

# Fundamental

## Research Corp.

*Investment Analysis for Intelligent Investors*

January 16, 2019

### Monarques Gold Corporation (TSXV: MQR): Newmont-Goldcorp Deal Encouraging for Juniors with Advanced Stage Assets

**Sector/Industry: Junior Mining / Exploration**

[www.monarquesgold.com](http://www.monarquesgold.com)

#### Market Data (as of January 16, 2019)

Current Price	C\$0.21
Fair Value	C\$0.71
Rating*	BUY
Risk*	4
52 Week Range	C\$0.15 - C\$0.41
Shares O/S	236,372,573
Market Cap	C\$49.64 mm
Current Yield	N/A
P/E (forward)	N/A
P/B	1.2x
YoY Return	-46.2%
YoY TSXV	-7.4%

\*see back of report for rating and risk definitions

\*all figures in C\$ unless otherwise stated.



#### Highlights

- In late 2018, Monarques Gold Corporation's ("MQR", "company") shares were upgraded from the TSX Venture to the TSX Exchange.
- We believe Newmont Mining's (NYSE: NEM) acquisition of Goldcorp (TSX: G), and Barrick Gold (TSX: ABX) and Randgold's recent merger will bring renewed interest in the gold sector. We expect mid-tier gold producers to seek consolidation, which is positive for companies such as MQR, with advanced stage assets. Note that Alamos Gold (TSX: AGI) holds 19% of MQR's shares.
- In December 2018, MQR announced results of a Feasibility Study ("FS") on the Wasamac gold project. Based on a 11 year mine life (142 Koz per year), the project is estimated to have an After-Tax Net Present Value ("AT-NPV") @ 5% of \$311 million, and an AT Internal Rate of Return ("AT-IRR") of 18.5%. The initial CAPEX is estimated at \$464 million, and the operating cost is estimated at just \$692 per oz. The project has an AT-NPV at 5% of \$103 million, even at a gold price of US\$1,000 per oz.
- Q1 (quarter ended September 30, 2018) revenues totaled \$7.78 million, down 23% QoQ. Revenues came from the Beaufor mine (down 33% QoQ), and through custom milling (up 7% QoQ). In December 2018, the company suspended production at the Beaufor mine, primarily due to lower than expected grades. Custom milling operations continue to generate revenues, at an annualized revenue run rate of \$11 million.
- MQR's properties currently hold measured and indicated resources totaling 3.16 Moz, and inferred resources of 0.44 Moz, implying an Enterprise Value ("EV") of just \$15 per oz versus the comparables average of \$50 per oz.
- We believe not only does the current share price not fully value Wasamac, but assigns zero value to any of the other projects in MQR's portfolio.

#### Key Financial Data (FYE - June 30)

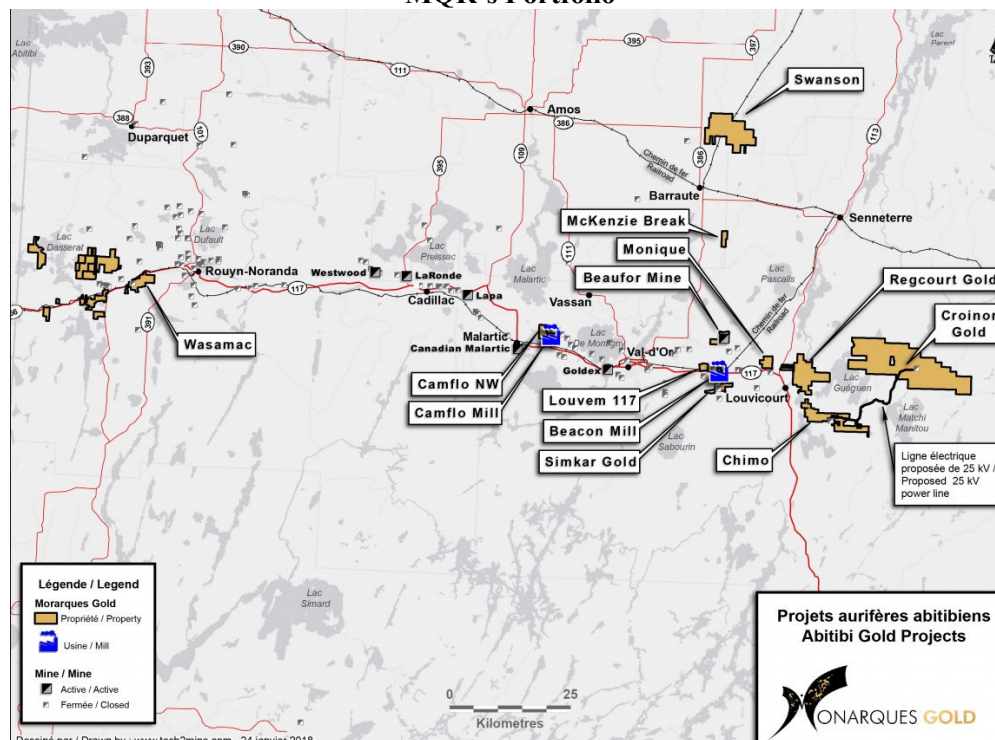
(C \$)	2017	2018	Q1-2019	2019E
Cash	\$7,356,155	\$15,046,248	\$10,737,361	
Working Capital	\$5,798,654	\$6,928,023	\$5,596,536	
Mineral Assets + PPE	\$16,606,843	\$46,197,575	\$49,422,279	
Total Assets	\$26,657,724	\$73,665,169	\$70,551,294	
Revenues	-	\$30,125,421	\$7,777,365	\$18,567,651
Net Income (Loss)	\$2,281,190	-\$4,776,851	-\$1,850,545	
EPS	-\$0.02	-\$0.02	-\$0.01	

- We are not presenting EPS forecasts as the company suspended production at Beaufor.

## Robust FS on Wasamac

In December 2018, MQR announced results of a FS on the Wasamac gold project, located in Abitibi, Quebec. Wasamac, a historic producer, produced 253 koz of gold from 1965 to 1971. Wasamac was part of Richmond Mines Inc.'s portfolio that MQR acquired in 2017 by issuing 34.63 million common shares (valued \$12 million based on a share price of \$0.35). Richmond maintains a 1.5% NSR on Wasamac, of which, 0.5% can be bought for \$7.5 million.

### MQR's Portfolio



**MQR's key assets include two mills (Camflo and Beacon), five advanced stage gold projects (Wasamac, Croinor Gold, Beaufor, McKenzie Break and Swanson) and two exploration projects covering more than 300 sq. km in the Abitibi region.**

Source: Company

The FS was based on 100% of Wasamac's reserves of 21.5 Mt (average grade of 2.56 gpt), calculated in December 2018, and 72% of the measured and indicated resource of 30 Mt (average grade of 2.70 gpt), calculated in October 2017.

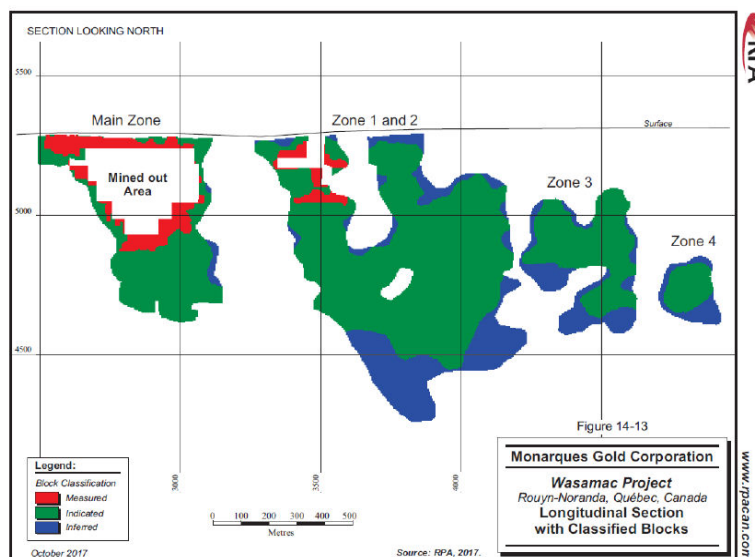
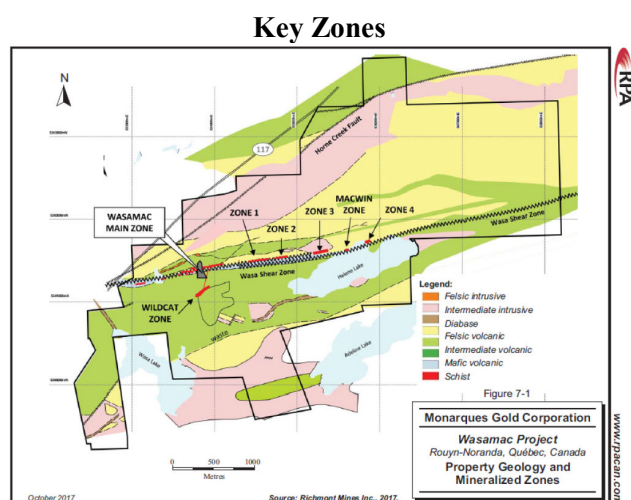
### Wasamac's Reserve and Resource Estimates

	Tonnes (000 t)	Grade (g/t Au)	Contained Gold (000 oz)
Proven	1,028	2.66	88
Probable	20,427	2.56	1,679
<b>Total Proven and Probable</b>	<b>21,455</b>	<b>2.56</b>	<b>1,767</b>

Resource Category	Tonnes (Mt)	Grade (g/t Au)	Contained Gold (oz)
Measured Resources	3.99	2.52	323,300
Indicated Resources	25.87	2.72	2,264,500
<b>Total Measured + Indicated Resources</b>	<b>29.86</b>	<b>2.70</b>	<b>2,587,900</b>
Inferred Resources	4.16	2.20	293,900

Source: Company

**Based on a 6,000 tpd operation, Wasamac's underground mine is estimated to have a mine life of 11 years.** Operations will primarily consist of crushing / grinding, leaching, and Carbon in pulp (CIP) and ADR (Adsorption – Desorption – Regeneration) circuits. The underground mine consists of **five zones**: Main Zone (“MZ”), Zone 1, Zone 2, Zone 3 and Zone 4. The primary focus of mining will be on MZ and Zone 2. The locations of each zone, and their resources, are shown in the images below.



Source: Company

The project is estimated to have an AT NPV @ 5% of \$311 million, and an AT IRR of 18.5%. The initial CAPEX is estimated at \$464 million, which includes key items such as \$138 million for underground mine development, \$132 million for a processing plant, and \$31 million for contingency. The **operating cost is on the lower side**, as it is estimated at \$692 per oz (\$50.24 per tonne milled), including key items such as \$368 per oz (mining) and \$245 per oz (processing).

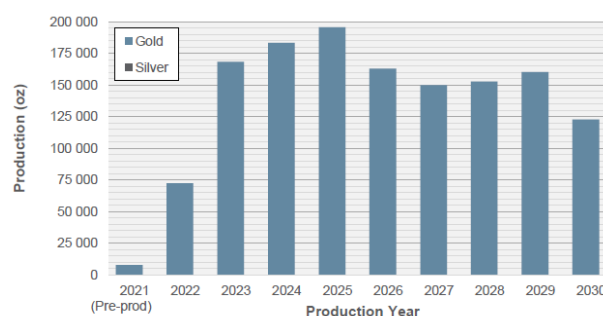
### FS Summary

Description	Unit	Value
Long term gold price	US\$/oz	1,300
Exchange rate	C\$:US\$	1.31
Total tonnes mined	M Tonnes	21.5
Average diluted gold grade	g/t	2.56
Average gold recovery rate	%	88.2
Total gold contained	koz	1,767
Total gold production	koz	1,558
Average annual gold production	oz per year	142,000
Mine life	year	11
Production cash costs	\$/oz	720
Production cash costs	US\$/oz	550
All-in sustaining costs (AISC)	\$/oz	826
All-in sustaining costs (AISC)	US\$/oz	630
Estimated capital expenditure		
Total preproduction capital cost	\$M	464
Sustaining capital	\$M	175
Site restoration cost	\$M	6
Salvage value	\$M	(16)
<b>Pre-tax summary</b>		
NPV (5%)	\$M	522
IRR	%	23.6
Payback period	years	3.6
<b>After-tax summary</b>		
NPV (5%)	\$M	311
IRR	%	18.5
Payback period	years	3.9

Source: Company

The average annual gold production is estimated at 142 Koz; a production scenario is shown below.

### Production Profile



Source: Company

The NPV is robust as shown below by its sensitivity to gold prices, exchange rates and discount rates. The project has an AT-NPV at 5% of \$103 million, even at a gold price of US\$1,000 per oz.



### Sensitivity Analysis (BT-NPV)

	Discount rate						
	0%	3%	5%	7%	9%	11%	13%
NPV	574.6	651.2	521.5	414.8	326.5	253.2	192.1

### Sensitivity Analysis (BT-NPV at 5% and BT-IRR)

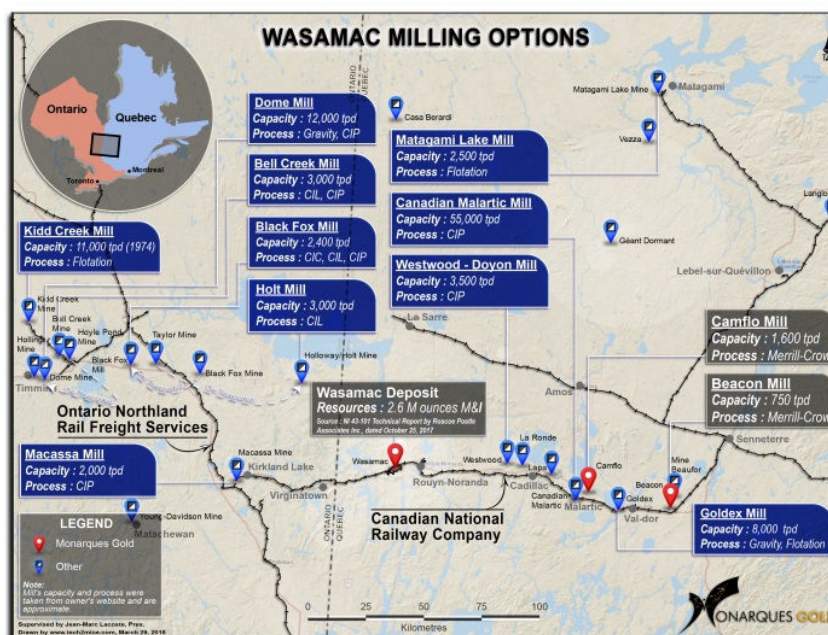
CAD:USD	Gold Price (US\$/oz)							
	\$1,000	\$1,100	\$1,200	\$1,250	\$1,300	\$1,400	\$1,500	\$1,600
1.11	(109.2)	9.2	127.6	186.8	246.0	364.4	482.8	601.2
1.18	(39.6)	85.8	211.2	273.9	336.5	461.9	587.3	712.7
1.25	38.8	172.0	305.2	371.8	438.4	571.6	704.8	838.0
1.31	102.7	242.3	381.9	451.7	521.5	661.1	800.7	940.3
1.43	229.1	381.3	533.6	609.7	685.8	838.0	990.3	1,142.5
1.54	346.2	510.1	674.1	756.1	838.0	1,002.0	1,165.9	1,329.9
1.67	482.8	660.4	838.0	926.8	1,015.6	1,193.2	1,370.8	1,548.5

CAD:USD	Gold Price (US\$/oz)							
	\$1,000	\$1,100	\$1,200	\$1,250	\$1,300	\$1,400	\$1,500	\$1,600
1.11	(0.2%)	5.4%	10.3%	12.5%	14.6%	18.6%	22.4%	25.9%
1.18	3.2%	8.6%	13.4%	15.6%	17.7%	21.7%	25.5%	29.1%
1.25	6.7%	11.9%	16.7%	18.9%	21.0%	25.1%	28.9%	32.5%
1.31	9.3%	14.5%	19.2%	21.4%	23.6%	27.7%	31.5%	35.2%
1.43	14.0%	19.2%	23.9%	26.2%	28.4%	32.5%	36.5%	40.3%
1.54	18.0%	23.2%	28.0%	30.3%	32.5%	36.8%	40.9%	44.8%
1.67	22.4%	27.6%	32.5%	34.9%	37.2%	41.6%	45.8%	49.8%

Source: Company

Custom milling is expected to lower the project's CAPEX by about \$230 million, which will significantly enhance the expected IRR. The proposed mine infrastructure will be next to a Trans-Canada highway, and just 200 m from a railway leading to key regional custom milling facilities. Various custom milling options are shown below.



Source: Company

### Update on the Rest of the Portfolio

**Overall, we were pleased with the FS. Key attractive points include low cost, attractive NPV even at US\$1,100 per oz, a high production profile (142 Koz per year), and the ability to choose custom milling options.**

In December 2018, the company suspended production at the **Beaufor mine**, primarily due to lower than expected grades. The following table shows production since the mine's acquisition. In Q1-2019 (quarter ended September 30, 2018), Monarques produced 3,604 oz of gold, down 23% QoQ. As shown in the table below, the average grade had been on a declining trend. In Q1-FY2019, the production cost was \$1,817 per oz versus \$1,609 per oz in Q4-FY2018. MQR intends to continue exploration at the Beaufor mine to potentially increase its gold resource.

#### Production – Beaufor Mine

	Q2-2018	Q3-2018	Q4-2018	2018	Q1-2019
Production (oz)	5,444	4,932	4,695	15,071	3,604
Sales (oz)	5,444	4,823	4,589	14,856	3,272
Ore Mined	35,005	32,866	30,523	98,394	29,375
Grade (gpt)	4.9	4.7		4.8	4.2
Recovery (%)	98.70%	98.91%		98.76%	98.00%
Average Selling Price (\$/oz)	\$1,583	\$1,624	\$1,617	\$1,610	\$1,520
Production Cash Cost (\$/oz)	\$1,338	\$1,642	\$1,609	\$1,532	\$1,817
All-in Sustaining Cost (\$/oz) - excl corporate	\$1,525	\$1,782	\$2,005	\$1,770	\$1,934
Average Selling Price (US\$/oz)	\$1,245	\$1,284	\$1,273	\$1,268	\$1,162
Production Cash Cost (US\$/oz)	\$1,052	\$1,298	\$1,267	\$1,206	\$1,387
All-in Sustaining Cost (US\$/oz)	\$1,201	\$1,409	\$1,579	\$1,394	\$1,476

Source: FRC / Data Source: Company

**MQR continues to generate revenues from custom milling.** Revenues from Camflo's custom milling operations were up 7.3% QoQ to \$2.78 million in Q1-FY2019. Camflo's current clients include:

- Eldorado Gold Corporation (TSX: ELD) to process ore from the Lamaque gold mine.
- Wallbridge Mining Company Limited (TSX: WM) to process ore from the Fenelon gold property.
- Nottaway Resources Inc. to process ore from the Vezza mine.

MQR's **Beacon Mill** (fully permitted 750-tpd capacity mill) remains on care and maintenance, but is capable of commencing operations upon receipt of custom milling contracts. **At full capacity, we estimate the Camflo, and Beacon mills, could generate approximately \$20 million in revenues, with a gross profit of \$2 million.**

At **Croinor**, MQR completed a diamond drill program (89 holes / 19,935 m / infill and step-out) from March to September 2018.

In September 2018, MQR started a 8,350 m drill program at the McKenzie Break gold project.

The following tables shows the resource estimates of all of MQR's projects. **The properties hold reserves of 1.93 Moz. Reserves are included in measured and indicated resources totaling 3.16 Moz, and inferred resources of 0.44 Moz.**

### Consolidated Resource Estimates

	Tonnes	Grade (g/t Au)	Ounces		Tonnes (metric)	Grade (g/t Au)	Ounces
<b>Wasamac Property</b>				<b>Beaufor Mine</b>			
Proven Reserves	1,028,000	2.66	88,000	Proven Reserves	28,100	5.95	5,400
Probable Reserves	20,427,000	2.56	1,679,000	Probable Reserves	111,500	7.05	25,200
<b>Total Proven &amp; Probable Reserves</b>	<b>21,455,000</b>	<b>2.56</b>	<b>1,767,000</b>	<b>Total Proven &amp; Probable Reserves</b>	<b>139,600</b>	<b>6.83</b>	<b>30,600</b>
Measured Resources	3,990,000	2.52	323,300	Measured Resources	74,400	6.71	16,100
Indicated Resources	25,870,000	2.72	2,264,500	Indicated Resources	271,700	7.93	69,300
<b>Total Measured &amp; Indicated Resources</b>	<b>29,860,000</b>	<b>2.70</b>	<b>2,587,800</b>	<b>Total Measured &amp; Indicated Resources</b>	<b>346,100</b>	<b>7.67</b>	<b>85,400</b>
Inferred Resources	4,160,000	2.20	293,900	Inferred Resources	46,100	8.34	12,400
<b>Croinor Gold Mine</b>				<b>Simkar Gold Property</b>			
Proven Reserves	166,540	5.33	28,543				
Probable Reserves	436,454	7.18	100,759				
<b>Total Proven &amp; Probable Reserves</b>	<b>602,994</b>	<b>6.66</b>	<b>129,302</b>				
Measured Resources	80,100	8.44	21,700	Measured Resources	33,570	4.71	5,079
Indicated Resources	724,500	9.20	214,300	Indicated Resources	208,470	5.66	37,905
<b>Total Measured &amp; Indicated Resources</b>	<b>804,600</b>	<b>9.12</b>	<b>236,000</b>	<b>Total Measured &amp; Indicated Resources</b>	<b>242,040</b>	<b>5.52</b>	<b>42,984</b>
Inferred Resources	160,800	7.42	38,400	Inferred Resources	98,320	6.36	20,103
<b>McKenzie Break Property</b>				<b>Swanson Property</b>			
Indicated Resources (pit)	939,860	1.59	48,133	Indicated Resources (pit)	1,694,000	1.8	98,100
Indicated Resources (UG)	281,739	5.9	53,448	Indicated Resources (UG)	58,100	3.17	5,900
<b>Total Indicated Resources</b>	<b>1,221,599</b>	<b>2.58</b>	<b>101,581</b>	<b>Total Indicated Resources</b>	<b>1,752,100</b>	<b>1.85</b>	<b>104,000</b>
Inferred Resources (pit)	304,677	1.52	14,897	Inferred Resources (pit)	17,400	2.53	1,400
Inferred Resources (UG)	270,103	5.66	49,130	Inferred Resources (UG)	56,600	3.1	5,600
<b>Total Inferred Resources</b>	<b>574,780</b>	<b>2.58</b>	<b>64,027</b>	<b>Total Inferred Resources</b>	<b>74,000</b>	<b>1.85</b>	<b>7,000</b>
<b>Total</b>							
Proven & Probable Reserves			1,926,902				
Measured & Indicated Resources			3,157,765				
Inferred Resources			435,830				

Source: FRC / Data Source: Company

### Upcoming Catalysts

The following outlines management's key objectives for the year:

- Advance permitting, and seek financing / JV partners on Wasamac
- Increase resource estimates of the Croinor gold and McKenzie Break properties;
- Expand custom milling revenues

### Financials

Q1 revenues totaled \$7.78 million, down 23% QoQ. Revenues came from the sale of 3,272 oz of gold from the Beaufor mine (\$4.97 million – 64% of the total – down 33% QoQ), and through custom milling at the Camflo mill (\$2.78 million – 36% of the total – up 7% QoQ).

**Q1's run rate implies FY2019 revenues from custom milling will be approximately \$11 million. The gross margin of custom milling is approximately 10%.**

In Q1, the company reported an average sales price of \$1,520 per oz (\$1,617 per oz in Q4-

FY2018), with a higher production cost of \$1,817 per oz (\$1,609 per oz in Q4-FY2018) due to lower grades. As a result, gross margins dropped significantly in Q1-FY2019, as shown in the table below.

	Q2-2018	Q3-2018	Q4-2018	2018	Q1-2019
Gross	19.2%	2.9%	15.8%	12.8%	-0.2%
EBITDA	1.8%	-16.0%	-22.0%	-11.9%	-29.0%
Net	6.5%	-22.0%	-32.8%	-15.9%	-23.8%

Source: FRC / Data Source: Company Financial Statements

EBITDA was -\$2.26 million in Q1 versus -\$2.20 million in Q4-FY2018. The company reported a normalized net loss of \$3.25 million (EPS: -\$0.01) in Q1 versus \$3.94 million (EPS: -\$0.01) in Q4.

As a result of the suspension of production at Beaufor, we are discontinuing our EPS projections.

Free cash flows were -\$7.10 million in Q1-2019, which also included \$2 million in exploration.

Summary of Cash Flows	2018	Q1-2019
Cash Flows from Operations	-\$2,310,413	-\$5,284,428
Cash Flows from Investing	-\$10,377,164	\$1,057,409
Cash Flows from Financing	\$20,377,670	-\$81,868
Net Change	\$7,690,093	-\$4,308,887
Free Cash Flows	-\$7,985,381	-\$7,105,100

Source: FRC / Data Source: Company Financial Statements

## Balance Sheet

At the end of Q1-FY2019 (quarter September 30, 2018), the company had cash and working capital of \$10.74 million and \$6.00 million, respectively. Debt to assets was at 8.2%. Debt includes the remaining payments related to the acquisition of Beacon, Swanson and McKenzie Break. The following table summarizes the company's liquidity position.

(in C\$)	2017	2018	Q1-2019
Cash	\$7,356,155	\$15,046,248	\$10,737,361
Working Capital	\$5,798,654	\$6,928,023	\$5,596,536
Current Ratio	3.86	1.52	1.50
ST Debt / Purchase Price Payable	-	\$2,046,258	\$2,040,490
LT Debt / Purchase Price Payable	3,346,971.00	\$5,763,525	\$5,778,933
LT Debt/ Asset	12.6%	7.8%	8.2%

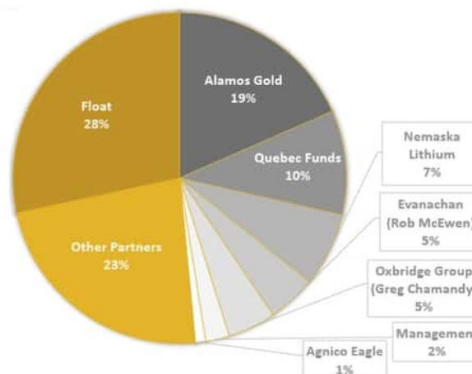
Source: FRC / Data Source: Company Financial Statements

In December 2018, the company closed a \$1 million financing by issuing 3.03 million flow-through shares at \$0.33 per share. Alamos Gold (TSX: AGI) remains the single



largest shareholder of MQR. As shown in the chart below, the company is backed by a number of key industry players –which, we believe, is a positive sign for any junior.

### Share Ownership



Source: Company

### Stock Options and Warrants

We estimate MQR has 9.87 million options outstanding (weighted average exercise price of \$0.29) and 24.08 million warrants outstanding (weighted average exercise price of \$0.41). Currently, 2.48 million options are in-the-money. **The company can raise up to \$0.27 million if these options are exercised.**

### Valuation

Our fair value estimate on Wasamac is \$0.47 per share. We have used 100% of the measured and indicated, and 50% of the inferred resource estimate (while the FS used only 100% of the reserve estimate), which gave an 18 year mine life. We have also used a higher discount rate of 11.5% (FS used 5%), which is in line with the discount rate we typically use for gold projects in safe jurisdictions. The operating cost and CAPEX estimates in our models are in line with the FS' inputs.

DCF Valuation - Wasamac	
Tonnage (Mt)	32
Weighted Avg Grade (gpt)	2.68
Recovery	88.2%
Recovered Au (oz)	2,412,138
Mine Life (years)	18
Operating costs (\$/t)	\$50.24
Initial Capital Cost (\$M)	\$464
Long-Term Gold Price (US\$/oz)	\$1,300
Long-Term C\$/US\$	1.10
Discount rate	11.49%
Net Asset Value (\$)	<b>\$111,288,618</b>
No. of Shares (treasury stock method)	237,554,716
Fair Value per Share (\$)	<b>\$0.47</b>

Source: FRC

The sensitivity of our valuation to key inputs are shown below:

		Gold Price (US\$/oz)				
		\$1,100	\$1,200	\$1,300	\$1,400	\$1,500
Discount Rate	7.0%	\$0.32	\$0.74	\$1.16	\$1.58	\$2.00
	9.0%	\$0.10	\$0.45	\$0.80	\$1.15	\$1.50
	11.5%	-\$0.10	\$0.18	<b>\$0.47</b>	\$0.75	\$1.04
	13.0%	-\$0.19	\$0.06	\$0.31	\$0.57	\$0.82
	15.0%	-\$0.29	-\$0.07	\$0.15	\$0.37	\$0.58

		Gold Price (US\$/oz)				
		\$1,100	\$1,200	\$1,300	\$1,400	\$1,500
Exchange Rate (C\$/US\$)	1.00	-\$0.39	-\$0.13	\$0.13	\$0.39	\$0.65
	1.05	-\$0.24	\$0.03	\$0.30	\$0.57	\$0.84
	1.10	-\$0.10	\$0.18	<b>\$0.47</b>	\$0.75	\$1.04
	1.20	\$0.18	\$0.49	\$0.81	\$1.12	\$1.43
	1.30	\$0.47	\$0.81	\$1.14	\$1.48	\$1.82

Source: FRC

**At the current share price of \$0.21 per share, the market discounts our value of \$0.47 per share on Wasamac by 55%, and assigns zero value to any of the other projects in MQR's portfolio.**

In order to value the entire portfolio, we continue to value MQR based on an average EV to resource ratio of comparable juniors. **We estimate MQR's shares currently trade at just \$15 per oz versus the comparables average of \$50 per oz.**

	Company	EV / Resource
1	Osisko Mining	\$313.89
2	Probe Metals Inc.	\$90.12
3	Pure Gold Mining Inc.	\$88.79
4	Victoria Gold Corp	\$66.67
5	Bonterra Resources <sup>1</sup>	\$53.21
6	Nighthawk Gold Corp.	\$48.46
7	Marathon Gold Corp.	\$39.05
8	Gowest Gold Ltd.	\$33.77
9	Gatling Exploration	\$30.86
10	Cartier Resources <sup>1</sup>	\$26.26
11	Eastmain Resources, Inc.	\$20.58
12	Monarques Gold	\$14.55
13	Moneta Porcupine Mines Inc.	\$13.00
14	Maple Gold Mines Ltd.	\$11.32
	<b>Average (excl outliers)</b>	<b>\$49.78</b>

1. FRC internal resource estimates

2. Net Resource = 100% of Measured and Indicated + 50% of Inferred Resources

MQR's Resource	3,375,680
Average EV/ Resource Ratio (comparables)	\$49.78
Fair Value of Assets	\$168,033,451
WC- Debt	\$767,603
Fair Value of MQR Shares	\$168,801,054
No. of Shares (calculated based on the treasury stock method)	237,554,716
Fair Value per Share	\$0.71

Based on an average EV/resource ratio of \$50 per oz, we believe MQR should be trading at \$0.71 per share. This is lower than our previous fair value estimate of \$0.97 per share as the average EV/resource of comparables was \$64 per oz then. Despite our lower fair value estimate, we believe MQR's fundamentals have significantly strengthened as a result of Wasamac's FS. **We reiterate our BUY rating on MQR's shares with a risk rating of 4.**

## Risks

The following risks, though not exhaustive, may cause our estimates to differ from actual results:

- The value of the company is dependent on gold prices.
- The production cost at the Beaufor mine must be lowered to make the project more

attractive.

- Exploration and development risks at MQR's other assets.
- Access to capital and share dilution.

#### Fundamental Research Corp. Equity Rating Scale:

**Buy** – Annual expected rate of return exceeds 12% or the expected return is commensurate with risk

**Hold** – Annual expected rate of return is between 5% and 12%

**Sell** – Annual expected rate of return is below 5% or the expected return is not commensurate with risk

**Suspended or Rating N/A**— Coverage and ratings suspended until more information can be obtained from the company regarding recent events.

#### Fundamental Research Corp. Risk Rating Scale:

**1 (Low Risk)** - The company operates in an industry where it has a strong position (for example a monopoly, high market share etc.) or operates in a regulated industry. The future outlook is stable or positive for the industry. The company generates positive free cash flow and has a history of profitability. The capital structure is conservative with little or no debt.

**2 (Below Average Risk)** - The company operates in an industry where the fundamentals and outlook are positive. The industry and company are relatively less sensitive to systematic risk than companies with a Risk Rating of 3. The company has a history of profitability and has demonstrated its ability to generate positive free cash flows (though current free cash flow may be negative due to capital investment). The company's capital structure is conservative with little to modest use of debt.

**3 (Average Risk)** - The company operates in an industry that has average sensitivity to systematic risk. The industry may be cyclical. Profits and cash flow are sensitive to economic factors although the company has demonstrated its ability to generate positive earnings and cash flow. Debt use is in line with industry averages, and coverage ratios are sufficient.

**4 (Speculative)** - The company has little or no history of generating earnings or cash flow. Debt use is higher. These companies may be in start-up mode or in a turnaround situation. These companies should be considered speculative.

**5 (Highly Speculative)** - The company has no history of generating earnings or cash flow. They may operate in a new industry with new, and unproven products. Products may be at the development stage, testing, or seeking regulatory approval. These companies may run into liquidity issues, and may rely on external funding. These stocks are considered highly speculative.

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