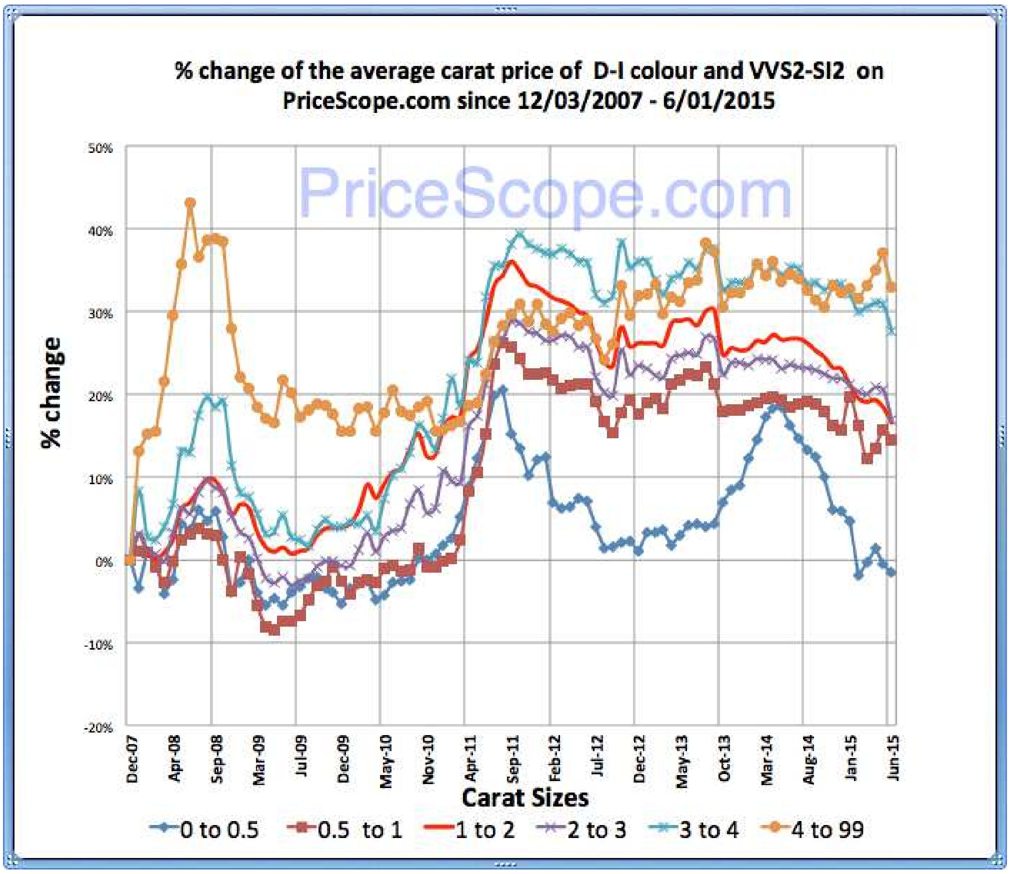
Risks

Unlike many miners that buy an asset first and then ponder how to finance it, Tango preferred to put its financing ducks in a row before closing. This effectively removes financing risk, which is the biggest pitfall these days.

The specific risks for this project are:

- That diamond prices suffer a bout of weakness
- Problems with the coal mining operations (e.g. labour issues)
- Pricing challenges after the expiry of the three-year offtakes on the coal output

The chart below shows prices for the lowest grades have not changed significantly since 2007 but the best grades have performed well and held up well.



Source: PriceScope

Diamond prices are fair at this time and with production of rough diamonds rising at a modest 2% per annum between now and 2024 combined with surging demand from China there is a good supply/demand scenario. De Beers remain the guiding hand of the industry and have a very substantial vested interest in ensuring orderly markets.

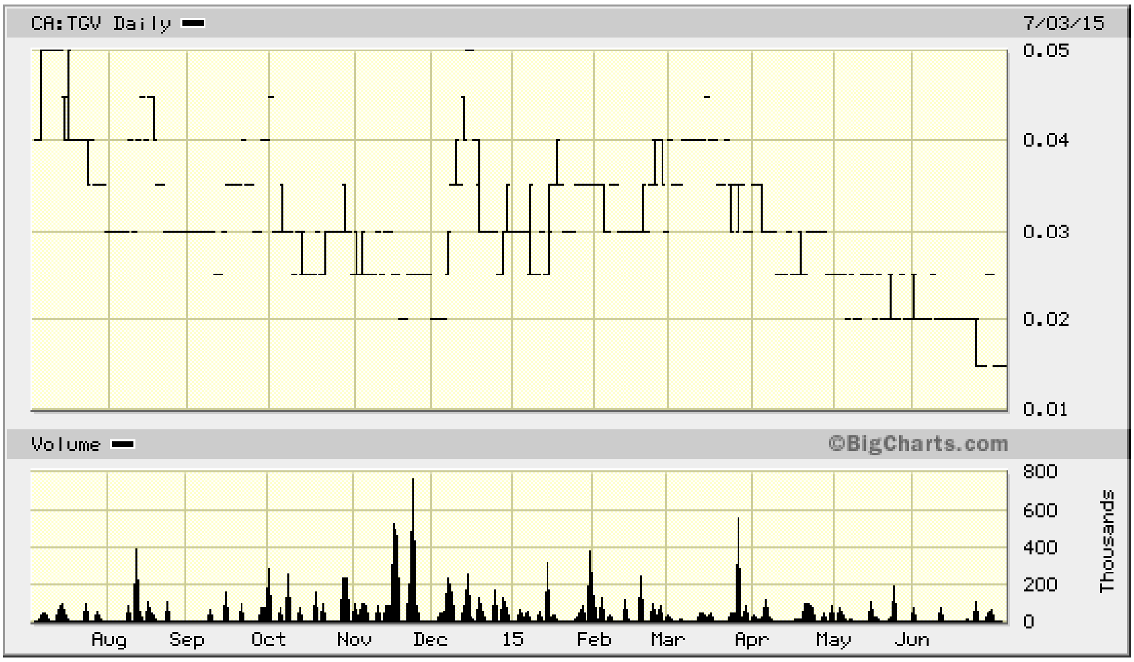
The coal processing operations have good labour relations at the moment. Pricing of coal is currently weak giving hope that prices will be back on an upcycle by the time contracts are up for renewal. Moreover, Tango will no longer be so concentrated upon coal by that time.

Conclusion

In the fickle mining investment scene, Africa has been somewhat out of favour in recent years. This is a situation which has been reversed over the last year as investors have finally learnt to hone their political risk skills and focus on countries where they know they have legal protection and political support.

Tango Mining is on a fast track of transformation and in our opinion is pushing the right buttons (well, pushing the same button three times) with production, production and production. This is the mantra of our times. In relatively short order the company will have changed from a disparate (geographically and product-wise) company with an exploration asset in the Nicaraguan jungle into one with a focus on southern Africa and four producing mines with its main focus being diamonds and coal.

In light of the sound core earnings stream, the incremental income likely from Oena and the rather stunningly low P/E ratio on even our modest earnings projections we are prompted to make our strategy call on Tango Mining a **Long,** while our target price for the next 12-months is for an appreciation to at least CAD 12 cts.



Important disclosures

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