

Midday Comments

OIL & GAS

Leucrotta Exploration Inc.

Buy | \$3.25 | Est ↑↓

In-line Q4; Material Well Events

Leucrotta Exploration (LXE) announced in-line Q4/16 results.

GOLD & PRECIOUS METALS

Erdene Resource Development Corp.

Speculative Buy | \$1.50

Wheels in Motion at Bayan Khundii

We recently caught up with Erdene's management team. The drilling season at Bayan Khundii is off to a swift start — one drill is currently turning with a second arriving next week. Nine holes have been completed thus far, and investors can expect a busy exploration season with first results expected by mid-May. Erdene has brought together a very solid technical team on the ground and we are excited for what the season will bring.

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Leucrotta Exploration Inc.

OIL & GAS

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All figures in C\$, unless otherwise noted.

Rating: Buy

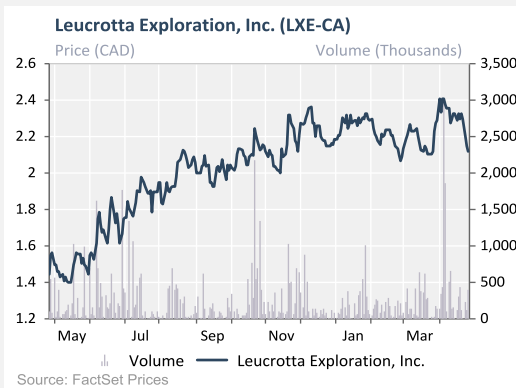
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12-Month Target: \$3.25

unchanged

Ticker	LXE-T	2P NAV (\$/sh)	1.45
Price	\$2.10	Mkt Cap (\$mm)	347
Shares O/S (mm)	165.2	Net Debt (\$mm)	-16
FD Shares (mm)	189.3	EV (\$mm)	331
Potential ROR	54.8%	Riskd NAV (\$/sh)	3.38

FY Dec 31	2016A	2017e	2018e	
Pricing				
WTI (US\$/bbl)	43.26	55.00	57.50	
NYMEX (US\$/mmbtu)	2.48	3.25	3.25	
AECO (C\$/mcf)	2.18	2.75	2.75	
FX Rate (C\$/US\$)	0.76	0.76	0.78	
Estimates	2016A	2017e	2018e	
Production				
Liquids (bbl/d)	325	925	1,650	
Gas (mmcf/d)	4.0	12.0	23.0	
Boe/d	1,050	3,000 ↓	5,450	
Financials				
Cash Flow (\$mm)	(1.0)	14.0	29.6	
CFPS (diluted)	-0.01	0.08	0.17 ↑	
Valuation				
P/2P NAV	145%			
P/Riskd NAV	62%			
EV/DACF	N/A	6.5x	3.2x	
D/CF	N/A	0.4x	0.7x	
Previous Estimates				
Production (boe/d)	1,100	3,225	5,450	
CFPS (diluted)	-0.00	0.08	0.15	
FactSet Consensus				
Production (boe/d)	1,038	2,824	4,559	
Liquids (bbl/d)	317	807	1,379	
Gas (mmcf/d)	4.3	12.3	19.4	
CFPS (diluted)	-0.01	0.07	0.15	
WTI (US\$/bbl)	43.40	54.07	58.23	
NYMEX (US\$/mmbtu)	2.55	3.17	3.18	
AECO (US\$/mmbtu)	2.12	2.84	2.91	
2017 Quarterly Est.	Q1e	Q2e	Q3e	Q4e
Production (boe/d)	1,750	3,000	3,375	3,825
Liquids (bbl/d)	550	950	1,000	1,175
Gas (mmcf/d)	7.0	12.0	14.0	16.0
CFPS (diluted)	0.01	0.02	0.02	0.03



Source: FactSet, Company filings, Paradigm Capital Inc.

Company description: Leucrotta Exploration was formed as a spinco when Long Run Exploration acquired Crocotta Energy in the summer of 2014. It is focused on the Montney, primarily in the Doe/Sunrise area.

In-line Q4; Material Well Events

Investment Thesis. Leucrotta Exploration is a well-capitalized Montney player with a significant acreage in the Doe/Sunrise area. The strong management team, previously of Crocotta Energy, has an excellent track record and we believe the projected growth profile of the company makes it an exciting investment opportunity.

Event

Leucrotta Exploration (LXE) announced in-line Q4/16 results.

Highlights

- **Production in Line with Consensus** | Production averaged 1,038 boe/d compared to our estimate of 1,100 boe/d and consensus of 1,050 boe/d. In Q4/16 and early Q1/17, LXE completed a tie-in of four previously drilled delineation wells. This increased production to over 3,000 boe/d (25% oil/NGLs).
- **CFPS In Line with Estimates** | LXE generated cash flow of \$0.00/FD share, matching our estimate; consensus was (\$0.01)/FD share.
- **Closing of Previously Announced \$80mm Financing** | Subsequent to year-end, LXE completed a common share offering for \$80mm in gross proceeds. With the additional capital raised, LXE signed agreements to acquire an additional 18.5 sections of land in its core Doe/Mica Montney area. The company is well capitalized to fund its capital program.
- **Operational Update** | LXE highlighted two new well events:
 - 1) **The 8-4-82-14W6 well** was production tested for seven days after the original clean-up and produced at an average rate of 1,060 boe/d (50% gas, 50% oil and condensate) over that period, excluding load fluid and energizing fluid. The 8-4 well is within the oil window and very encouraging. While early days, the initial test rate is well above the GLJ forecast for Montney High GOR light oil.
 - 2) **The 12-6-81-13W6 well** was production tested for seven days after the original clean-up and produced at an average rate of 550 boe/d (60% gas, 40% oil and condensate) over that period, excluding load fluid and energizing fluid. The 12-6 looks to be on the edge of the High GOR Oil and rich gas window and looks to be in line with the GLJ forecast for a high GOR light oil well.

Valuation & Conclusion

With the closing of the \$80mm financing, LXE remains well capitalized to execute on its de-risking program within its Doe and Mica regions. The new well events are encouraging and help give higher confidence to the upside resource potential of the name. With worries about the NDP election in B.C., Montney-based companies in that region may experience some short-term downward pressure. We would use the pullback as a compelling entry point into the name or a layering in opportunity. We use a blended combination of a P/NAV ratio of 105% (2P NAV \$1.45), a target 2017 EV/DACF multiple of 5.5x (2018 DACF \$29.6mm), plus the estimated unbooked upside to determine our target price. We maintain our Buy rating and \$3.25 target.

Figure 1: Financial and Estimate Summary

Ticker:	LXE	Recommendation:	Buy		
Share Price:	\$2.10	Target Price:	\$3.25		
Market Cap. (\$mm):	\$347	Total Return (%):	55%		
Enterprise Value (\$mm):	\$331				
		2015A	2016A	2017e	2018e
Production					
Oil & NGL	bbl/d	325	325	925	1,650
Heavy Oil	bbl/d	0	0	0	0
Natural Gas	mmcf/d	6.0	4.0	12.0	23.0
boe/d (6:1)	boe/d	1,350	1,050	3,000	5,450
% Gas	%	76%	69%	69%	70%
Growth	%	-38%	-22%	186%	82%
boe/d Per mm Shares		0.01	0.01	0.02	0.03
Growth Per Share	%	-52%	-23%	181%	82%
boe/d Per mm Shares Debt Adj.		0.01	0.01	0.02	0.03
Growth	%	-41%	-39%	151%	74%
Financials					
Revenue	\$mm	\$10.9	\$8.9	\$33.7	\$62.1
Royalty	\$mm	-\$1.0	-\$0.6	-\$2.0	-\$3.7
Royalty %	%	10%	7%	6%	6%
Hedging	\$mm	\$0.0	\$0.0	\$0.0	\$0.0
Operating/Transp. Costs	\$mm	-\$5.2	-\$5.5	-\$12.4	-\$22.6
G&A/Mgmt Fees	\$mm	-\$4.6	-\$4.2	-\$5.2	-\$6.2
Interest	\$mm	\$0.4	\$0.3	-\$0.1	\$0.0
Current Taxes/Other	\$mm	\$0.0	\$0.0	\$0.0	\$0.0
Cash Flow	\$mm	\$0.6	-\$1.0	\$14.0	\$29.6
Net Debt	\$mm	-\$45.6	-\$26.1	\$4.9	\$20.3
Average D/CF		N/A	N/A	0.4x	0.7x
Capital Spending	\$mm	-\$59.2	-\$22.6	-\$45.0	-\$45.0
Per Share Values					
CFPS (diluted)	\$/share	\$0.00	-\$0.01	\$0.08	\$0.17
EPS (diluted)	\$/share	\$0.07	-\$0.07	-\$0.05	-\$0.07
Basic Shares Outstanding	mm	165.2	165.2	165.2	165.2
FD Shares Outstanding	mm	165.2	166.6	171.2	171.2
\$/boe Values					
Revenue	\$/boe	\$22.34	\$23.45	\$30.83	\$31.25
Operating Costs	\$/boe	-\$8.25	-\$10.92	-\$8.20	-\$8.23
G&A/Mgmt Fees	\$/boe	-\$9.41	-\$11.07	-\$4.77	-\$3.10
Operating Netback	\$/boe	\$9.00	\$7.24	\$17.59	\$17.95
Corporate Netback	\$/boe	-\$16.20	-\$12.17	\$5.43	\$7.85
Commodity Prices					
WTI Crude Oil	US\$/bbl	\$48.71	\$43.26	\$55.00	\$57.50
Edmonton Par	C\$/bbl	\$58.02	\$52.91	\$67.50	\$70.00
AECO Natural Gas	C\$/mcf	\$2.44	\$2.18	\$2.75	\$2.75
Valuation					
P/CF		N/A	N/A	24.8x	11.7x
EV/DACF		N/A	N/A	6.5x	3.2x
EV/boe/d	\$/boe/d	\$88,791	\$242,680	\$121,557	\$69,726
EV/boe P+P Reserves	\$/boe	\$6.93			
Reserves					
Proven	mmboe	8.2	10.2		
Proven + Probable	mmboe	17.1	22.7		
RLI - Proven	Years	20.8			
RLI - Proven + Probable	Years	43.6			
Proven FD&A incl FDC	\$/boe	\$11.81			
P+P FD&A incl FDC	\$/boe	\$10.13			
Recycle Ratio (Proven)		0.0x			
Recycle Ratio (P+P)		0.0x			

Source: Company filings, Paradigm Capital Inc.

DISCLAIMER SECTION

Company	Ticker	Disclosures
Leucrotta Exploration Inc.	LXE-T	2,3

Note: Please refer to above table for applicable disclosure numbers.

1. The analyst has an ownership position in the subject company.
2. Paradigm Capital Inc. has assumed an underwriting liability for, and/or provided financial advice for consideration to the subject companies during the past 12 months.
3. Paradigm Capital Inc. expects to receive or intends to seek compensation for investment banking services from the subject companies in the next 3 months.
4. Paradigm Capital Inc. has greater than a 1% ownership position in the subject company.
5. The analyst has a family relationship with an Officer/Director of subject company.

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Stock Coverage History

Date	Target	Rating	Estimates
4/5/2017	\$3.25↑	Buy	FY17-18 CFPS↑
8/18/2016	\$3.00	Buy	FY16-17 CFPS↑
8/2/2016	\$3.00	Buy	FY16-17 CFPS↑
8/19/2014	\$3.50	Buy	Initiating Coverage

Research Rating System

Paradigm Capital Inc. uses the following rating recommendation guidelines in its research:

Recommendation	Number of Companies	Percentage Breakdown	
Buy	98	62%	Buy – Expected returns of 20% or more over 12 months.
Spec. Buy	17	11%	Speculative Buy - Expected returns of 20% or more over the next 12 months on high-risk development or pre-revenue companies, such as junior mining and other early stage companies.
Hold	16	10%	Hold - Expected returns of less than +/- 20% over the next 12 months.
Sell*	7	4%	Sell - Expected returns of -20% or more over the next 12 months.
Under Review	21	13%	Under Review - Estimates, Target and/or Recommendation under review.
Total	159		

*Includes companies with a "Tender" recommendation

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Erdene Resource Development Corp.

PRECIOUS METALS

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All figures in US\$, unless otherwise noted.

Rating: Speculative Buy

unchanged

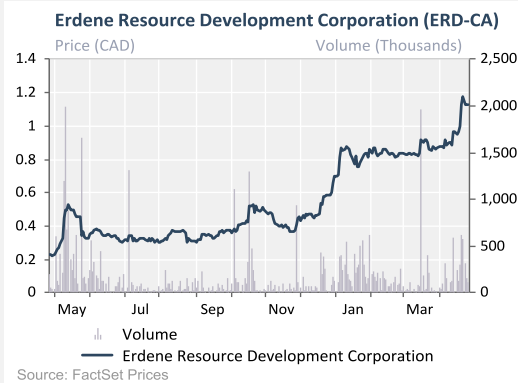
12-Month Target: C\$1.50

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Price (C\$)	\$1.13
Ticker	ERD-T
FYE	31-Oct
Potential ROR (incl. dividend)	33%
Avg 3-month daily vol. (000s)	184
Shares O/S	
Basic (M)	145.4
FDIM (M)*	145.4
FD (M)**	153.9
Market Cap	
Basic (C\$M)	164
FDIM (M)*	164
FD (M)**	174

* FDIM - Fully Diluted, In-the-Money **FD - Fully Diluted

Company's Reporting Currency	C\$
Cash (\$M)	14
Long-Term Debt (\$M)	0
Working Capital (\$M)	14
Enterprise Value (\$M)	151



Source: FactSet, Company filings, Paradigm Capital Inc.

Company description: Erdene is an exploration company with a large land package in southeastern Mongolia. Management has been exploring in Mongolia since 2003, and has assembled a highly experienced, Mongolia-focused board. We believe it has made a very good, possibly a major, near-surface gold discovery called Bayan Khundii with unusually strong widths and grades.

Wheels in Motion at Bayan Khundii

Investment Thesis. Erdene's 100%-owned Bayan Khundii (BK) project in Mongolia shows many of the features that we look for in a new discovery: high, continuous grade; near surface, major camp-scale upside potential and good metallurgical recovery. We believe that over the next 12–18 months, BK will continue to grow as Erdene moves toward an initial resource estimate and additional exploration step-out holes are completed.

Event

We recently caught up with Erdene's management team. The drilling season at Bayan Khundii is off to a swift start — one drill is currently turning with a second arriving next week. Nine holes have been completed thus far, and investors can expect a busy exploration season with first results expected by mid-May. Erdene has brought together a very solid technical team on the ground and we are excited for what the season will bring.

Highlights

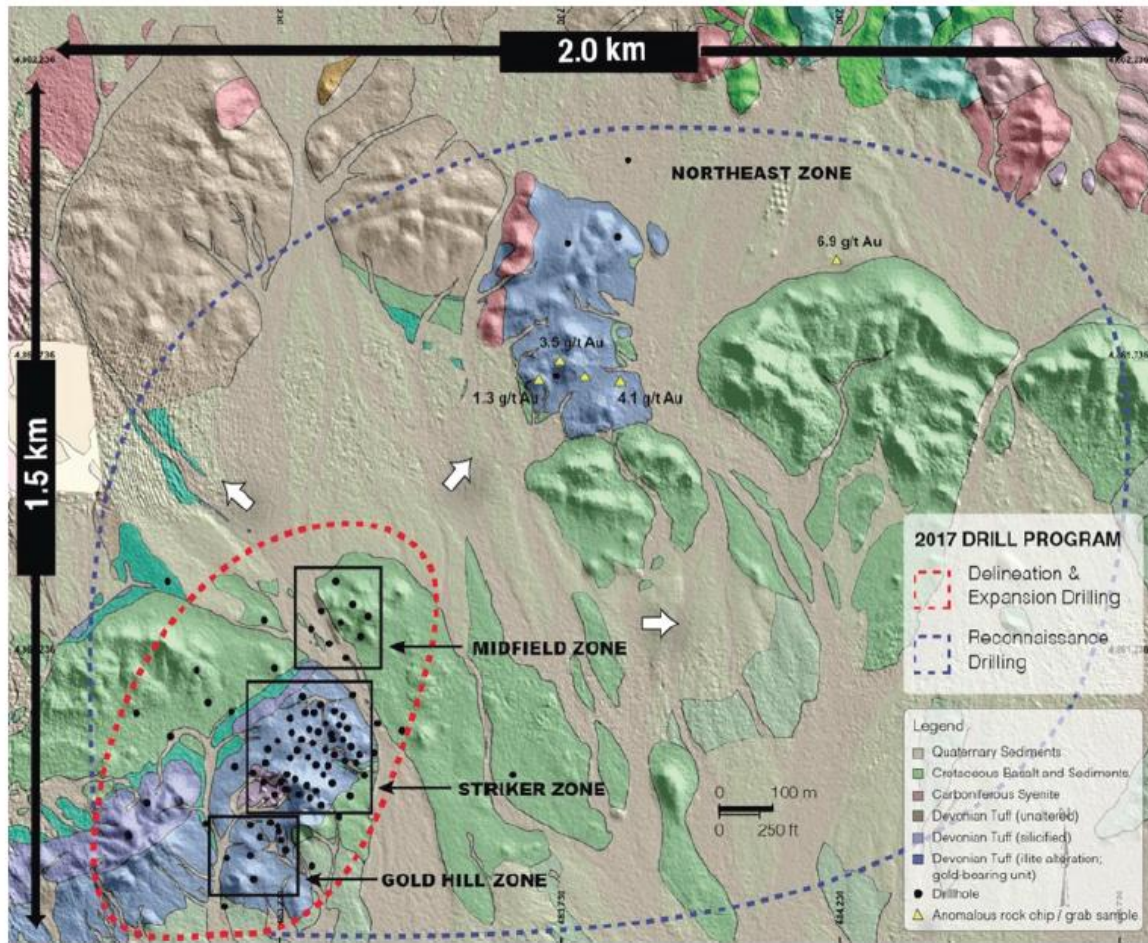
- ▶ **Drilling Kicked Off — 9 Holes Complete** | The first drill rig has been focusing on the Striker and Midfield zones (Figure 1), and has completed six new holes, averaging ~150m depth, and extended three existing holes. First results are expected by mid-May, and management has indicated that it is encouraged by the quartz-adularia alteration styles intersected so far. Below we outline the preliminary drilling plans for this season:
 - **Striker and Midfield Zone — Bayan Khundii** | Both zones remain largely open in all directions, and the first target area will be the zone between Midfield and Striker that has yet to be drilled (seen on the gm-metre map in Figure 2), targeting the down-plunge extensions of the wider veins of the Midfield zone (Figure 3). The nine holes in the Midfield Zone average 108 gm-meters — the best results to date — so we are looking forward to what the extensional drilling will bring. Following that, ERD will step-out to the west of Striker and Midfield, and to the north of Striker to the untested areas, most of which remain under post-mineral cover (Figure 1).
 - **Rapid Delineation of the Zone** | Management plans to drill off the 400m x 700m area surrounding the Midfield, Striker and Gold Hill zones to indicated and inferred-level confidence by early July (Figure 1). We estimate the holes will average ~150m depth, and will be spaced at 40m centres in the areas of highest grade-widths and confidence. As we outline in our January 26 research note, to date we think in the order of ~1Moz has been outlined in a conservative package of dimensions 600m along strike and 250m wide within the 400m x 800m zone, assuming a mineralized thickness of 50m. Given that 30% of holes have ended in mineralization and the lateral dimensions remain mostly open, we see a substantial amount of upside to our estimate.
 - **Altan Nar** | The second rig, which is expected to arrive on site next week, will follow up at the Altan Nar project, 16 km north of BK (Figure 4). Although exploration at Altan Nar took a back seat to BK in 2016, the 110m of 9.3 gpT intersection at Altan Nar announced on Dec. 19 warrants follow-up. The discovery of this new high-grade structure is a promising new development. Management is planning to drill 5–6 holes at the Discovery Zone to gain a better understanding of the orientation of the high-grade structures.

- **Altan Arrow** | Reconnaissance drilling will also target the Altan Arrow prospect, 3.5-km north of BK. Maiden drilling in 2016 intersected high-grade veining (23.5 gpT over 2m at 50m depth) with visual mineralization similarities to Bayan Khundii. The gold geochemical anomaly associated with BK and Altan Arrow is seen in Figure 5.
- ▶ **Boots on the Ground Technical Team** | The exploration team, led by CEO Peter Akerley and VP Exploration Mike MacDonald, consists of six geologists, two of which were part of the original Bayan Khundii discovery team. Over the last year, and continuing this year, several of the world's leading epithermal experts have advised on the project, including Dr. Jeff Hedenquist, the leading expert on epithermal systems. This season should bring even more understanding to Erdene's talented geological team as the drilling will bring new insight into the structural and mineralogical controls on the system. Additional metallurgical work is ongoing on two BK composites, following on to last year's yield of 99% for the high-grade composite (25 gpT), and 92% from the low-grade (0.7 gpT) using gravity concentration and cyanidation.
- ▶ **Water Source** | In 2010, Erdene completed a 3,000m water drilling program 40-km northeast of BK in the Tsahildag Khudag Basin and identified an estimated aquifer water resource of 116L/s. Although positive, the harsh winter climate in southern Mongolia will make water pipelines vulnerable to freezing damage. Management will explore for closer water sources this season, within 5–10 km of the project area. Given BK's location in the foothills of the Gobi-Altai Mountains, the chances of finding a more proximal water source are likely.
- ▶ **Upcoming Catalysts** | Drilling from Phase 1 will be ongoing through the end of September, with first results likely to arrive in mid-May. A follow-up Phase 2 program will be planned and initiated in Q4 based on the Q2 and Q3 drilling results. A maiden resource estimate may be made in late Q4; however, this may be pushed back depending on results. We expect the initial resource estimate will be conservative given the early-stage nature of the project; however, it will be a good first step toward growing the NI 43-101-compliant resource to its true potential. Securing a close water source will also be an important milestone for ERD. Finally, as we outline in our March 17 Gold Sector research note, Mongolia as a country appears to be taking the right steps toward promoting new mining investment in the country and the market is beginning to pay attention — for the first time in several years.

Valuation & Conclusion

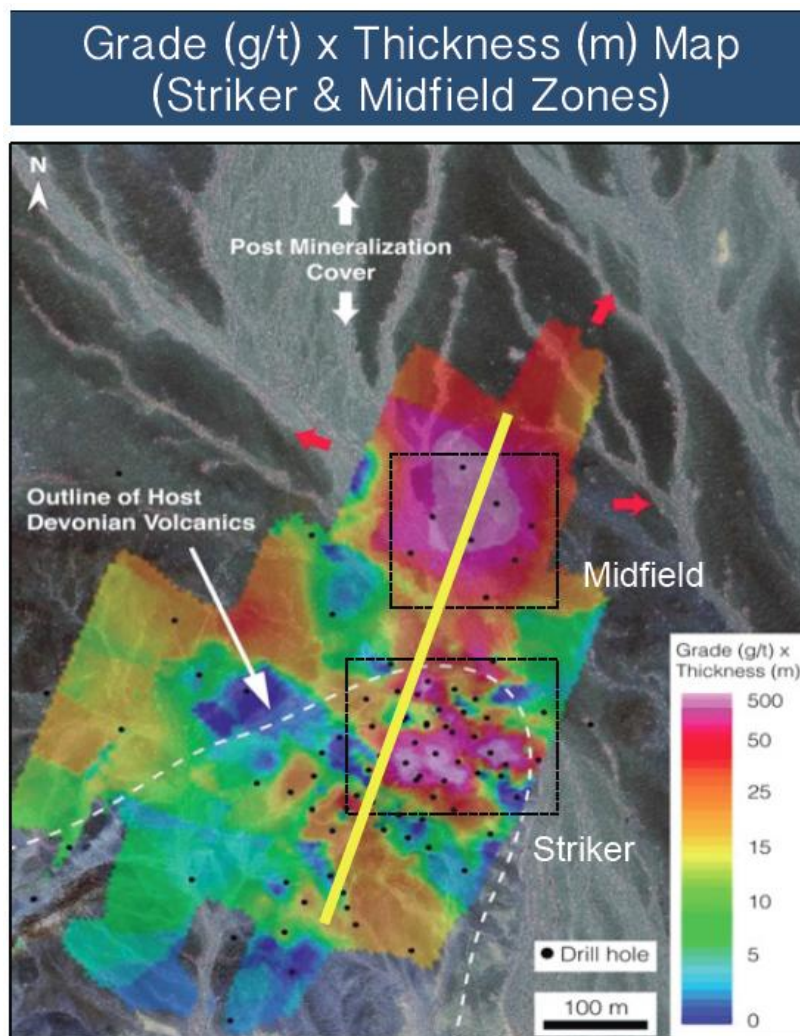
Although there are no assurances in exploration, Erdene has produced some exceptional results to date and we continue to view BK as one of the most interesting discoveries we have seen in a long time. We are excited for what the 2017 season will bring, and are confident that further growth at BK should continue to tip the risk-reward scale for potential corporate buyers. Ultimately, we believe Erdene's attractiveness to an acquirer will be based on the sum of the 15-km x 20-km land package potential, not just Bayan Khundii's. We reiterate our Speculative Buy rating and C\$1.50 target price.

Figure 1: Bayan Khundii Plan View



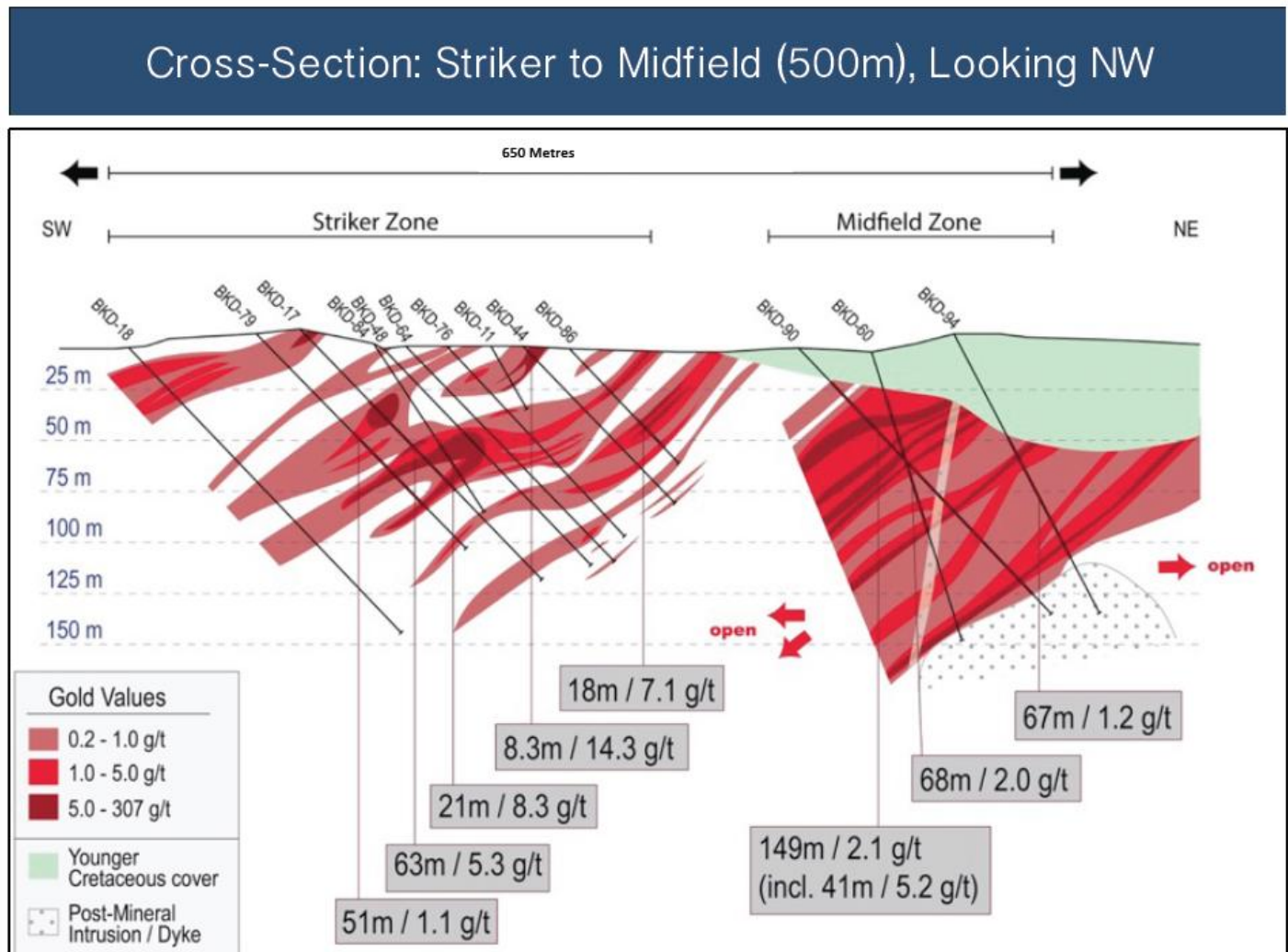
Source: Company filings

Figure 2: Striker and Midfield Zone Grade-Thickness Contour Map



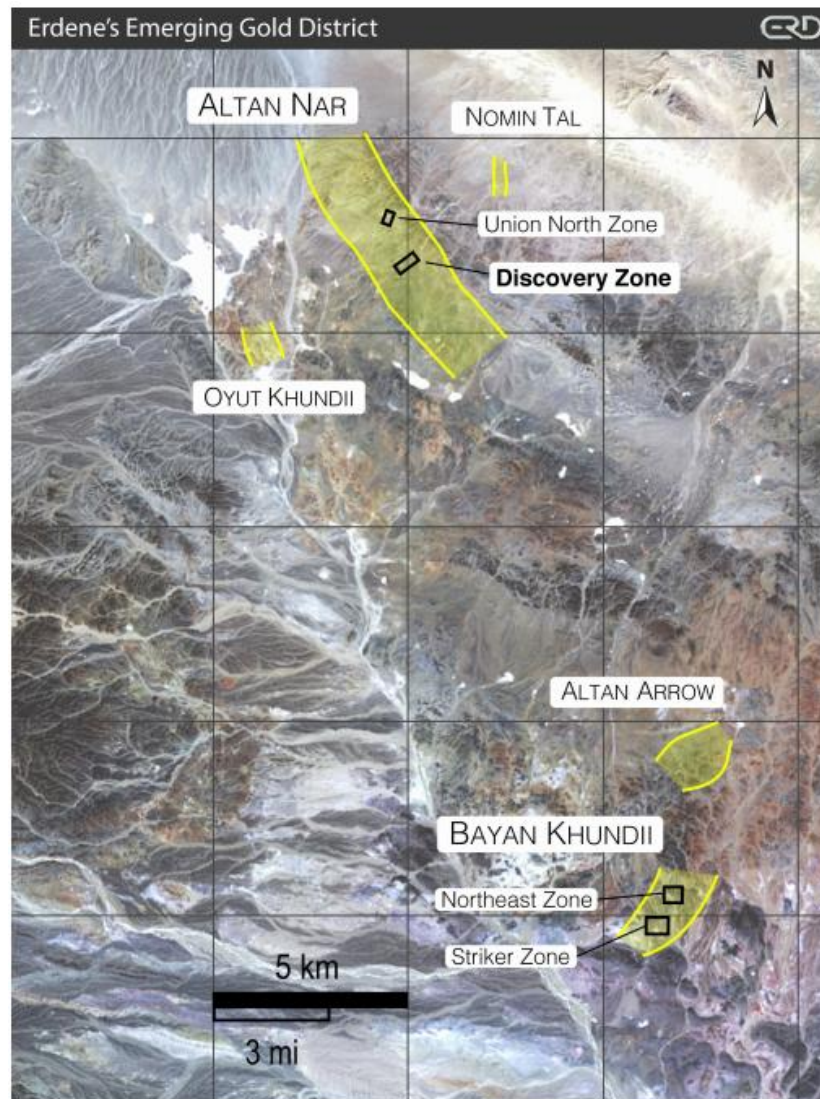
Source: Company filings

Figure 3: Cross Section Looking NW through Striker and Midfield



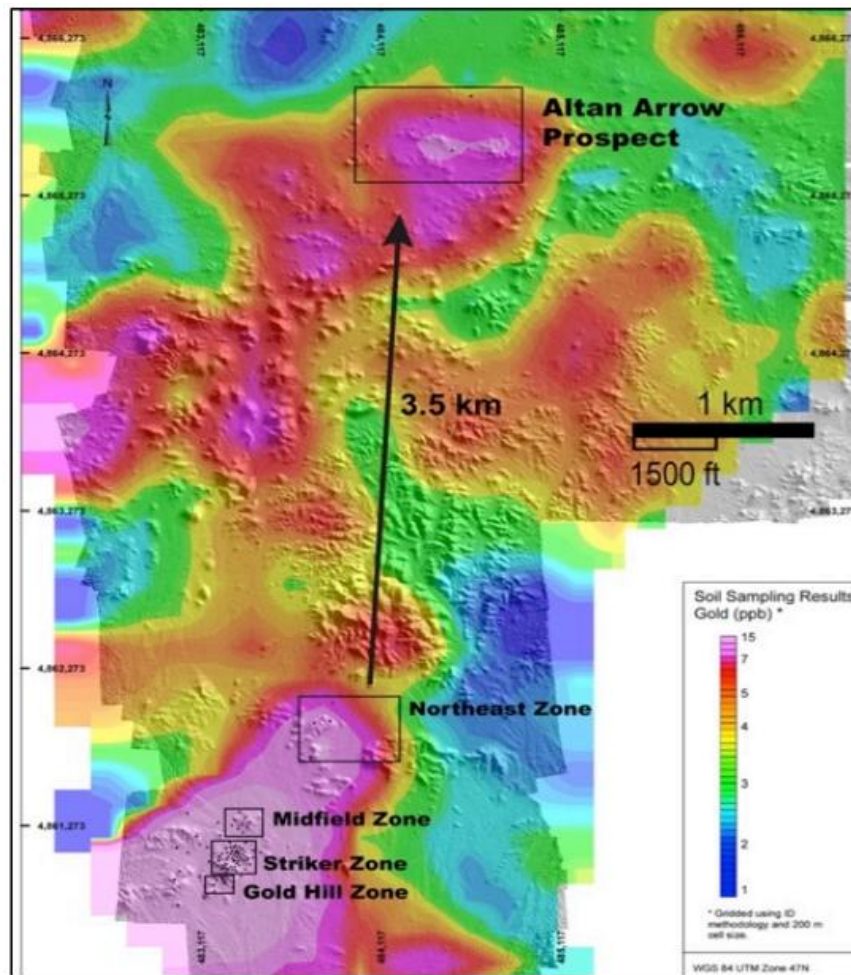
Source: Company filings

Figure 4: District Map of Bayan Khundii, Altan Nar and Altan Arrow



Source: Company filings

Figure 5: Altan Arrow – Bayan Khundii Geochemical Gold Trend



Source: Company filings

DISCLAIMER SECTION

Company	Ticker	Disclosures
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Stock Coverage History

Date	Target	Rating	Estimates
1/18/2017	\$1.50	Spec. Buy	Initiating Coverage

Research Rating System

Paradigm Capital Inc. uses the following rating recommendation guidelines in its research:

Recommendation	Number of Companies	Percentage Breakdown	
Buy	97	58%	Buy – Expected returns of 20% or more over 12 months.
Spec. Buy	22	13%	Speculative Buy - Expected returns of 20% or more over the next 12 months on high-risk development or pre-revenue companies, such as junior mining and other early stage companies.
Hold	13	8%	Hold - Expected returns of less than +/- 20% over the next 12 months.
Sell*	3	2%	Sell - Expected returns of -20% or more over the next 12 months.
Under Review	31	19%	Under Review - Estimates, Target and/or Recommendation under review.
Total	166		

*Includes companies with a "Tender" recommendation

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