EDISON

Endeavour Mining

Q3 results

Materially ahead of expectations

Metals & mining

Endeavour's Q318 results were materially ahead of our expectations, driven by better than expected operational performances at Karma and Ity and lower operating expenses and depreciation relative to Q2, notwithstanding the usual rains during the quarter. These were partially counteracted by a higher tax charge. However, we have still materially increased our forecasts for FY18 in light of the Q318 results and in expectation of a further improvement in Q4. Higher than expected net debt reflected merely the acceleration of Ity CIL capex from H119 into H218.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	Operating cash flow per share (US$)	Capex (US$m)	Net debt** (US$m)
12/16	566.5	213.9	103.4	1.91	212.3	21.4
12/17	652.1	201.2	51.6	2.25	441.4	216.8
12/18e	720.5	261.0	74.8	1.53	456.5	475.4
12/19e	762.1	372.1	153.3	2.77	81.4	305.9

Note: *PBT is normalised, excluding amortisation of acquired intangibles, discontinued operations and exceptional items; **includes restricted cash.

FY18 production and cost guidance to be met easily

In the aftermath of its third-quarter results, Endeavour's operations seem likely to broadly meet their production guidance, with the notable exception of the Ity heap leach operation, which has already surpassed its own target and now seems likely to produce a further 15koz gold in Q4. Similarly, all operations appear likely to achieve their AISC cost guidance, with the exception of Tabakoto, which was expected since at least Q2 and which has been sold as a consequence. Group-wide guidance for FY18 is now for production to be at the upper end of the 555–590koz range (Edison 582koz) at an all-in sustaining cost (AISC) at the bottom end of the US$760–810/oz range (Edison US$773/oz).

Adjusted net EPS forecast upgrades

As a result of its operational outperformance in Q3, Endeavour reported adjusted net EPS of minus 1.3c compared with our prior forecast of a loss of 9.9c (ie a positive 8.6c variance). In anticipation of continued improvements in the aftermath of the traditional Q3 rains, we have also increased our expectations for Q4, from 2.0cps to 2.8cps (ie a positive 0.8c variance) and for the full year, from 23.3cps to 32.7cps (a positive 9.4c variance – see Exhibit 2).

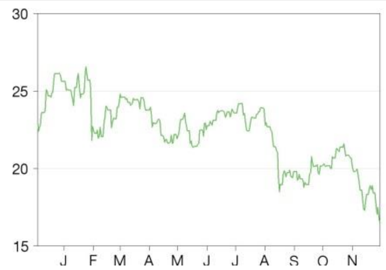
Valuation: US$30.74/sh vs US$29.76 previously

In valuing Endeavour, we have opted to discount potential cash flows back over four years from end-FY18 and then to apply an ex-growth, ad infinitum terminal multiple of 10x (consistent with a discount rate of 10%) to forecast cash flows in that year (FY22). In the case of Endeavour, our estimate of cash flow in FY22 is US$3.36 per share (including exploration expenditure), in which case our terminal valuation of the company at end-FY22 is US$33.63/share, which (in conjunction with forecast intervening cash flows) discounts back to a value of US$30.74/share (cf US$29.76/share previously) at the start of FY19.

3 December 2018

Price	**C$16.56**
Market cap	**C$1,785m**
	C$1.3209/US$
Net debt (US$m) at end-September 2018	509.2
Shares in issue	107.8m
Free float	70.1%
Code	EDV
Primary exchange	TSX
Secondary exchange	US OTC

Share price performance



%	1m	3m	12m
Abs	(18.0)	(16.4)	(29.1)
Rel (local)	(18.9)	(10.6)	(25.0)
52-week high/low		C$26.6	C$16.6

Business description

Endeavour Mining is an intermediate gold producer, with five mines in Côte d'Ivoire (Agbaou and Ity), Burkina Faso (Houndé, Karma) and Mali (Tabakoto) and two major development projects (Ity CIL and Kalana) in the highly prospective west African Birimian greenstone belt.

Next events

Kalana updated resource and feasibility study	Q418 and H119
Ity CIL production	Mid-FY19
Q418/FY18 results	March 2019

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Edison profile page

Endeavour Mining is a research client of Edison Investment Research Limited

Investment summary

Endeavour's Q318 results were materially ahead of our expectations, driven by better than expected operational performances at Karma and Ity, partially offset by a worse than expected performance at Agbaou. From a financial perspective, operating expenses were US$9.1m (9.6%) better than our prior forecast (see Exhibit 2), while depreciation was US$10.2m lower (owing to lower mined tonnages) and there was a US$24.8m gain on financial instruments (which we declined to forecast). These were partially counteracted by a US$15.6m higher tax charge to result in profit after tax US$33.4m higher. However, this was mostly offset by a US$25.9m negative variance in net profits from discontinued operations (ie Tabakoto) – although this figure included a non-cash US$32.0m impairment to the related assets. A full comparison between Endeavour's actual results and both those of Q218 and our prior expectations is provided in Exhibit 2.

In general, the depredations of the rainy season were more muted than we had expected – especially at Ity and Karma. **Houndé**, in particular, continued to perform well, with the plant continuing to operate nearly 30% above nameplate capacity and despite the rains limiting access to higher grade ore and the utilisation of fresh ore resulting in increased processing costs. At **Agbaou**, mining was constrained to low-grade areas and mill feed continued to be supplemented from low-grade stockpiles. The proportion of fresh ore also increased, from 28% to 32%, at the same time that the plant was subject to scheduled maintenance. Despite lower mining rates on account of the rainy season, production at **Karma** increased as it benefited from the higher grades and better recovery rates associated with Kao oxide ore. At the same time, notwithstanding lower grades stacked on account of supplemental feed from stockpiles and a lower recovery rate, opportunistic mining based on equipment availability at **Ity** resulted in an increase in ore stacked as a result of high plant availability and utilisation, such that production materially outperformed our expectations and has already surpassed Endeavour's production guidance of 60–65koz for the full 12-month period. Finally, production at **Tabakoto** remained flat, despite the effect of heavy rainfall, as slightly higher mill throughput was offset by a slightly lower average processed grade.

Endeavour has a good history of meeting its production and cost guidance targets. For FY18, the overall guidance ranges for both production and costs remain unchanged, albeit with the following qualifications:

Exhibit 1: Current Endeavour production and AISC cost guidance, by mine

Mine	Production guidance (koz)	AISC cost guidance (US$/oz)
Hondé	Top end of 250–260koz	Low end of US$580–630/oz
Agbaou	Lower end of 140–150koz	Low end of US$860–900/oz
Karma	Low end of 105–115koz	Top end of US$780–830/oz
Ity (heap leach)	Already surpassed guidance of 60–65koz	Bottom half of US$790–850/oz
Continuing operations	Upper end of 555–590koz	Bottom end of US$760–810/oz
Tabakoto	Low end of 115–130koz	Above US$1,200–1,250/oz

Source: Endeavour Mining

The current year is a transitional one for Agbaou, in particular, with a focus on waste capitalisation activities, which are expected to provide access to higher-grade areas in the latter part of Q418. Karma's profile also is expected to improve slightly in the fourth quarter, following the end of the rainy season. Our financial forecasts for Q418 and FY18, within this context (reflecting, in particular, a general recovery from the rains of Q3) are as follows:

Exhibit 2: Endeavour Mining FY18 earnings forecasts, by quarter (US$000s unless otherwise indicated)

					Q3/Q2	Q3 vs Q3e		Previous		Current	
	*Q118	Q218	Q318e	Q318	Change (%)	Variance (%)	Variance (units)	Q418e	FY18e	Q418e	FY18e
Houndé production (koz)	73.8	66.9	58.4	60.7	-9.3	3.9	2.3	58.4	258	63	264
Agbaou production (koz)	32.1	33.7	34.3	31.2	-7.4	-9.0	-3.1	39.8	140	37	134
Karma production (koz)	28.2	21.0	22.0	26.1	24.3	18.6	4.1	33.5	105	29	104
Ity heap leach production (koz)	18.3	25.0	11.1	21.0	-16.0	89.2	9.9	5.6	60	15	79
Tabakoto production (koz)	32.4	26.8	25.7	26.5	-1.1	3.1	0.8	32.7	117	27	112
Total gold produced (koz)	152	147	126	139	-5.4	10.3	13	137	562	144	582
Total gold sold (koz)	154	151	126	134	-11.3	6.3	8	137	568	144	583
Gold price (US$/oz)	1,328	1,306	1,212	1,161	-11.1	-4.2	-51	1,225	1,249	1,225	1,237
Cash costs (US$/oz)	524	608	758	643	5.8	-15.2	-115	667	633	680	612
AISC (US$/oz)	669	768	924	820	6.8	-11.3	-104	828	790	846	773
Revenue											
- Gold revenue	198,894	189,515	152,506	155,764	-17.8	2.1	3,258	168,189	709,104	176,341	720,514
Cost of sales											
- Operating expenses	83,276	92,646	95,375	86,238	-6.9	-9.6	-9,137	91,547	362,844	97,860	360,020
- Royalties	12,183	10,254	8,801	8,293	-19.1	-5.8	-508	10,005	41,243	9,854	40,584
Gross profit	103,435	86,615	48,330	61,233	-29.3	26.7	12,903	66,637	305,017	68,627	319,910
Depreciation	(39,504)	(43,538)	(46,120)	(35,911)	-17.5	-22.1	10,209	(47,034)	(176,196)	(40,786)	(159,739)
Expenses											
- Corporate costs	(6,488)	(6,130)	(5,957)	(5,888)	-3.9	-1.2	69	(5,957)	(24,532)	(5,957)	(24,463)
- Impairments	0	0	0	0	N/A	N/A	0	(13,195)	(13,195)	1,129	1,129
- Acquisition etc costs	0	0	0	0	N/A	N/A	0	0	0	0	0
- Share based compensation	(2,668)	(10,109)	(5,986)	(4,007)	-60.4	-33.1	1,979	(5,986)	(24,749)	(7,000)	(23,784)
- Exploration costs	(2,754)	(2,284)	(1,720)	(2,583)	13.1	50.2	-863	(1,720)	(8,478)	(3,000)	(10,621)
Total expenses	(11,910)	(18,523)	(13,663)	(12,478)	-32.6	-8.7	1,185	(26,858)	(70,954)	(14,828)	(57,739)
Earnings from operations	52,021	24,554	(11,453)	12,844	-47.7	-212.1	24,297	(7,255)	57,867	13,012	102,431
Interest income	0	0			N/A	N/A	0		0		0
Interest expense	(7,496)	(4,549)	(4,818)	(6,679)	46.8	38.6	-1,861	(4,818)	(21,681)	(7,743)	(26,467)
Net interest	(7,496)	(4,549)	(4,818)	(6,679)	46.8	38.6	-1,861	(4,818)	(21,681)	(7,743)	(26,467)
Loss on financial instruments	(11,403)	10,922		24,755	126.7	N/A	24,755		(481)		24,274
Other expenses	(165)	(818)		(173)	-78.9	N/A	-173		(983)		(1,156)
Profit before tax	32,957	30,109	(16,271)	30,747	2.1	-289.0	47,018	(12,073)	34,722	5,269	99,082
Current income tax	10,772	17,095	1,823	17,443	2.0	856.8	15,620	5,000	34,691	5,540	50,850
Deferred income tax	(4,881)	4,432	0	(2,007)	-145.3	N/A	-2,007	0	(449)	0	(2,456)
Total tax	5,891	21,527	1,823	15,436	-28.3	746.7	13,613	5,000	34,242	5,540	48,394
Marginal tax rate	*17.9*	*71.5*	*(11.2)*	*50.2*	-29.8	-548.2	61.4	*(41.4)*	*98.6*	*105.1*	*48.8*
Profit after tax	27,066	8,582	(18,094)	15,311	78.4	-184.6	33,405	(17,074)	480	(271)	50,688
Net profit from discontinued ops.	593	(24,025)	(9,798)	(35,705)	48.6	264.4	-25,907	(2,466)	(35,696)	(56)	(59,193)
Total net and comprehensive loss	27,659	(15,443)	(27,892)	(20,394)	32.1	-26.9	7,498	(19,540)	(35,216)	(327)	(8,505)
Minority interest	14,567	(132)	(3,369)	(3,619)	2,641.7	7.4	-250	400	11,466	2,522	13,338
Minority interest (%)	*52.7*	*0.9*	*12.1*	*17.7*	1,866.7	46.3	5.6	*(2.0)*	*(32.6)*	*(771.1)*	*(156.8)*
Profit attributable to shareholders	13,092	(15,311)	(24,523)	(16,775)	9.6	-31.6	7,748	(19,940)	(46,682)	(2,849)	(21,843)
Dividend	0	0	0	0	N/A	N/A	0	0	0	0	0
Retained earnings	13,092	(15,311)	(24,523)	(16,775)	9.6	-31.6	7,748	(19,940)	(46,682)	(2,849)	(21,843)
Basic EPS from continuing ops. (US$)	0.116	0.037	(0.137)	0.136	267.6	-199.3	0.273	(0.162)	(0.102)	(0.026)	0.347
Diluted EPS from continuing ops. (US$)	0.116	0.037	(0.136)	0.136	267.6	-200.0	0.272	(0.162)	(0.100)	(0.026)	0.339
Basic EPS (US$)	0.122	(0.142)	(0.228)	(0.156)	9.9	-31.6	0.072	(0.185)	(0.433)	(0.026)	(0.203)
Diluted EPS (US$)	0.121	(0.142)	(0.227)	(0.155)	9.2	-31.7	0.072	(0.185)	(0.424)	(0.026)	(0.198)
Norm. basic EPS from continuing ops (US$)	0.222	(0.064)	(0.137)	(0.094)	46.9	-31.4	0.043	(0.040)	0.025	(0.036)	0.111
Norm. diluted EPS from continuing ops (US$)	0.221	(0.064)	(0.136)	(0.094)	46.9	-30.9	0.042	(0.040)	0.025	(0.036)	0.111
Adj net earnings attributable (US$000s)	24,411	9,189	(10,646)	(1,408)	-115.3	-86.8	9,238	2,150	25,104	3,070	35,262
Adj net EPS from continuing ops. (US$)	0.227	0.085	(0.099)	(0.013)	-115.3	-86.9	0.086	0.020	0.233	0.028	0.327

Source: Endeavour Mining, Edison Investment Research. Note: *Q1 restated to reflect Tabakoto as a ‘discontinued operation’. Company reported basis.

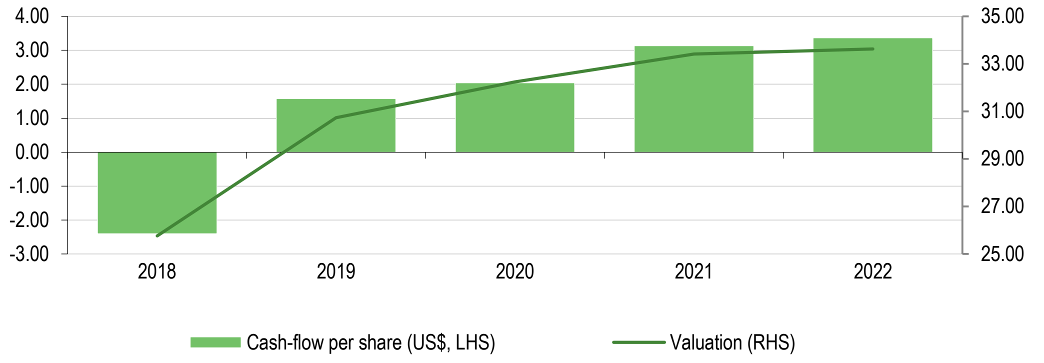
Note that the US$32.2m non-cash impairment to the value of Tabakoto has contributed to the reduction in the value of its net assets from US$73.2m as at end-Q218 to US$58.9m as at end-Q319 and has therefore reversed our anticipated loss on its sale in Q4 for US$60m, from US$13.2m to a profit of US$1.1m (under forecast 'impairments' in the above table).

Valuation

Endeavour is a multi-asset company that has shown a willingness and desire to trade assets in order to maintain production, reduce costs and to maximise returns to shareholders (eg the sale of Youga in FY16 and Nzema in FY17). Rather than our customary method of discounting maximum potential dividends over the life of operations back to FY19, therefore, we have opted to discount potential cash flows back over four years from end-FY18 and then to apply an ex-growth terminal multiple of 10x (consistent with using a standardised discount rate of 10%) to forecast cash flows in that year (ie FY22). In the normal course of events, exploration expenditure would be excluded from such a calculation, on the basis that it is an investment. In the case of Endeavour, however, we have included it in our estimate of FY22 cash flows on the grounds that it may be a critical component of ongoing business performance in its ability to continually expand and extend the lives of the company's assets.

In the wake of its Q318 results, our estimate of Endeavour's cash flow in FY22 is, to all intents and purposes, unchanged at US$3.36 per share (cf US$3.38/sh in our note Endeavour: From the ground upwards, published on 16 October 2018), on which basis our terminal valuation of the company at end-FY22 is US$33.63/share (cf US$33.76/sh previously), which (in conjunction with forecast intervening cash flows) discounts back to a value of US$30.74/share (cf US$29.76/share previously) at the start of FY19.

Exhibit 3: Endeavour forecast valuation and cash flow per share, FY18–FY22 (US$/share)



Source: Edison Investment Research

Financials

Endeavour had US$509.2m in net debt on its balance sheet at end-Q3, compared with US$399.9m at end-Q218, after US$110.8m in 'mining interests' capex. This level of net debt equates to a gearing (net debt/equity) ratio of 52.1% and leverage (net debt/[net debt+equity]) ratio of 34.3%. Note that US$509.2m accords with Endeavour's accounts; it differs from the figure of US$535.4m quoted in some of the company's other materials, since the formal accounting treatment of the finance leases on the balance sheet in particular requires future cash flows to be discounted back to present value – whereas the higher figure is quoted on an undiscounted basis. In addition, the higher figure does not include restricted cash.

The company has embarked on a major period of capital expenditure in FY18 relating to the Ity CIL project. Construction is reported to be progressing on budget and ahead of schedule, with overall project completion standing at 75% and tailings storage facility completion standing at over 70%. To achieve this, capital expenditure was brought forward from FY19 into FY18. As at 30 September therefore, project capital expended amounted to US$276m (out of an estimated total of US$351m), including c US$232m in cash outflow, US$33m in leased equipment and US$11m in non-cash working capital. Cash outflow for Q418 is expected to be c US$50–60m (almost completely offset by US$60m in cash proceeds from the Tabakoto sale, which we assume will be received by Endeavour in Q4), with the remaining expenditure of c US$62-72m expected to occur by end-H119. As a result, we now forecast that Endeavour will have US$475.4m in net debt as at end-FY18 (cf US$304m previously, which assumed an equal split of Ity CIL capex between FY18 and FY19), which will equate to a gearing ratio of 48.2% and a leverage ratio (see above) of 32.5%. First gold is now expected from the Ity CIL plant early in Q219. Thereafter, net debt should decline rapidly (notwithstanding capex related to the Kalana project) such that we estimate the company will be net debt-free in FY21, at which point it will potentially be able to make dividend distributions to shareholders.

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Exhibit 4: Financial summary

US$'000s	2016	2017	2018e	2019e	2020e
December	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS					
Revenue	566,486	652,079	720,514	762,133	1,002,952
Cost of Sales	(376,794)	(597,528)	(458,343)	(390,076)	(441,940)
Gross Profit	189,692	54,551	262,171	372,057	561,012
EBITDA	213,916	201,166	261,042	372,057	561,012
Operating Profit (before amort. and except.)	127,981	70,379	101,302	200,811	377,829
Intangible Amortisation	0	0	0	0	0
Exceptionals	(36,272)	(149,942)	25,403	0	0
Other	(1,989)	(2,242)	(1,156)	0	0
Operating Profit	89,720	(81,805)	125,549	200,811	377,829
Net Interest	(24,593)	(18,789)	(26,467)	(47,540)	(30,592)
Profit Before Tax (norm)	103,388	51,590	74,835	153,271	347,237
Profit Before Tax (FRS 3)	65,127	(100,594)	99,082	153,271	347,237
Tax	(27,643)	(32,945)	(48,394)	(55,962)	(95,285)
Profit After Tax (norm)	73,756	16,403	25,285	97,309	251,952
Profit After Tax (FRS 3)	37,484	(133,539)	50,688	97,309	251,952
Average Number of Shares Outstanding (m)	80.6	98.5	107.7	107.8	107.8
EPS - normalised (c)	(37.8)	(6.5)	(43.9)	63.5	185.9
EPS - normalised and fully diluted (c)	(37.5)	(6.5)	(42.9)	62.2	181.8
EPS - (IFRS) (c)	28.8	(114.5)	34.7	63.5	185.9
Dividend per share (p)	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	33.5	8.4	36.4	48.8	55.9
EBITDA Margin (%)	37.8	30.8	36.2	48.8	55.9
Operating Margin (before GW and except.) (%)	22.6	10.8	14.1	26.3	37.7
BALANCE SHEET					
Fixed Assets	1,073,562	1,331,745	1,477,848	1,387,960	1,390,711
Intangible Assets	29,978	6,267	6,267	6,267	6,267
Tangible Assets	1,039,529	1,317,952	1,464,055	1,374,167	1,376,918
Investments	4,055	7,526	7,526	7,526	7,526
Current Assets	283,536	361,766	143,578	324,970	614,291
Stocks	110,404	141,898	147,044	155,537	204,684
Debtors	36,572	95,212	103,734	107,155	126,948
Cash	124,294	122,702	(135,884)	33,594	253,974
Other	12,266	1,954	28,684	28,684	28,684
Current Liabilities	(149,626)	(241,185)	(213,632)	(186,496)	(205,283)
Creditors	(145,311)	(223,527)	(195,974)	(168,838)	(187,625)
Short term borrowings	(4,315)	(17,658)	(17,658)	(17,658)	(17,658)
Long Term Liabilities	(246,811)	(451,705)	(391,894)	(391,894)	(391,894)
Long term borrowings	(146,651)	(323,184)	(323,184)	(323,184)	(323,184)
Other long term liabilities	(100,160)	(128,521)	(68,710)	(68,710)	(68,710)
Net Assets	960,661	1,000,621	1,015,900	1,134,540	1,407,824
CASH FLOW					
Operating Cash Flow	164,522	244,092	185,719	354,338	532,191
Net Interest	(19,626)	(15,212)	(26,467)	(47,540)	(30,592)
Tax	(10,625)	(22,301)	(21,357)	(55,962)	(95,285)
Capex	(212,275)	(441,396)	(456,481)	(81,358)	(185,934)
Acquisitions/disposals	32,098	(37,332)	60,000	0	0
Financing	174,702	116,536	0	0	0
Dividends	(2,612)	(5,177)	0	0	0
Net Cash Flow	126,184	(160,790)	(258,586)	169,478	220,380
Opening net debt/(cash)	152,856	26,672	218,140	476,726	307,248
HP finance leases initiated	0	0	0	0	0
Other	0	(30,678)	0	0	0
Closing net debt/(cash)	26,672	218,140	476,726	307,248	86,868

Source: Endeavour Mining, Edison Investment Research. Note: includes discontinued operations; *excludes restricted cash.

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