

Orosur Mining

San Gregorio stabilises as Colombia takes off

Orosur's H118 results indicate San Gregorio (SG) continues to perform well, albeit with a small deferral of 2koz of gold production to narrow FY18 guidance from 30-34koz to c 30koz. Orosur's focus remains on the most profitable mining possible rather than extracting its reserves ad hoc. SG's geological data are being thoroughly examined such that additional production opportunities are identified. The process has already yielded SG UG West (a current mainstay of production), with SG Central located adjacent and being developed to provide production during H218. Veta A is another old pit reopening as an underground mine project. We consider that Orosur should be able to return to profitability by end FY18, with upside clearly linked to the very positive initial drill results coming from its increasingly important Colombian asset base.

Year end	Revenue (US\$m)	PBT* (US\$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
05/16	42.9	3.2	(1.2)	0.0	N/A	N/A
05/17	44.2	2.1	2.6	0.0	5.8	N/A
05/18e	37.7	7.9	5.8	0.0	2.6	N/A
05/19e	44.5	10.1	8.1	0.0	1.8	N/A

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

SG UG Central drilling highlights remnant potential

The original San Gregorio open pit produced over 0.5Moz. Sitting beneath this old pit are gold resources that may well contribute to future production. This includes a gold-bearing crown pillar situated between the old SG pit floor and the uppermost reaches of the SG UG West workings. A separate SG UG Central gold resource, is being optimised and will replace production from SG UG West when it ceases during H218. In our view these underground resources, as well as development of Veta A (situated 1.2km from the SG plant) are the near-term sources of gold for Orosur to mine and maintain SG's profitable operation.

Valuation: Revised for narrowed guidance, gold price

Factoring in all our valuation revisions (see pages 5 and 6), we now value Orosur's shares at £0.17, using a US\$/£ forex rate of 1.38 to convert the company's US dollar-denominated earnings. While this represents a hefty 41% decrease over our previous valuation published in October 2017 (£0.29/share), it still provides a considerable 56% upside to the company's current share price. The decrease in our valuation results, predominantly, from our long-term revision of expected yearly production, with 35kozpa estimated now compared to 40kozpa previously. We expect Orosur's ongoing significant exploration programmes over its mining areas, both new and old, to provide significant increases in reserves. As and when these reserve estimates are formalised and released to market, we foresee a potential increase in our long-term production assumptions, which would represent an upside risk to our estimates and valuation. Our revised valuation uses our new gold price forecasts (comparable to our previous forecasts, see page 6) and a 10% discount rate to reflect general equity risk.

H118 results and outlook

Metals & mining

26 January 2018

Price **10.85p**

Market cap **£13m**

£/US\$1.38

Net cash (US\$m) at 30 November 2017 0.3

Shares in issue 117.6m

Free float 86%

Code OMI

Primary exchange TSX

Secondary exchange AIM

Share price performance



% 1m 3m 12m

Abs (10.5) (27.1) (37.1)

Rel (local) (10.8) (28.7) (41.6)

52-week high/low 18.2p 10.8p

Business description

Orosur Mining owns (100%) and operates its San Gregorio gold mine in Uruguay. It explores for gold close to San Gregorio and further afield in Chile, at the Anillo gold property. It also owns 100% of the highly prospective, high-grade Anzá gold property in Colombia, which is currently undergoing a 15,000m drill programme.

Next events

Anza exploration results Q3/Q4 FY18

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Realising San Gregorio's further potential

Key to Orosur's future in Uruguay is finding more gold in, under, and around the location of past producing assets as well the discovery of fresh new orebodies across the Isla Cristalina belt, in which it has a dominant land position. The potential for new discoveries, as well as the definition of new resources and reserves near to and underneath old open pits, is huge and only limited by the company's financial position. Orosur has mined over 1.5Moz from its numerous open pit and underground operations at San Gregorio. Under previous management, it appears that this was not always undertaken in an orderly and responsible fashion. As a result, the application of modern and systematic exploration techniques are being applied by Orosur's current management team to identify those areas of mineralisation that were previously missed, and which may potentially lead to far more gold being discovered as mining practices become increasingly focused on the underground extraction of ore. We also note that the Uruguayan government has granted Orosur an exemption on royalty payments (equal to 3% of sales) for the period April 2017 to March 2018. This is a definite positive, demonstrates a healthy relationship between the two parties and potentially bodes well for any permitting needed by Orosur as it looks to expand exploration in country.

FY18 outlook – guidance should still be met at lower end

It has been unfortunate that Orosur had to announce the deferral of 2koz of gold from its H118 production to the second half of FY18. However, it should be stressed that this was not due to an unexpected decrease in gold grades or any failure of the technical processes that feed into the mine planning process. The shortfall in production was simply due to the failure of long-hole mining machinery used underground. While this could be argued as avoidable, it is a far better reason for a production miss than any of the previous points mentioned.

As a result of the failure of its long-hole mining equipment, Orosur has narrowed its guidance and now expects c 30koz to be produced in FY18 vs previous guidance for 30-35koz produced. C1 equivalent cash cost guidance remains unchanged for FY18 at US\$800/oz to US\$900/oz.

Colombian assay results hint at high-grade potential

With increasing investment into exploration-stage mining plays in South America over the past couple of years and the opening of new regional offices in Ecuador by some 27 different companies, including the likes of BHP, Orosur has elevated the importance of its exploration-stage Colombian Anza project. This project is associated with the same type of tectonic processes that formed the more notable discoveries in Ecuador and Colombia. The reasoning for Anza's elevated importance appears justified on viewing preliminary drill results, which indicate a strong presence at decent concentrations of both gold and base metals. The potential in Colombia is fast becoming evident, and to this end Orosur is potentially open to joint venturing on Anza and seeking further funding to significantly progress exploration. Exploration in Colombia runs alongside ongoing mining at its longstanding San Gregorio mine in Uruguay.

Orosur is well into its fully funded Phase 1 exploration programme (started October 2017) at its high-grade precious and base metals Anza project, located in the middle-caucus region of northern Colombia. The first assay results have been received with all holes intercepting mineralisation, indicating that the project has good potential to allow for a maiden mineral resource to be defined and, most importantly, for a far more precise understanding of both the geology and geological structures that govern the mineralisation known to be present. While Anza has been drilled before

(most recently by previous owners Waymar Resources), questions remain as to what type of geological model best explains the high-grade precious and base metals occurrences that have either been observed in outcrop or drilled at depth. Previously, it was thought that mineralisation at Anza could hint at a volcanogenic massive sulphide deposit which can host, inter alia, significant tonnages of high grade metal sulphides rich in base metals such as copper, zinc or lead, as well as associated amounts of gold and silver. However, it is thought now that the mineralisation being encountered during drilling is epithermal in nature, narrow veined and potentially associated in regional setting with a much larger porphyritic system. Anzá is in the most prospective district in Colombia, the Colombian Gold Belt, where most of the largest gold deposits have been defined, close to Continental Gold's Buriticá project located along strike to the north from Anza. The APTA target represents <10% of the total Anzá area. Anzá's potential has yet to be tested given the identification of four high-priority targets with coincident geochemical and geophysical anomalies. Orosur's exploration programme aims are as follows:

- Step out drilling on extensions of the APTA discovery. Delineation and in-fill of the high-grade Au zones.
- Initial drilling at nearby targets, starting with Charrascala.
- Systematic exploration of the district potential.

Only partial drill results representing 30% of the samples to be analysed from the first two holes (MAP54 & MAP55) was sent to SGS Laboratory in Medellin, with the following table containing the results released by Orosur to date.

Exhibit 1: MAP54 partial assay results						
Hole number	From (m)	To (m)	Interval (m)	Au g/t	Cu ppm	Zn (%)
MAP-54	97.10	101.73	4.63	5.47	771.3	1.44
Including	97.10	98.20	1.1	2.59	140.1	0.48
	98.20	99.50	1.3	3.67	424.0	0.75
	99.50	100.75	1.25	4.41	1,050.1	1.87
	100.75	101.73	0.98	12.43	1,584.9	2.90
MAP-54	126.00	127.00	1.0	1.68	193.2	1.22
MAP-54	144.50	149.82	5.32	17.76	4,724.7	4.84
Including	144.50	145.70	1.2	8.71	778.0	0.80
	145.70	146.70	1.0	37.96	575.1	0.70
	146.70	148.00	1.3	19.76	324.8	0.25
	148.00	148.87	0.87	17.63	4,531.5	7.56
	148.87	149.82	0.95	5.31	20,200.0	17.54
MAP-54	149.82	159.10	9.28	1.84	2,398.0	2.26
Including	149.82	150.85	1.03	1.4	17,500.0	14.26
	150.85	151.90	1.05	1.43	39.5	0.05
	151.90	153.00	1.10	0.94	246.1	0.88
	153.00	154.10	1.10	3.19	2,777.8	1.84
	154.10	155.00	0.90	3.73	52.6	0.29
	155.00	156.00	1.00	1.79	306.4	0.99
	156.00	157.00	1.00	0.97	354.6	1.30
	157.00	158.00	1.00	0.92	79.9	0.24
	158.00	159.10	1.10	2.34	70.2	0.42

Source: Orosur Mining press release, 14 November 2017

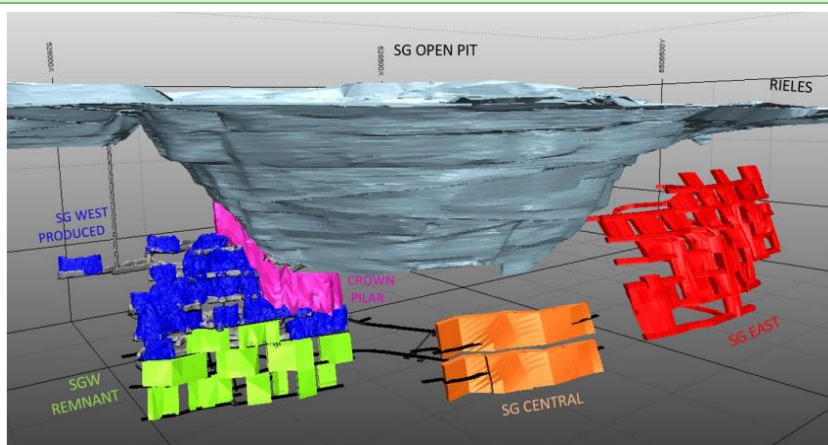
MAP54 was drilled in the central area of the APTA project and appears to have been drilled to confirm the data contained within previous drill holes located nearby. Orosur has not indicated whether MAP54 confirms old drill data or not. Nonetheless, the assay results presented in the above exhibit show promising precious and base metal concentrations across meaningful and potentially economic mining widths. Of course, further drilling is required to confirm the potential for a high grade precious metal/base metal resource, and Orosur expects to release more drilling information over both Q318 and Q418 as it progresses through its fully funded 15,000m drill campaign.

H2 outlook: Reserve increases are a work-in-progress

During H118 mining was focused at the SG UG West development. This operation has been the mainstay for San Gregorio's gold production since November 2016. As mining at SG UG West is expected to conclude during H218, development of the SG Central deposit (see below) has started with the development of an underground access ramp.

However, it appears that the mining of SG Central will require further refinement to the mine schedule as parts of this mineral resource are understood to be uneconomic at current gold prices, especially at depth and to the east due to narrowing thicknesses of the ore body and also a reduction in the gold grade. As a result, Orosur's mining consultant, SRK Peru, is revising the mine schedule to focus on extraction of the most profitable parts. These are stated to be in the shallower (ie upper) reaches of SG Central orebody.

Exhibit 2: Current and near-term UG mining operations



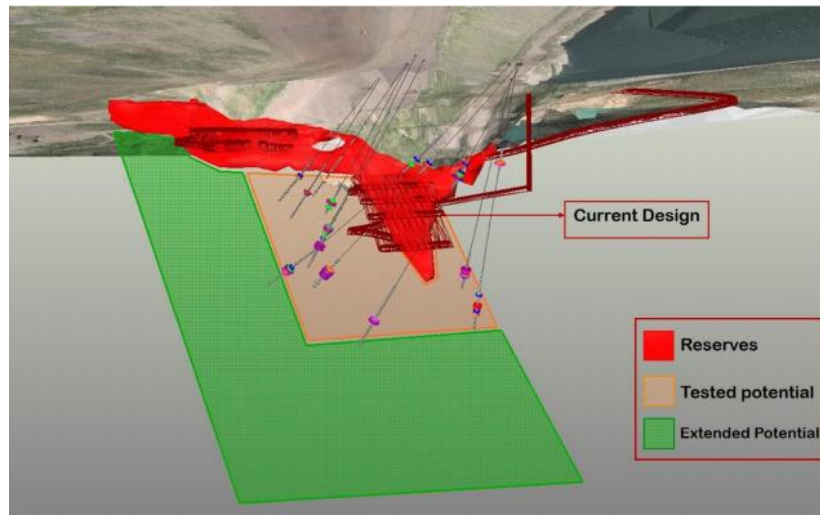
Source: Orosur Mining, H118

As can be seen from the above exhibit, SG Central is planned to be accessed from the mining operation at SG UG West via a 250m development access ramp which is under construction. We also highlight the company's ongoing assessment to mine the (pink shaded area) crown pillar shown in the exhibit above. Crown pillars are put in place when mining close to the floor of open pits (as in this example), or where a section of a mine needs to be protected from the effects of mining elsewhere.

Veta A underground – mining beneath old open pits

The historic Veta A open pit mined 29,000 ounces of gold at an average grade of 3.1g/t. Of most significance however, is that mining was stopped as the Veta A mineralisation appeared to run under the previous and now reclaimed tailings storage facility. This same tailings storage facility is no longer used and has been remediated and returned to nature, as has the historic Veta open pit. As such, all ground settlement should have ceased and mining beneath this TSF is now being considered due to the extension of the Veta A orebody thought to run beneath it. Exhibit 3 illustrates the potential mineralisation Orosur is looking to delineate an economic ore reserve from.

Exhibit 3: Exploration potential of the Veta A orebody at depth



Isometric view showing increased geological potential in green, currently tested potential in orange with the DD holes drilled on H1 and the current design. Not to scale.

Source: Orosur Mining

The current reserve estimate in place for Veta A is 9,440ozs (ie 122,328 tonnes at 2.40g/t Au), and Orosur intends to undertake further drilling to achieve “a significant increase in reserves following a positive drilling campaign that proved the continuity and extension of the ore body over 140m from the current defined reserves.” From the following drill results, it appears that the claims by Orosur that further mining at Veta A could capitalise on the highest-grade gold resource currently delineated at San Gregorio.

Exhibit 4 is a summary of drill results obtained from drilling across the Veta A and indicates that the potential for extensions at depth to known mineralisation is strong.

Exhibit 4: Veta A drill results

Hole ID	From (m)	To (m)	Intercept length (m)	Au g/t
VADD17-006	161.9	168.6	6.7	5.0
VADD17-007	165.2	167.1	1.9	3.3
VADD17-008	125.0	131.1	6.1	2.6
VADD17-009	170.5	175.3	4.8	1.8
VADD17-010	107.7	109.7	2.0	0.4
VADD17-011	107.6	110.2	2.6	5.8
VADD17-012	124.4	130.8	6.4	1.7
VADD17-013	97.5	99.0	1.5	1.5
VADD17-014	96.3	97.7	1.4	0.7
VADD17-015	155.4	157.0	1.6	1.6
VADD17-016	133.6	136.7	3.1	3.4

Source: Orosur Mining

Revisions to our model and valuation

We have made the following changes to our model:

- We have reviewed our estimates for San Gregorio’s future production. In consideration of the mine’s performance over the past two years, we have reduced gold production from 40koz pa to 35koz pa through to FY24. We estimate that this production will be achieved within a cash operating cost range of US\$800/oz to US\$900/oz, also in line with the company’s cash cost guidance for the last two financial years.

- We have adjusted our capital expenditure forecasts for FY18 and beyond, from US\$5m to US\$9m. Orosur stated in its H118 release that it had spent more than previously guided to, due to increased exploration and development expenditures (see financing section below).
- We have removed the 3% government royalty on sales for FY18 due to the Uruguayan government's ongoing support for its only operating gold mine – San Gregorio.
- We have adjusted our US\$/£ forex rate from 1.34 to 1.38, which affects our valuation of sterling-denominated shares.

Gold price revisions

We have published our annual mining review ([Unlocking the price to NPV discount](#) published November 2017), and as a result our gold price assumptions have changed. For the background to these changes please read page 79 onwards from the aforementioned report. Our revised gold price assumptions follow in Exhibit 5.

Exhibit 5: Edison's old and revised gold price assumptions, 2018 to 2024							
Calendar year	2018	2019	2020	2021	2022	2023	2024
Old gold price	1,220	1,284	1,362	1,344	1,281	1,274	1,257
New Gold price	1,220	1,263	1,482	1,437	1,304	1,303	1,264
% change	0.0%	-1.6%	8.8%	6.9%	1.8%	2.3%	0.6%
Source: Edison Investment Research							

Valuation – 56% upside to current share price

Factoring in all our revisions, we now value Orosur's shares at £0.17, using a US\$/£ forex rate of 1.38 to convert its US dollar denominated earnings. While this represents a hefty 41% decrease over our previous valuation published October 2017, it nonetheless still provides a considerable 56% upside to the company's current share price. The decrease in our valuation results predominantly from our long-term revision of expected yearly production, with 35koz estimated now as compared to 40koz previously. This has also resulted in the downward revision of our financial estimates (FY18e and FY19e EBITDA of US\$12.2m and US\$14.0m vs US\$17.5m and US\$18.7m before; see Exhibit 6 for more details).

We expect Orosur's ongoing significant exploration programmes over its mining areas, both new and old, to provide for a visible increase in reserves. As and when these reserve estimates are formalised and released to market, we foresee a potential increase in our long-term production assumptions, which would represent an upside risk to our estimates and valuation.

Financials

H118 gold production was 15,677oz, a y-o-y decrease of c 7%. Operating cash costs for H118 were US\$886/oz, a y-o-y increase of 13%, with all-in sustaining costs up 25% y-o-y from US\$1,422/oz to US\$1,135/oz. The average price received year to date for each gold ounce sold was US\$1,277/oz. All told, Orosur ended H118 slightly in the red reporting a net loss of US\$0.542m.

The increase in AISC was due to Orosur's significant ramp-up in exploration drilling needed to aid delineation of new mineral resources and ore reserves, and also included development capital of US\$1.704m in Q2 (ytd: US\$6.164m).

Looking towards the end of FY18, Orosur's expected year-end capex is estimated at around US\$8m to US\$9m. We include the upper end of this guidance in our model and valuation. We estimate an operating cash cost figure per H218 gold ounce produced of US\$875/oz, which is towards the upper end of the company's own guidance of US\$800/oz to US\$900/oz.

Cash position

Orosur ended H118 with cash on hand of US\$2.1m, and net cash of US\$0.3m. The company's debt comprises a small Santander overdraft, which was fully drawn down during H118 due to the prolonged equipment failure that led to a 2koz deferral of gold production to H218. Orosur also classifies some equipment leasing as debt, but this amounts to no more than US\$0.4m. We note Orosur has successfully renewed its Santander arrangement, making a further US\$1.5m credit line available in case of unforeseen set-backs.

We assume an average gold price across all four quarters in FY19 of US\$1,263/oz, factoring in our cost, capex and working capital assumptions, Orosur should be able to repay its Santander credit line and finish FY19 comfortably in the black. Our current estimate for end FY19 net cash is US\$1.1m.

Exhibit 2: Financial summary

	US\$'000s	2014	2015	2016	2017	2018e	2019e
31-May		IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue		80,370	65,868	42,866	44,226	37,694	44,467
Cost of Sales		(72,905)	(69,715)	(42,073)	(40,271)	(30,903)	(35,228)
Gross Profit		7,465	(3,847)	793	3,955	6,791	9,238
EBITDA		23,935	10,708	9,121	9,436	12,191	13,956
Operating Profit (before amort. and except.)		5,197	(5,861)	3,146	2,293	8,097	10,356
Intangible Amortisation		0	0	0	0	0	0
Exceptionals		(869)	(43,164)	(6,328)	(101)	(810)	0
Other		0	0	0	0	0	0
Operating Profit		4,328	(49,025)	(3,182)	2,192	7,287	10,356
Net Interest		(666)	(376)	24	(164)	(224)	(288)
Profit Before Tax (norm)		4,531	(6,237)	3,170	2,129	7,873	10,067
Profit Before Tax (FRS 3)		3,662	(49,401)	(3,158)	2,028	7,063	10,067
Tax		1,461	(4,975)	1,948	557	(353)	(503)
Profit After Tax (norm)		5,123	(54,376)	(1,210)	2,585	6,710	9,564
Profit After Tax (FRS 3)		5,123	(54,376)	(1,210)	2,585	6,710	9,564
Average Number of Shares Outstanding (m)		78.1	96.6	97.6	99.9	114.7	117.6
EPS - normalised (c)		6.6	(56.3)	(1.2)	2.6	5.8	8.1
EPS - normalised fully diluted (c)		6.6	(56.3)	(1.2)	2.6	5.8	8.1
EPS - (IFRS) (c)		6.6	(56.3)	(1.2)	2.6	5.8	8.1
Dividend per share (c)		0.0	0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		9.3	-5.8	1.8	8.9	18.0	20.8
EBITDA Margin (%)		29.8	16.3	21.3	21.3	32.3	31.4
Operating Margin (before GW and except.) (%)		6.5	-8.9	7.3	5.2	21.5	23.3
BALANCE SHEET							
Fixed Assets		79,278	34,992	30,661	37,731	48,637	53,037
Intangible Assets		41,955	18,330	20,555	21,571	27,571	31,571
Tangible Assets		37,323	16,662	10,106	16,160	21,066	21,466
Investments		0	0	0	0	0	0
Current Assets		28,410	20,925	18,159	18,033	10,515	13,847
Stocks		14,254	14,362	12,069	13,157	9,191	10,843
Debtors		3,338	1,775	1,770	1,519	1,295	1,527
Cash		10,818	4,788	4,320	3,357	29	1,477
Other		0	0	0	0	0	0
Current Liabilities		(17,919)	(15,073)	(11,199)	(14,963)	(7,276)	(6,944)
Creditors		(13,941)	(13,944)	(10,946)	(14,761)	(7,074)	(6,742)
Short term borrowings		(3,978)	(1,129)	(253)	(202)	(202)	(202)
Long Term Liabilities		(6,789)	(6,958)	(5,426)	(5,606)	(7,077)	(5,577)
Long term borrowings		(961)	(352)	(99)	(201)	(1,672)	(172)
Other long term liabilities		(5,828)	(6,606)	(5,327)	(5,405)	(5,405)	(5,405)
Net Assets		82,980	33,886	32,195	35,195	44,799	54,363
CASH FLOW							
Operating Cash Flow		22,767	11,753	6,539	12,349	7,531	11,237
Net Interest		(666)	(376)	24	(164)	(224)	(288)
Tax		0	0	0	0	0	0
Capex		(13,062)	(12,835)	(6,612)	(13,199)	(15,000)	(8,000)
Acquisitions/disposals		0	0	0	0	0	0
Financing		0	0	710	0	2,894	0
Dividends		0	0	0	0	0	0
Net Cash Flow		9,039	(1,458)	661	(1,014)	(4,799)	2,948
Opening net debt/(cash)		3,362	(5,879)	(3,307)	(3,968)	(2,954)	1,845
HP finance leases initiated		0	0	0	0	0	0
Other		202	(1,114)	0	0	0	0
Closing net debt/(cash)		(5,879)	(3,307)	(3,968)	(2,954)	1,845	(1,103)

Source: Company accounts, Edison Investment Research

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