EDISON

Euromax Resources

Project timings

Potential US$87.2m in initial capex savings

Metals & mining

In November 2016, Euromax embarked on a contract mining tender process (in contrast to the owner-operator model envisaged in its DFS). The tender focused on the first seven years of mine life and, based on indicative offers received to date, holds out the prospect of a c US$42.2m capex saving in return for a US$0.17/t, or (estimated) US$42.9m life-of-mine, increase in (undiscounted) mining operating costs and adds C$0.05, or 5.7%, to our EOX valuation on a like-for-like basis (see Exhibit 3).

Year end	Revenue (C$m)	PBT* (C$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/15	4.7	(8.4)	(7.2)	0.0	N/A	N/A
12/16	5.5	(14.3)	(12.3)	0.0	N/A	N/A
12/17e	0.0	(14.0)	(5.3)	0.0	N/A	N/A
12/18e	0.0	(8.2)	(2.0)	0.0	N/A	N/A

Note: *PBT and EPS are normalised, excluding amortisation of acquired intangibles and exceptional items.

Additional capex savings potentially worth C$0.10/sh

In addition to a US$42.2m initial capex saving as a result of adopting a contract mining business plan, Ausenco (with which Euromax has a lump-sum turnkey, or LSTK, agreement for the development of Ilovica-Shtuka) is reported to have identified c US$45m in further capex savings as a result of building the plant on a tighter footprint. Combined, the two reduce initial capex from US$431.2m to a potential US$344.0m and increase our valuation of EOX to C$0.97 (fully diluted).

Timetable

Euromax expects final construction permits to be awarded in approximately six months' time, after which it will complete the Ausenco LSTK negotiations and conclude terms with the winning contract miners. After pulling together interim mining and metallurgical work, it will then publish an optimised technical report (effectively an optimised DFS) in approximately August this year, including a detailed plan of execution. After raising the required equity finance in c Q417, Euromax intends to break ground on the project in early FY18 and, after two years of construction, enter commercial production in early FY20.

Valuation: ~100% potential share price upside

Based on the present value of the fully diluted potential dividend stream to investors, discounted at 10% pa, we value Euromax's shares at C$0.87/share vs C$1.37/share at the time of our last update note – the decrease being primarily attributable to the recent fall in Euromax's share price and the consequent increase in assumed future dilution (see Exhibit 3). This valuation has the potential to increase to C$0.97/share if Ausenco is able to crystallise an additional c US$45m in potential capex savings and to C$0.99/share if management decides to maximise its debt potential (see pages 4-5). In the meantime, considered purely as a 2.9Moz gold resource predominantly in the Measured category, we estimate that Ilovica-Shtuka has an in-situ value in the range US$135.0-178.3m (US$47.05-62.14/oz) cf Euromax's current market capitalisation of c US$40.1m.

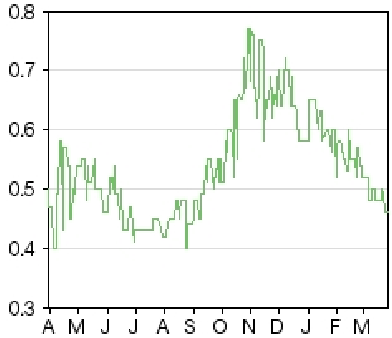
28 March 2017

Price	**C$0.46**
Market cap	**C$55m**

CAD1.3409/USD

Net debt* (C$m) at end December 2016 *Excludes liability relating to Royal Gold streaming agreement.	14.7
Shares in issue	120.3m
Free float	47.8%
Code	EOX
Primary exchange	TSX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(14.8)	(22.0)	(20.7)
Rel (local)	(14.3)	(22.6)	(31.4)
52-week high/low		C$0.8	C$0.4

Business description

Euromax Resources is a Canadian resource company that focuses on the acquisition and development of mineral-bearing assets in south-east Europe. Its flagship asset, Ilovica-Shtuka, in Macedonia, is the subject of a recently completed definitive feasibility study.

Next events

Optimised BFS	August
Permitting	Q317
Conclude contracts	Q317

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Edison profile page

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Politics and economics

Politics

Macedonia held parliamentary elections on 11 December. The elections were called following an EU-brokered agreement after the prime minister, Nikola Gruevski, stepped down in January 2016 amid opposition allegations of the widespread wiretapping of Macedonian citizens. In the ensuing elections, his party, the nationalist VMRO-DPMNE, won 51 of 120 parliamentary seats (a reduction of 10 compared to the previous election). The opposition Social Democrats won 49 seats, while the main ethnic Albanian party – the Democratic Union for Integration (DUI) – which has long been junior partner in coalition with the governing VMRO-DPMNE, came third with 10 seats. Election observers from the Organization for Security & Co-operation in Europe (OSCE) said that the voting had been conducted smoothly. Observers said there had been some irregularities but that no political party had complained about either the electoral process or the result.

While the election had been seen as a delaying factor regarding construction permits at Ilovica-Shtuka, the eventual granting of the permits was never perceived as being in doubt, given that both main parties in the election had voiced their support for the project. While the election gave the government a technical majority of one however, a genuine coalition government in partnership with the DUI has proved difficult to form, with the latter's demands in return for its support being perceived as onerous by the ruling party. As a result, something of a political vacuum has developed and informed opinion appears to incline towards the expectation of a second election in the foreseeable future. Notwithstanding the resulting absence of political leadership however, technical government in the form of the requisite bureaucratic processes is reported to have continued, more or less, uninterrupted.

Requisite bureaucratic processes

As a result of the continuation of bureaucratic, if not political, government, Euromax has achieved two key milestones in the granting of an exploitation permit:

1. The approval of the Strategic Environmental Impact Assessment by the Macedonian Ministry of Environment; and
2. The merger of the company's two exploitation concessions (Ilovica 6 and Ilovica 11 – over which the Ilovica-Shtuka project footprint extends).

Of the two, the latter milestone is arguably the more significant, since Euromax's exploitation plan was presented on a combined basis and the subsequent merger of the two concessions now allows this submission to be formally considered by the government, having previously been held up.

Mine planning and contract mining

Following additional mine plan work, Euromax embarked on a contract mining tender process in November 2016. The tender was focused on the first seven years of mine life (ie the two-year construction and pre-strip period plus five years of operation). Compared to the owner-operated business model envisaged in its definitive feasibility study, the average cost per tonne of material mined was 10.5% higher (US$1.79/t vs US$1.62/t), while capex was c US$42.2m lower (US$58.5m vs US$100.7m).

Engineering, procurement and construction (EPC)

In the meantime, Euromax has also agreed a binding Memorandum of Understanding (MoU) with Ausenco Engineering Canada for further initial, detailed engineering and design and a framework to allow Ausenco to proceed through a two-step process to provide Euromax with a lump-sum turnkey (LSTK) price for the construction of the process plant and related infrastructure for the project. The first step of a two-step process is for Ausenco to provide Euromax, within 90 days of commencing the work, a guaranteed maximum price (GMP) for the project, based on an agreed scope of work on an ‘open book’ basis. Following the delivery of the GMP (and assuming that the GMP is at or below the project capex as envisaged in the DFS), Ausenco will then proceed to negotiate with Euromax the terms of a final LSTK price for the development of the project that will be at, or below, the GMP.

Ausenco has already made a site visit to Ilovica-Shtuka and is reported to have identified a potential c US$45m in (stage 1) savings, largely based on a tighter plant footprint, which thereby requires less steel, concrete and civil engineering etc. In addition, management believes that further savings may be made in the related infrastructure budget (currently estimated at US$23.7m) – eg via reduced mining infrastructure costs, many of which are incorporated in the mining contractor tenders.

Once stage 2 is completed therefore, Euromax should benefit, not only from a reduction in cost inflation risk as a result of the LSTK nature of its development contract with Ausenco, but also the fact that the capital cost of the mining fleet will have been removed from its balance sheet. Moreover, under the terms of the MoU, the cost of Ausenco’s work to deliver the GMP will be settled via the issuance of Euromax shares to Ausenco at a premium to the share price immediately prior to the delivery and announcement of the GMP. Based on Euromax shares’ market price immediately prior to its 23 February announcement (C$0.58/share), management estimated that the number of common shares to be issued to Ausenco in connection with the MoU would be “less than 5%” of the 116.8m that were then issued and outstanding ie less than 5.8m shares at a price of C$0.58 each, or C$3.4m.

Timing

Euromax now expects final construction permits to be awarded in approximately six months’ time, after which it will complete the Ausenco LSTK negotiations and marshal the winning contract miners. After pulling together interim mining and metallurgical work, it intends to publish an optimised technical report (effectively an optimised DFS) in approximately August this year, including a detailed plan of execution.

After raising the required equity finance in c Q417, Euromax plans to break ground on the project in early FY18 and, after two years of construction, to pour first gold in early FY20.

Valuation

As stated in our Outlook note of March 2016, Euromax envisages financing Ilovica-Shtuka’s funding requirement via debt, equity and streaming in approximately the following proportions:

Exhibit 1: Ilovica-Shtuka funding, by type

Method	Amount (US$m)	Percentage (%)	Comment
Streaming	175	34	Announced October 2014
Debt	240	47	SocGen, UniCredit and UniCredit Austria mandated to provide US$215m; Caterpillar Financial mandated to provide US$25m. Announced 1 May 2015. Covered by German UFK scheme
Equity	100	19	
Total	**515**	**100**	

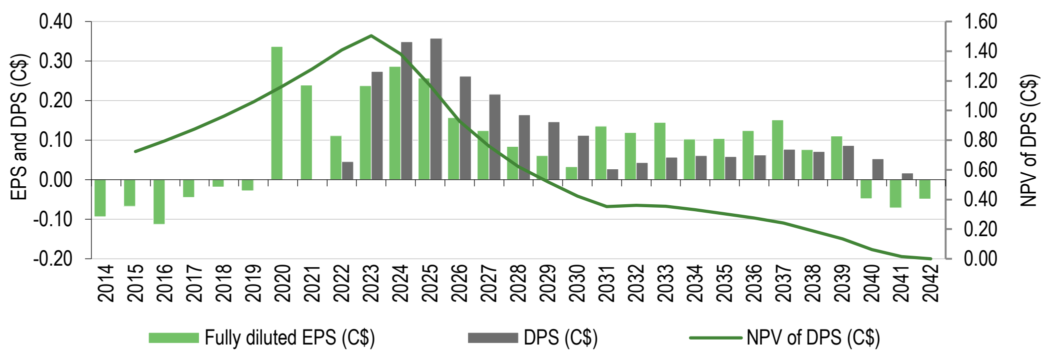
Source: Edison Investment Research, Euromax Resources

Assuming the following:

- A capex saving of US$42.2m
- A 10.5% increase in life-of-mine mining opex
- A notional US$100m equity raise in the form of 291.5m shares at the prevailing share price of C$0.46 per share and a forex rate of C$1.3409/US$

We estimate an updated value for Euromax's shares of C$0.87 per share, based on the net present value of maximum potential dividends payable to shareholders over the life of operations, discounted at 10% per year:

Exhibit 2: Euromax estimated life-of-mine EPS and (maximum potential) DPS



Source: Edison Investment Research

This valuation increases to C$1.50 in 2023, when conventional debt (ie excluding the Royal Gold stream) has been repaid and the first substantive dividend distribution is payable. Also of note is the fact that execution of the mining plan at the parameters indicated implies future potential (fully diluted) EPS as high as C$0.34/share and average sustainable (fully diluted) EPS in the order of C$0.15/share, which compares favourably with Euromax's current share price of C$0.46.

Stated alternatively, investors buying Euromax shares at the current price of C$0.46/share may expect a 19.6% internal rate of return from their investment in Canadian dollar terms over 24 years to FY41 (inclusive).

A summary of the components in the evolution of our updated valuation of Euromax compared with that in our last update note is as follows:

Exhibit 3: Euromax valuation revision factors

	Valuation (C$/share)	Change (C$/share)
Prior valuation	**1.37**	
■ Updated share price	1.10	-0.27
■ Updated forex rate*	1.00	-0.10
■ March non-brokered private placement	0.99	-0.01
■ Timing to commercial production	0.86	-0.13
■ Capex and opex adjustments	0.91	+0.05
■ Other	0.87	-0.04
Current valuation	**0.87**	

Source: Edison Investment Research. Note: *Primarily the strong Euro vs US dollar.

Sensitivity

As noted on page 3, Ausenco has identified a potential c US$45m capex saving as a result of its site visits, based largely on the presumption of a tighter plant footprint, which will therefore require less steel, concrete and civil engineering etc. In combination with the US$42.2m capex reduction in the event that a contractor, rather than an owner-operator, business model is chosen, this would reduce initial capex from its original US$431.2m to US$344.0m and increase our valuation of Euromax by a further C$0.10, from the C$0.87/share noted above, to C$0.97/share.

Financials

Excluding the contingent liability relating to its streaming agreement with Royal Gold, Euromax had C$14.7m of net debt as at end-December 2016. We assume that it will raise c US$100m (or C$134.1m) later this year, approximately coincident with the signing of final debt funding agreements with its consortium of banks. As it draws down debt to fund the initial capital expenditure on Ilovica-Shtuka, net debt (excluding the contingent liability relating to its Royal Gold streaming agreement) will increase to peak at C$289.1m (US$215.6m) in FY19 – equating to a contemporary leverage (debt/[debt+equity]) ratio of 75.1% – before reducing under the influence of positive operational cash flows until it is eliminated in FY22.

Note that this estimated C$289.1m, or US$215.6m, net debt requirement is below the figure of US$240m (C$321.8m) for which Euromax's consortium of financial partners has been mandated (Exhibit 1). If Euromax instead decides to maximise its debt funding capability, it would require the raising of only C$102.8m (US$76.6m) in equity and would result in a 13.8% uplift in our valuation of Euromax's shares (albeit with proportionately greater financial risk) to C$0.99/share.

Exhibit 4: Financial summary

C$'000s	2011	2012	2013	2014	2015	2016	2017e	2018e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS								
Revenue	0	0	0	2,695	4,729	5,473	0	0
Cost of Sales	0	0	0	(2,251)	(4,005)	(4,419)	0	0
Gross Profit	0	0	0	444	724	1,054	0	0
EBITDA	(2,521)	(4,973)	(5,276)	(6,366)	(7,749)	(12,544)	(12,937)	(12,937)
Operating Profit (before amort. and except.)	(2,611)	(5,056)	(5,375)	(6,492)	(7,917)	(12,745)	(13,138)	(13,138)
Intangible Amortisation	0	0	0	(21)	(19)	(9)	(9)	(1)
Exceptionals	(40)	59	(1,806)	(4,186)	(1,979)	(4,181)	0	0
Other*	(835)	(428)	(835)	4	24	9	0	0
Operating Profit	(3,485)	(5,425)	(8,015)	(10,695)	(9,891)	(16,926)	(13,147)	(13,139)
Net Interest	0	0	(17)	(127)	(434)	(1,555)	(881)	4,899
Profit Before Tax (norm)	(2,611)	(5,056)	(5,392)	(6,619)	(8,351)	(14,300)	(14,019)	(8,239)
Profit Before Tax (FRS 3)	(3,485)	(5,425)	(8,033)	(10,822)	(10,325)	(18,481)	(14,028)	(8,240)
Tax	0	(33)	(30)	(25)	(47)	(46)	0	0
Profit After Tax (norm)	(2,514)	(4,947)	(5,414)	(6,640)	(8,374)	(14,337)	(14,019)	(8,239)
Profit After Tax (FRS 3)	(3,485)	(5,458)	(8,063)	(10,847)	(10,372)	(18,527)	(14,028)	(8,240)
Average Number of Shares Outstanding (m)	48.0	63.4	82.6	85.3	115.8	116.8	264.3	411.8
EPS - normalised (c)	(5.2)	(7.8)	(6.6)	(7.8)	(7.2)	(12.3)	(5.3)	(2.0)
EPS - normalised and fully diluted (c)	(4.5)	(6.7)	(5.8)	(5.7)	(5.4)	(8.7)	(4.5)	(1.8)
EPS - (IFRS) (c)	(7.3)	(8.6)	(9.8)	(12.7)	(8.9)	(15.9)	(5.3)	(2.0)
Dividend per share (c)	0.0	0.0	0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)	N/A	N/A	N/A	N/A	N/A	19.3	N/A	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A	-229.2	N/A	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A	-232.9	N/A	N/A
BALANCE SHEET								
Fixed Assets	11,929	17,084	18,015	16,641	29,696	35,424	35,214	332,415
Intangible Assets	0	0	29	430	514	498	489	488
Tangible Assets	11,929	17,084	17,985	16,211	29,182	34,926	34,725	331,927
Investments	0	0	0	0	0	0	0	0
Current Assets	2,798	3,341	6,290	3,180	4,871	236	342,353	36,911
Stocks	0	0	0	0	0	0	0	0
Debtors	776	1,579	608	199	1,056	236	0	0
Cash	2,022	1,762	1,335	2,110	3,478	0	342,353	36,911
Other	0	0	4,346	871	337	0	0	0
Current Liabilities	(530)	(749)	(1,208)	(5,831)	(5,443)	(25,482)	(31,353)	(31,352)
Creditors	(530)	(749)	(1,208)	(4,996)	(5,443)	(10,807)	(15,615)	(15,614)
Short term borrowings	0	0	0	(835)	0	(14,675)	(15,738)	(15,738)
Long Term Liabilities	0	0	0	0	(15,596)	(14,947)	(229,491)	(229,491)
Long term borrowings	0	0	0	0	(15,596)	(15,150)	(229,694)	(229,694)
Other long term liabilities	0	0	0	0	0	203	203	203
Net Assets	14,198	19,675	23,096	13,990	13,528	(4,769)	116,724	108,484
CASH FLOW								
Operating Cash Flow	(1,966)	(5,178)	(4,496)	(2,494)	(5,765)	(5,165)	(8,774)	(8,038)
Net Interest	0	0	(17)	(18)	(144)	(6)	0	0
Tax	0	0	(35)	(26)	(93)	(33)	0	0
Capex	(5,245)	(6,947)	(5,047)	(2,122)	(12,956)	(8,481)	0	(297,403)
Acquisitions/disposals	0	1,468	1,041	3,023	705	650	0	0
Financing	7,907	10,479	7,961	(74)	5,255	(220)	135,520	0
Dividends	0	0	0	0	0	0	0	0
Net Cash Flow	696	(178)	(594)	(1,711)	(12,998)	(13,255)	126,746	(305,442)
Opening net debt/(cash)**	(1,253)	(2,022)	(1,762)	(1,406)	(1,275)	12,118	29,825	(96,921)
HP finance leases initiated	0	0	0	0	0	0	0	0
Other	73	(83)	167	1,580	(395)	(4,452)	0	0
Closing net debt/(cash)**	(2,022)	(1,762)	(1,335)	(1,275)	12,118	29,825	(96,921)	208,521

Source: Company sources, Edison Investment Research. Note: *Includes fair value loss on financial liabilities in FY16; **net debt/(cash) includes ‘restricted cash’ from FY14.

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