EDISON

Orosur Mining

Q216 results

Cost cutting supports AISC at/below US$1,000/oz

Metals & mining

With wide-ranging material cost-cutting initiatives completed or underway (including government suspension of royalties for one year) and gold production ahead of target, Orosur is well positioned to return to profitability during H216. San Gregorio (SG) Deeps is advancing through permitting, and de-watering of the pit has been completed to allow for extraction of an initial 1,500oz and also preliminary underground development works. While profitable production and cost cutting at SG remains the key focus, Orosur is investigating potential third-party opportunities to develop and or complement its non-core assets within Uruguay and Columbia.

Year end	Revenue (US$m)	PBT* (US$m)	EPS* (c)	DPS (c)	P/E (x)	Yield (%)
05/14	80.4	4.5	6.6	0.0	1.2	N/A
05/15	65.9	(6.2)	(56.3)	0.0	N/A	N/A
05/16e	41.2	0.6	0.3	0.0	25.4	N/A
05/17e	52.2	12.7	9.9	0.0	0.8	N/A

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

Cash costs and AISC down by c US$100/oz

SG produced 8,172oz in Q216, a 34% decrease on Q116's production of 12,471oz. Gold production was achieved at cash operating costs of US$858/oz, a 10% reduction q-o-q (Q216: US$954/oz). All-in sustaining costs (AISC) reduced 6.0% from US$1,166/oz to US$1,095/oz. Further cost cutting is due, which we understand from discussions with management should support AISC reducing to at or below US$1,000/oz for H216 and the potential for further unit cost reductions linked to mining higher grade ore at SG Deeps during FY17.

Safe haven demand for gold ETFs improves

Notwithstanding improving costs of production, profitability hinges on the gold price maintaining or improving from its current levels. An early 2016 rally in the gold price reached a level above US$1,100/oz and gold ETF inflows have also seen an increase for the first time since August 2015.

Valuation: Maintained due to cost reductions

We have revised our valuation and forecasts to reflect Q1 and Q2 2016 results. We maintain our production profile such that production ramps up to 41koz in FY17 and FY18, reaching c 51koz of gold in FY19 and FY20. This production profile will be revised as Orosur completes optimisation studies on its mining projects at SG and is currently the main risk to our base case valuation. On this basis and using a 10% discount rate to reflect general equity risk and gold prices as per our September 2015 Outlook note, we maintain our tentative value of Orosur's shares at £0.28. At flat gold prices of US$1,000/oz and US$1,200/oz, this valuation becomes £0.05 and £0.18 respectively. We forecast Orosur will turn a small net profit at end FY16 of US$0.3m driven by it cutting costs and achieving 35koz of gold production sold at an average FY16 gold price of US$1,086/oz.

20 January 2016

Price	**5.5p**
Market cap	**£5m**
	US$/£:1.43
Net cash (US$m)	1.8
Shares in issue	96.6m
Free float	86%
Code	OMI
Primary exchange	TSX
Secondary exchange	AIM

Share price performance

%	1m	3m	12m
Abs	(6.4)	(10.2)	(51.1)
Rel (local)	(3.0)	(3.5)	(46.4)
52-week high/low		C$12.50	C$4.88

Business description

Orosur Mining owns (100%) and operates its San Gregorio gold mine in Uruguay. It also explores for gold close to San Gregorio and further afield in Chile, at the Anillo gold property. It also owns 100% of the newly acquired and highly prospective high-grade Anzá gold property in Colombia.

Next events

Q316 results	April 2016
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Production guidance maintained despite cost cutting

It is notable that while the gold price has decreased 4.2% q-o-q, Orosur's gross profit has remained at or around break even. This demonstrates the company's ongoing ability to reduce expenditures as well as maintaining its FY16 production guidance of 30-35koz. On 1 December 2015 Orosur announced a broad swathe of additional cost-cutting measures, comprising reductions in pay and in the workforce, and a reorganisation and streamlining of its management team. Further, the support of the Uruguayan government towards the country's only operating mine was shown in it waiving royalty payments altogether, for one year. In total, these measures are expected to save Orosur c US$2.0m (with the 3% government royalty calculated at a gold price of US$1,100/oz) in FY16.

Development works underway at SG to access UG resources

Two main development projects are underway at SG. The SG Deeps project is progressing through permitting, with a preliminary permit awarded by the Uruguayan environmental authorities in Q116, and the mining permit being applied for with the local mining authority. While permitting is finalised, Orosur has de-watered the historical SG open pit (this being the original open pit for the SG gold mine). With the pit de-watered, Orosur will extract an initial 1,500oz of gold from the bottom of the historic pit before undertaking preliminary underground (UG) development works, which will comprise connecting the main pit ramp with the designed portal to the underground phase. Material excavated to complete these works carries a grade of between 2g/t and 5g/t (based on limited sampling).

The SG Deeps project is planned to enter its main production phase during Q117 and provide the majority of FY17 gold production.

The second development project is the testing of an extension to the existing Arenal Deeps underground mine. Arenal Deeps has provided the majority of gold production at SG and its structure and geology is therefore well known. The deposit is known to pinch and swell and this knowledge underpins the current scope of works. To complete the investigation of the down-dip extension of Arenal Deeps, a 90m-long tunnel has been driven to provide for suitable drill positions, a standard exercise in underground mines. A 1,100m drill campaign was initiated on 15 December 2015 and is expected to be completed by April 2016.

If an appropriately sized gold resource is defined down-dip of the current Arenal Deeps workings, Orosur intends to develop on to it during FY17.

Chilean greenfield exploration ongoing at no cost to Orosur

Orosur's Anillo project JV partner, Asset Chile (AC), is solely funding the exploration of the project. Under the terms of the November 2014 non-binding farm-in contract, AC is required to provide a decision to Orosur about whether it will initiate tranche two funding totalling US$1.2m by end FY16. While information on the potential for Anillo to mirror that of the world-class projects located nearby (see below) is not yet conclusive, the fact that Orosur is managing to stay active in greenfield exploration at no cost to its own balance sheet is a clear advantage when most of the precious metals miners are significantly decreasing or stopping exploration. Exploration activities will also be married to current and longer-term market conditions/projections, which will likely mean that the resource definition will result in a more robust estimate of in-situ metal content than was achieved during the boom years (resource and reserves estimates have been continually written down in parallel with decreasing metal prices). With global gold production thought to have peaked for the current commodity cycle, the paring back in global exploration spend ultimately leads to an increasingly under-capitalised precious metals sector. Such a situation only provides support to maintaining exploration activities wherever possible.

Anillo sits within Region 2 of Chile, an area host to world-class precious metals mines including Yamana's (NYSE:AUY) El Peñon underground gold-silver mine, which operates on a cash-cost basis of US$676/oz Au and US$8.39/oz Ag (30 October 2015 Yamana presentation). El Penon, at 31 December 2014, had proven and probable reserves of 1.7Moz of gold and 58.1Moz of silver.

A detailed description of the Anillo Project, commitments and timelines are provided on page 6 of our September Outlook note.

Development of non-core assets being looked into

As an indication that Orosur's management is not just content with producing gold at SG, it is also actively looking into how to progress its assets outside of the Isla Cristalina belt (on which the SG gold mine is situated) and also within Columbia. At this stage no capital has been allocated and assessment is purely conceptual in nature.

Orosur's management states that for its non-core (to operations at SG) assets outside the Isla Cristalina belt in Uruguay, it may consider agreeing deals whereby third parties are brought in to develop ore reserves of small volumes but high-grade for treatment at the SG processing plant. This would provide cash flow to Orosur without having to incur costly exploration expenditures or capex. However, we highlight that the company would need to structure deals so as not to negatively affect its unit cost base.

Its Columbian asset Anza is highly prospective for high-grade narrow veined gold and minor base metal deposits. Orosur is investigating how to progress this asset and envisages any such development would incur very low capex with a very quick pay-back period.

Sprott ETF holdings increase first time since August 2015

The Sprott managed SPDR Gold ETF constitutes (as of 14 January 2016) 44.1% of the total known ETF gold holdings recorded by Bloomberg. As such, the Sprott ETF is an important measure of capital investment into this asset type. Significantly, holdings in this ETF increased 3.1% month-on-month at 14 January 2016, with 624,591oz of gold added. This is the first such increase in this fund since August 2015. Continued investment into gold-backed ETFs will only serve to provide support to the gold price and bolster gold's image as a safe-haven investment.

Valuation

Our valuation is maintained at £0.28 per share on incorporating H1 results. We have maintained our production profile (ramping to 41koz gold in FY17/FY18 and 51koz in FY19/FY20) but note that the key risk to our valuation lies in any revision to this as Orosur completes optimisation studies on its mining projects at SG. We have slightly adjusted our gold price assumption to reflect December's actual average gold price of US$1,068/oz (previously US$1,164/oz), we retain all other gold price assumptions as per our September 2015 Outlook note.

For guidance on end FY16 and FY17 net cash positions at US$1,050/oz and US$1,100/oz gold prices, please see the financials section below.

Financials

Orosur's end Q216 cash position was US$2.6m, a reduction of US$2.0m from its end Q116 cash balance of US$4.6m and relates to normal operational expenditures paired with a falling gold price during H116. We forecast that as long as the gold price is maintained at around current levels, based on production costs and expenditures (see below), then the company should finish FY16 with cash of US$2.7m.

Further, from our discussions with management we highlight that during H216:

- All-in-sustaining costs of production are expected to stabilise slightly below US$1,100/oz for the remainder of FY16.
- Development capex should be at a similar level to H116, that is, c US$1.8m for an end FY16 total of US$3.5m.
- Exploration expenditures should also mirror H116's of US$1.6m leading to our end FY16 total of US$3.2m.
- No further restructuring costs (associated with Orosur's reduction in workforce) are envisaged
- With Pantanillo already fully impaired in FY15, the company sees no further material impairments. Some further small impairments relating to exploration expenditures may occur and will be dependent on the gold price.

Our end FY16 and FY17 estimated net cash positions based on our house gold price deck are US$2.7m and US$13.5m respectively. Using a flat gold price of US$1,050/oz these become US$2.5m and US$8.5m, and at a flat gold price of US$1,100/oz become US$2.7m and US$10.0m respectively. These projections are based on gold production in FY16 of 35koz (the upper end of the 30-35koz production guidance, which now looks eminently achievable based on gold production year to date) rising to 41koz (plus immaterial amounts of silver of c 48koz) in FY17. Note that the FY17 production figure is our estimate and we await management's guidance on this post FY16 year end.

Exhibit 1: Financial summary

	US$'000s	2013	2014	2015	2016e	2017e
31-May		IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue		105,884	80,370	65,868	41,156	52,226
Cost of Sales		(97,657)	(72,905)	(69,715)	(44,474)	(48,492)
Gross Profit		8,227	7,465	(3,847)	(3,317)	3,734
EBITDA		22,663	23,935	10,708	7,536	23,940
Operating Profit (before amort. and except.)		2,951	5,197	(5,861)	536	12,647
Intangible Amortisation		0	0	0	0	0
Exceptionals		(18,339)	(869)	(43,164)	(22)	0
Other		0	0	0	0	0
Operating Profit		(15,388)	4,328	(49,025)	514	12,647
Net Interest		(253)	(666)	(376)	66	54
Profit Before Tax (norm)		2,698	4,531	(6,237)	602	12,700
Profit Before Tax (FRS 3)		(15,641)	3,662	(49,401)	580	12,700
Tax		816	1,461	(4,975)	(318)	(3,175)
Profit After Tax (norm)		(14,825)	5,123	(54,376)	261	9,525
Profit After Tax (FRS 3)		(14,825)	5,123	(54,376)	261	9,525
Average Number of Shares Outstanding (m)		78.1	78.1	96.6	96.6	96.6
EPS - normalised (c)		(19.0)	6.6	(56.3)	0.3	9.9
EPS - normalised fully diluted (c)		(19.0)	6.6	(56.3)	0.3	9.9
EPS - (IFRS) (c)		(19.0)	6.6	(56.3)	0.3	9.9
Dividend per share (p)		0.0	0.0	0.0	0.0	0.0
Gross Margin (%)		7.8	9.3	-5.8	-8.1	7.1
EBITDA Margin (%)		21.4	29.8	16.3	18.3	45.8
Operating Margin (before GW and except.) (%)		2.8	6.5	-8.9	1.3	24.2
BALANCE SHEET						
Fixed Assets		84,644	79,278	34,992	34,730	32,026
Intangible Assets		37,323	41,955	18,330	21,552	24,796
Tangible Assets		47,321	37,323	16,662	13,178	7,230
Investments		0	0	0	0	0
Current Assets		25,124	28,410	20,925	7,815	20,021
Stocks		15,715	14,254	14,362	3,430	4,352
Debtors		3,776	3,338	1,775	1,709	2,169
Cash		5,633	10,818	4,788	2,676	13,500
Other		0	0	0	0	0
Current Liabilities		(20,837)	(17,919)	(15,073)	(3,192)	(3,169)
Creditors		(16,665)	(13,941)	(13,944)	(3,192)	(3,169)
Short term borrowings		(4,172)	(3,978)	(1,129)	0	0
Long Term Liabilities		(10,971)	(6,789)	(6,958)	(6,606)	(6,606)
Long term borrowings		(4,823)	(961)	(352)	0	0
Other long term liabilities		(6,148)	(5,828)	(6,606)	(6,606)	(6,606)
Net Assets		77,960	82,980	33,886	32,747	42,272
CASH FLOW						
Operating Cash Flow		21,485	22,767	11,753	6,321	19,360
Net Interest		(253)	(666)	(376)	66	54
Tax		0	0	0	0	0
Capex		(30,325)	(13,062)	(12,835)	(7,077)	(8,589)
Acquisitions/disposals		0	0	0	0	0
Financing		70	0	0	0	0
Dividends		0	0	0	0	0
Net Cash Flow		(9,023)	9,039	(1,458)	(690)	10,824
Opening net debt/(cash)		(5,238)	3,362	(5,879)	(3,307)	(2,676)
HP finance leases initiated		0	0	0	0	0
Other		423	202	(1,114)	59	0
Closing net debt/(cash)		3,362	(5,879)	(3,307)	(2,676)	(13,500)

Source: Company accounts and Edison Investment Research

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