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# MESSAGE TO SHAREHOLDERS

## 2016

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**A CHALLENGING 2016 SETS THE PRIORITY  
ON NEW GROWTH OPPORTUNITIES**

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MANDALAY RESOURCES



Mandalay experienced a challenging 2016. Coming off a record 2015 in which the Company produced 166,679 ounces of gold equivalent from its Costerfield, Cerro Bayo, and Björkdal mines, the Company produced 145,497 ounces of gold equivalent in 2016, our third highest amount, but down 13% year-over-year.

The Company generated its second highest annual revenue of \$185.5 million (5% lower than the record \$194.5 million of the previous year) and paid out its second highest dividends of \$11.8 million, in keeping with our dividend policy of paying out quarterly dividends of 6% of trailing quarterly revenue. Our revenue performance in 2016 came during a year in which average gold and silver prices rose 8% and 9% year-over-year, respectively, while the average antimony price fell 10% year-over-year.

In 2016, our Company average cash production cost was \$899 per ounce of gold equivalent, 7% higher than the previous year; all-in cost (which we define as cash cost plus depreciation, depletion, and amortization) was \$1,189 per ounce of gold equivalent. The combination of higher costs and lower revenue led to a 25% decline in adjusted EBITDA to \$50.9 million and a consequent net loss before special items of \$2.5 million.

Despite the challenges of 2016, Mandalay enters 2017 on solid financial footing. The Company ended the year with \$66.9 million in cash and cash equivalents against our total debt of \$60 million and has a debt to EBITDA ratio of 1.2, significantly stronger than the industry average. This puts Mandalay in an excellent position to acquire new opportunities and create more value for shareholders.

### MANDALAY'S STRATEGY: PROVEN TO CREATE VALUE

Mandalay is a values-based and value-focused company that is founded on, and guided by, safe and efficient work practices, continuous improvement, fiscal responsibility, and effective community relationships.

Mandalay's strategy of creating value by acquiring undervalued and underperforming mining assets at deep discounts to the value that we believe we can create, and rapidly turning them around to deliver sustainable cash flow has worked extremely well since we put the strategy into effect in late 2009. Mandalay acquires properties with near-term cash flows, and allocates the cash first to dividends and servicing our modest debt; then to high-return investments in turnaround projects including mining method changes, metallurgical improvements and exploration; and, finally to make further accretive acquisitions.

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Mandalay invests in assets for which we see future potential that is not generally apparent, attracting little competing interest. We make these acquisitions with the objective of generating more than a 3X return on our investment within in a three to five-year period, based on specific and testable turnaround hypotheses. As of early 2017, the first two of our three producing acquisitions - the Costerfield gold-antimony mine in Victoria, Australia and the Cerro Bayo silver-gold mine in Aysen, Chile - have more than delivered these returns. Our third producing asset, the Björkdal gold mine in northern Sweden, is well on its way to delivering similar returns as we successfully increase Mineral Reserves and implement at commercial scale many of the proved improvements piloted in 2015 and 2016.

This strategy has led to excellent total shareholder returns across the last seven years. The Company has generated 11.5% cumulative total return from 2009 through 2016, which places us in the top two deciles of all of the companies in the mining sector.

#### MANDALAY'S OPERATIONS: 2016 OVERVIEW AND 2017 PLANS

The Björkdal gold mine in Skellefteå, Sweden, acquired in late 2014, continued its turnaround in 2016. It produced 48,143 ounces of gold - 9% more than in 2015 - at a cash production cost of \$956 per ounce. This strong performance at Björkdal was based on our grade control program, which produced the highest delivered grades from both the open pit and underground mines since many years before the acquisition. We expect improvements to continue through 2017, through:

- Further improvement of grade control methodologies;
- Incremental mining improvements to extract the higher grades faster;
- Implementation in January of Phase 1 of our low-grade ore sorting process that includes crushing and screening that has generated approximately a 50% grade uplift in processed fine material so far in 2017 (oversized material is being stockpiled for later optical sorting and further grade uplift);
- Construction and commissioning of the flotation expansion program in the third quarter of 2017 for an expected +1.7% recovery increase.

Exploration at Björkdal was very successful in 2016. We added 156,000 ounces of gold to Probable Reserves net of depletion and believe that we will be able to replicate this success in 2017 based on drilling already completed. With a mine life of ten years at current production rates, Björkdal is already Mandalay's longest lived mine and we look forward to continuing to grow mine life in the years to come.

The Costerfield gold-antimony mine delivered another year of excellent performance in 2016, producing 41,310 ounces of gold and 3,598 tonnes of antimony (60,076 ounces of gold equivalent) at cash costs of \$640 per ounce of gold equivalent, nearly matching 2015's record production. This performance generated approximately \$24 million in after-tax, free cash flow for the Company. Our exploration efforts at Costerfield in 2016 approximately replaced depletion. We obtained excellent intercepts at the Brunswick deposit, which the Company expects to add to Mineral Reserves in 2017 following further infill and extensional drilling. Mandalay expects strong, dependable performance with well-controlled costs to continue at Costerfield in 2017.

Cerro Bayo experienced challenges in 2016 as it transitioned through planned mine-outs of the Fabiola and Dagny veins and developed new mines at Delia SE and Coyita. The Fabiola and Dagny veins were mined out a quarter or so earlier than planned due to higher internal waste than expected, leaving us with a developed state inadequate to support customary production rates. We deployed a mining contractor to accelerate capital development on the new Coyita vein while we focused our own team on the new Delia SE vein and thereby regain developed state. However, when accessed in the second half of the year, the deeper Delia SE levels proved to have less metal endowment than expected from models based solely on drilling. As a result, the updated Mineral Reserves estimate along Delia SE contained approximately four million fewer silver ounces and 50 thousand fewer gold ounces than previously thought. While this was a relatively small decrease in Mineral

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Reserves for the overall operation, the decrease was focused on areas planned to support mining in late 2016 and throughout 2017. As a result of this, the mine produced a 1,731,031 ounces of silver and 13,792 ounces of gold (37,278 ounces of gold equivalent) in 2016, considerably lower than the 2015 production of 2,545,984 ounces of silver and 22,572 ounces of gold. While total spending was very well-controlled, cash costs per silver ounce net of gold credits rose to \$12.29 per ounce as a result of the grade-related drop in ounces.

2017 production is likely to be similar to 2016 as Cerro Bayo recovers its developed state by reaching the Coyita SE orebody and rehabilitating the previously mined Marcela vein. We believe that this mine will be restored to high profitability in 2018, 2019, and 2020.

Cerro Bayo currently has a mine life currently of four years. We look forward to the possibility of adding more high-grade Mineral Reserves under central Laguna Verde, previously unreachable from shore, as access is created by our capital development toward Coyita SE through 2017.

### FOCUS ON GROWTH IN 2017

While we will continue improving our operations in 2017, we know that renewed focus on finding and capturing accretive new opportunities is paramount to delivering superb shareholder returns going forward. Because of this, we have recently made changes to our management team and processes in order to increase our capacity to discover, evaluate and capture new acquisition opportunities at the same time as planning and delivering robust operating results at a growing number of operations going forward.

Armed with a strong balance sheet and increased management bandwidth, we are determined to add more assets to the portfolio for prices that are accretive to our shareholders while providing sellers with value-adding exits. This is nothing new - we have done this successfully three times in the last seven years, and the target returns on these acquisitions will continue to be tied to specific, testable turnaround hypotheses of a magnitude that support the potential for at least 3X returns within three to five years. Again, this is nothing new. What is new and exciting for me is the abundance of targets in the current market and the energy and creativity with which our people are approaching them.

Lastly, we will continue to apply relentless, disciplined financial management in 2017. We will continue to deliver long-term operating plans with maximum net present value, keeping our cash costs and sustaining capital as low as is consistent with those plans. We will continue to maintain low corporate overhead spending to maximize our EBITDA margins and will deploy our capital wisely through focused investment in operational improvement projects and exploration. We will continue to seek low-cost, prudent financial leverage to fund our growth, and we aim to do this with an eye on minimizing share dilution and sustaining our dividends.

### THANK YOU TO OUR PEOPLE AND SHAREHOLDERS

I would like to thank all of our people, on whom we rely for our success. None of our accomplishments would be possible without our dedicated and resilient staff, our dependable and reliable customers and suppliers, and the support of our communities. I would also like to express my gratitude to our shareholders for their trust, patience, and support for the Company as we work toward setting the foundations for our next chapter of growth. Lastly, I thank Mandalay's Board of Directors for their much-appreciated advice and guidance. Growth is a major priority for Mandalay in 2017. The Company will continue to move forward with investing in our future and seizing new opportunities to generate value and growth for all of our stakeholders.



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