EDISON

Euromax Resources

Site visit, elections, permits

Maximising Europe

Metals & mining

Ilovica-Shtuka is a large project (ultimately it will account for 1-2% of Macedonian GDP) in a poor area of Europe with high unemployment. Now that parliamentary elections are completed, the stage is set for Euromax to raise equity and for the government to grant final construction permits early in CY17.

Year end	Revenue (C$m)	PBT* (C$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
12/14	2.7	(6.6)	(7.8)	0.0	N/A	N/A
12/15	4.7	(8.4)	(7.2)	0.0	N/A	N/A
12/16e	3.8	(10.3)	(10.8)	0.0	N/A	N/A
12/17e	0.0	(41.8)	(18.9)	0.0	N/A	N/A

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

Macedonian elections and permitting expectations

Macedonia held elections on 11 December, in which the incumbent coalition was returned with a majority of one out of a total of 120 parliamentary seats. While the election had been seen as a delaying factor for construction permits, the eventual granting of the permits was never perceived to be in doubt, given that both main parties in the election had voiced their support for the project. Nevertheless, the continuity afforded by the incumbent government's victory should be helpful in expediting the process and Euromax now expects final construction permits to be granted early in 2017.

Financing underway

Euromax's C$8.9m net debt as at end September 2016 will be more than offset by the C$35m (US$26.3m) in equity that it is in the process of raising. All told, we estimate the company will raise US$100m (or C$133.0m) in pre-production equity, in which case net debt (excluding the contingent liability relating to its Royal Gold streaming agreement) will peak at C$263.5m (US$198.1m) in FY18 – equating to a contemporary leverage (debt/[debt+equity]) ratio of 92.4%. If Euromax instead decides to maximise its debt funding capability, however, we estimate that only C$79.3m (US$59.6m) in equity will need to be raised.

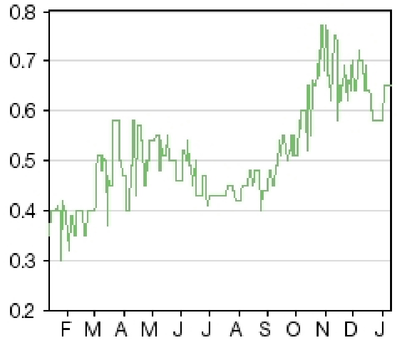
Valuation: From C$1.05/sh to C$1.37/sh

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$1.37/sh vs C$1.05/sh at the time of our last update note – the increase being primarily attributable to the increase in Euromax's share price since achieving a main board listing on the TSX and the consequent reduction in assumed future dilution. This valuation has the potential to increase to C$1.68/sh if management decides to maximise its debt potential, although it does so in conjunction with a self-evident increase in financial risk. 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 cf Euromax's current market capitalisation of c US$56m.

10 January 2017

Price	**C$0.64**
Market cap	**C$75m**
	C$1.3300/US$
Net debt* (C$m) at end September 2016 *Excludes liability relating to streaming agreement with Royal Gold.	8.9
Shares in issue	116.8m
Free float	47%
Code	EOX
Primary exchange	TSX
Secondary exchange	N/A

Share price performance



%	1m	3m	12m
Abs	(7.1)	8.3	85.7
Rel (local)	(7.6)	2.5	50.2
52-week high/low		C$0.8	C$0.3

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

Final construction permits	Q117
Construction begins	H117

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Edison profile page

Euromax Resources is a research client of Edison Investment Research Limited

Site visit

Euromax hosted a visit to the Ilovica-Shtuka site in November 2016; the following is a summary of the salient points.

Post-feasibility optimisation

Euromax released the results of the definitive feasibility study (DFS) on Ilovica-Shtuka on 6 January 2015. The study was conducted by Amec Foster Wheeler, Tetra Tech, DMT, Golder Associates and Schlumberger, among others, and calculated pre- and post-tax NPVs of US$513.0m and US$440.1m, respectively, at a 5% discount rate and long-term metal prices of US$1,220/oz Au and US$2.90/lb Cu. Corresponding internal rates of return were 19.8% and 17.8%. Capex was lower than in Euromax's 2014 pre-feasibility study, at US$474.3m vs US$501.8m. Updated World Gold Council-defined adjusted operating cash costs were estimated to be US$200/oz and all-in costs to be US$372/oz (after Cu credits), which should put Ilovica-Shtuka well within the industry's lowest-cost quartile.

The well-known mining consultant SRK has subsequently optimised the feasibility study. While exact details of the revisions are not known, a summary of key points is as follows:

- The mine plan has been updated so that it identifies working benches on a monthly level of detail and dovetails correctly with the tailings embankment raises, which utilise mine waste rock.
- The key effect resulting from the updated mining plan is reported to be the strip and pre-strip in early years, which has been adjusted to allow the mining of more waste, earlier, to reflect the lack of ore in the upper levels of the pit (effectively just below a ridge at the top of a moderately steep hill) – in part as a result of the decision to classify oxide material as waste. The overall effect of this adjustment is marginal however, with the strip ratio increasing from 1:1 to just 1.1 to one.
- Throughput is unchanged at 10Mtpa. However, it will now be achieved with a smaller fleet. Whereas it had been assumed to employ two hydraulic shovels with a fleet of up to 19 rigid dump trucks, the mining schedule is now assumed to be achieved using an up-scaled fleet comprising one shovel and 10 trucks of larger size (although not the largest size). Note that the possibility still remains to use smaller shovels and (possibly) smaller trucks from years 10 and 11 of a 19-year mine life.
- In part, the need for a smaller fleet of higher tonnage trucks can be justified by the decision to employ a high angle (sandwich) conveyor belt to convey ore from the bottom of the pit to the plant stockpile instead of trucking it, which was taken after the conclusion of a trade-off study between the two.

The economic consequences of the optimisation

Costs are continually updated as engineering advances. In the most recent iteration, capex costs and mining costs are said to have increased, primarily as a result of the up-scaling of the mining fleet. In the meantime however, initial bids returned on the mills and crusher indicated that capex relating to process equipment will be significantly reduced.

The team behind the team

Euromax's feasibility study and front-end engineering & design process was conducted by AMEC Foster Wheeler for plant and process design, DMT and SRK for mining, Golder Associates and Skopje University for tailings management, SGS for metallurgy and Tetra-Tech for geology.

Since then, Euromax has invited tenders for EPCM and/or EPC contracts relating to the construction and management of the process plant. A number of existing and new contractors are reported to have tendered bids in this process. In the meantime, Ilovica's funding consortium of banks has retained Runge Pincock Minarco (RPM) as its independent engineering consultant and D'Appolonia as its environmental consultant.

Engineering, technical and geotechnical matters

In general, many design features of the Ilovica-Shtuka pit are controlled by the topography of the area. Nevertheless, in common with the mine plan, SRK has also significantly updated the analysis around the pit's geotechnical parameters. In the first instance, this has involved recognising six different mining domains, compared to the one initially assumed. Among other things, this allows it to apply more appropriate geotechnical criteria to its ultimate design features. While drilling to this end is ongoing and the process has yet to be finalised, one immediate effect is that has resulted in a flattening off of the pit slopes from 43° to 37°. In addition, it has also resulted in SRK identifying intermittent (albeit impure) clay in a specific fault contact zone, 150m down into the pit, which will have to be allowed for in the pit's eventual bench design.

Tailings storage facility

In simple terms, the tailings storage facility (TSF) for the Ilovica-Shtuka mine will be located in the adjacent valley. This is being configured as a rock-filled, down-stream raised engineered waste dump. Since it is in an area designated an earthquake area, it therefore also needs compaction, to which end it has been decided to adopt a pallet dumping method of deposition.

Infrastructure

Water

Water infrastructure in the region includes the small Ilovica reservoir in the immediate vicinity as well as a larger (under-utilised) one some 15km away. Euromax is currently working with the local water company on plans to install a pipeline between the two to allow water to be pumped from the larger reservoir to the smaller one. This will beneficiate the local water supply and improve the quality of drinking water. It will also allow Euromax to use the smaller reservoir as an effective holding dam for water for its mining and processing operations. In addition to the existing reservoirs, Euromax is also drilling in the valley to establish the potential for groundwater in line with the terms of its environmental requirements.

Electricity

Under the terms of its long-term power purchase agreement with the electricity utility company, MEPSO, Euromax is designated a 'qualified consumer', which gives it direct access to high voltage grid power.

Logistics

The plant's ultimate products are gold doré bars and a copper-gold concentrate. Gold doré will be transported using a dedicated security service. In the meantime, the copper-gold concentrate output will be transported to Pirdop in Bulgaria for smelting using 20 30t trucks. Initially, Euromax will build a temporary road over state land to accommodate this transportation requirement. The road will be constructed on a 'lease, rehab and return' basis. In due course however, Euromax plans a new, permanent, dedicated road to be built over private land from the mine site to Macedonia's main arterial road link to Bulgaria.

Legal

Macedonia has a dry, mild climate and the Ilovica-Shtuka project is located on the slopes of a relatively steep hill covered in (largely) Mediterranean oak bushes, which are generally no more than about 10 feet tall. It is therefore typically used by villagers as a source of firewood.

The majority of the land underlying Euromax's area of operations is state owned. However, some of the state parcels are co-owned with private owners via inheritance and Euromax's strategy has been to trace these owners and to settle compensation with them, with compulsory purchase as a last resort.

Politics and permitting

Ilovica-Shtuka is a relatively large project for both the region and the country (it will account for between 1-2% of Macedonian GDP alone), situated in a poor area with high unemployment. As a result, there has been no opposition to the project from any quarter and no objections have been raised by any NGOs. After its exploitation licence was granted in 2013, Euromax opened an Information Centre in Ilovica and has been operating an 'open house' consultation policy with respect to the project. The company reports most of the enquiries at the centre to date have concerned employment.

In the meantime, 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 after being accused by the leader of the opposition of wiretapping tens of thousands of Macedonian citizens. Gruevski denied any culpability in the affair. 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, giving the government a technical majority of one. Election observers from the Organization for Security & Co-operation in Europe 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. Nevertheless, the continuity afforded by the incumbent government's victory should be helpful in expediting the process and Euromax now expects final construction permits to be granted early in 2017.

Environment

In general, Ilovica-Shtuka is situated in the drier east of the country. Owing to its location in a mountainous region however, it attracts above average rainfall of c 600-700mm per annum, albeit this is comparable to London (c 600mm per annum) and significantly less than New York City (c 1,270mm per annum). As noted previously, water infrastructure in the region includes two reservoirs, which the local water company plans to link. In addition, Euromax is also drilling in the valley to establish the potential for groundwater supplies. Euromax submitted its Environmental Impact Assessment to the Macedonian Ministry of Environment in H116 as the first step towards its international Environmental & Social Impact Assessment (ESIA). Whereas the ESIA requires a long-term water management plan, there is no such practical requirement at a local level. In addition, there are very few reclamation requirements at the mine site, other than to strip out the remaining equipment at the end of the life of the mine and to re-vegetate the area.

With respect to fauna, the only impediment to the mine appears to be that the region is a prime butterfly area. As a result, Euromax is conducting a study, presided over by a local academic and lepidopterist, including the potential to designate a neighbouring region as a prime butterfly area in mitigation.

Geology

Ilovica-Shtuka is located on the Tethyan magmatic arc that covers large areas of central Romania, Serbia, Macedonia, Bulgaria, Greece and Turkey. It is associated with a poorly exposed dacite-granodiorite plug on the north-eastern border of the Strumica graben and was previously explored by the Geological Institute of Macedonia. At surface the Ilovica intrusive complex consists of a central dacitic breccia diatreme that has been intruded by at least one dacite and two granodiorite porphyry stocks that have generated several hydrothermal pulses, resulting in widespread, multi-phase veining at depth within a mineralised stockwork with granodiorite (below) and dacite (above). The plug is hosted within granite, which is easily identified by an absence of trees.

As with many such systems, material blue-sky geological upside exists if Euromax can identify and delineate the underlying feeder zone.

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:

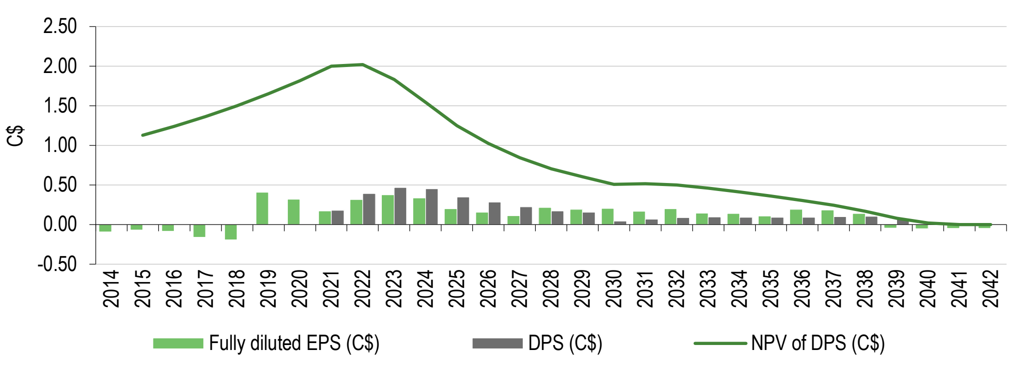
Exhibit 1: Ilovica-Shtuka funding, by type

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

On the basis of the existing BFS parameters (ie making no allowance for the subsequent optimisation) and assuming a notional US$100m equity raise in the form of 207.8m shares at the prevailing share price of C$0.64 per share and forex rate of C$1.3300/US$), we estimate a value for Euromax's shares of C$1.37 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$2.02 in 2022, when conventional debt (ie excluding the Royal Gold stream) is 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 in the DFS implies future potential (fully diluted) EPS as high as C$0.41/share and average (fully diluted) EPS of C$0.21/share, which compares favourably with Euromax's current share price of C$0.64.

Stated alternatively, despite the recent rise in its share price, investors buying Euromax shares at the current price of C$0.64/share may still expect a 23.3% internal rate of return from their investment in Canadian dollar terms over 24 years (cf 21.7% at the time of our last note, when the share price was C$0.50/sh).

A summary of the components in the evolution of our updated valuation of Euromax compared with that in our last update note of C$1.05/share is as follows:

Exhibit 3: Euromax valuation revision factors (C$/share)

	Valuation (C$/sh)	Change (C$/sh)
Prior valuation	**1.05**	
■ Updated forex rates and share price	1.54	+0.49
■ Updated gold prices*	1.32	-0.22
■ Progression of time	1.46	+0.14
■ Other**	1.37	-0.09
Current valuation	**1.37**	

Source: Edison Investment Research. Note: *See Edison's report, Gold and other metals, Normalisation augers well for exploration, published in October 2016; **Primarily Q216 & Q316 results.

Financials

Excluding the contingent liability relating to its streaming agreement with Royal Gold, Euromax had C$8.9m of net debt as at end-September 2016. The company is in the process of raising C$35m (US$26.3m) in equity and we assume it will raise an additional C$98.0m (US$73.7m) in the foreseeable future to bring the total to US$100m (or C$133.0m), 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, we estimate that net debt (excluding the contingent liability relating to its Royal Gold streaming agreement) will increase to peak at C$263.5m (US$198.1m) in FY18 – equating to a contemporary leverage (debt/[debt+equity]) ratio of 92.4% – before reducing under the influence of positive operational cash flows until it is eliminated in FY21.

Note that this estimated C$263.5m, or US$198.1m, net debt requirement is below the figure of US$240m (C$319.2m) for which Euromax's consortium of financial partners has been mandated. If Euromax instead decides to maximise its debt funding capability, it would require the raising of only C$79.3m (US$59.6m) in equity (ie 123.9m shares issued at C$0.64/sh) and would result in a 22.6% uplift in our valuation of Euromax's shares (albeit with proportionately greater financial risk) to C$1.68/share.

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Exhibit 4: Financial summary

C$'000s	2011	2012	2013	2014	2015	2016e	2017e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS							
Revenue	0	0	0	2,695	4,729	3,753	0
Cost of Sales	0	0	0	(2,251)	(4,005)	(3,013)	0
Gross Profit	0	0	0	444	724	740	0
EBITDA	(2,521)	(4,973)	(5,276)	(6,366)	(7,749)	(9,342)	(10,512)
Operating Profit (before amort. and except.)	(2,611)	(5,056)	(5,375)	(6,492)	(7,917)	(9,510)	(41,622)
Intangible Amortisation	0	0	0	(21)	(19)	(11)	0
Exceptionals	(40)	59	(1,806)	(4,186)	(1,979)	(569)	0
Other*	(835)	(428)	(835)	4	24	(2,295)	0
Operating Profit	(3,485)	(5,425)	(8,015)	(10,695)	(9,891)	(12,385)	(41,622)
Net Interest	0	0	(17)	(127)	(434)	(816)	(211)
Profit Before Tax (norm)	(2,611)	(5,056)	(5,392)	(6,619)	(8,351)	(10,326)	(41,832)
Profit Before Tax (FRS 3)	(3,485)	(5,425)	(8,033)	(10,822)	(10,325)	(13,201)	(41,832)
Tax	0	(33)	(30)	(25)	(47)	(20)	0
Profit After Tax (norm)	(2,514)	(4,947)	(5,414)	(6,640)	(8,374)	(12,641)	(41,832)
Profit After Tax (FRS 3)	(3,485)	(5,458)	(8,063)	(10,847)	(10,372)	(13,221)	(41,832)
Average Number of Shares Outstanding (m)	48.0	63.4	82.6	85.3	115.8	116.8	220.7
EPS - normalised (c)	(5.2)	(7.8)	(6.6)	(7.8)	(7.2)	(10.8)	(18.9)
EPS - normalised and fully diluted (c)	(4.5)	(6.7)	(5.8)	(5.7)	(5.4)	(8.1)	(16.1)
EPS - (IFRS) (c)	(7.3)	(8.6)	(9.8)	(12.7)	(8.9)	(11.3)	(18.9)
Dividend per share (c)	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	19.7	N/A
EBITDA Margin (%)	N/A	N/A	N/A	N/A	N/A	-248.9	N/A
Operating Margin (before GW and except.) (%)	N/A	N/A	N/A	N/A	N/A	-253.4	N/A
BALANCE SHEET							
Fixed Assets	11,929	17,084	18,015	16,641	29,696	37,749	316,058
Intangible Assets	0	0	29	430	514	503	503
Tangible Assets	11,929	17,084	17,985	16,211	29,182	37,246	315,555
Investments	0	0	0	0	0	0	0
Current Assets	2,798	3,341	6,290	3,180	4,871	1,547	30,105
Stocks	0	0	0	0	0	313	0
Debtors	776	1,579	608	199	1,056	1,234	0
Cash	2,022	1,762	1,335	2,110	3,478	0	30,105
Other	0	0	4,346	871	337	0	0
Current Liabilities	(530)	(749)	(1,208)	(5,831)	(5,443)	(12,796)	(15,696)
Creditors	(530)	(749)	(1,208)	(4,996)	(5,443)	(9,287)	(13,401)
Short term borrowings	0	0	0	(835)	0	(3,510)	(2,295)
Long Term Liabilities	0	0	0	0	(15,596)	(26,396)	(239,196)
Long term borrowings	0	0	0	0	(15,596)	(26,164)	(238,964)
Other long term liabilities	0	0	0	0	0	(232)	(232)
Net Assets	14,198	19,675	23,096	13,990	13,528	104	91,271
CASH FLOW							
Operating Cash Flow	(1,966)	(5,178)	(4,496)	(2,494)	(5,765)	(6,805)	(5,062)
Net Interest	0	0	(17)	(18)	(144)	0	0
Tax	0	0	(35)	(26)	(93)	(20)	0
Capex	(5,245)	(6,947)	(5,047)	(2,122)	(12,956)	(8,232)	(309,419)
Acquisitions/disposals	0	1,468	1,041	3,023	705	0	0
Financing	7,907	10,479	7,961	(74)	5,255	(203)	133,000
Dividends	0	0	0	0	0	0	0
Net Cash Flow	696	(178)	(594)	(1,711)	(12,998)	(15,260)	(181,480)
Opening net debt/(cash)**	(1,253)	(2,022)	(1,762)	(1,406)	(1,275)	12,118	29,673
HP finance leases initiated	0	0	0	0	0	0	0
Other	73	(83)	167	1,580	(395)	(2,295)	0
Closing net debt/(cash)*	(2,022)	(1,762)	(1,335)	(1,275)	12,118	29,673	211,153

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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