Endeavour Mining

Q121 results analysis

Showing its mettle as well as its metal

Metals & mining

Endeavour's Q121 financial results exceeded our expectations and were towards the top end of the range of analysts' forecasts. In summary, Endeavour produced c 20% more gold than we expected during the quarter and sold c 30% more. This (positive) variance was then partially offset by a fractionally higher (negative) variance in operating expenses (albeit these were artificially inflated by US$22.6m of non-cash operating expenses) to give rise to a positive variance in adjusted net earnings attributable to shareholders from continuing operations of 16.6% relative to our prior expectations (see Exhibit 1). Perhaps more significantly, the results demonstrate that the integration of the Teranga assets into Endeavour's portfolio is progressing smoothly (as expected) ahead of the latter's London listing next month.

Year end	Revenue (US$m)	EBITDA (US$m)	PBT* (US$m)	Op. cash flow per share (US$)	DPS (c)	Yield (%)
12/19	1,362.1	618.4	220.4	3.30	0	N/A
12/20	1,847.9	910.3	501.2	5.35	37	1.5
12/21e	2,758.1	1,386.6	788.1	3.65	37	1.5
12/22e	2,495.1	1,417.3	931.0	4.78	250**	10.2

Note: Pro forma basis. *PBT is normalised, excluding amortisation of acquired intangibles and exceptional items. **Maximum possible.

Four factors behind outperformance

While a number of factors can be invoked to explain both the operational and financial outperformance of Endeavour's mines, in general it may be reduced to four main factors: higher ore tonnes mined, generally; higher tonnes milled, stacked and/or processed (with the single exception of Agbaou); higher average head grade at Boungou; and well controlled unit costs across the portfolio (again, with the only real exception being those recorded at Agbaou).

Valuation: US$35.66/share or C$42.95/share

Based on the average multiples of its peers, we estimate a valuation for Endeavour of US$35.11, or C$42.29, per share, implying the potential for its shares to appreciate 46.4% from their current level. By contrast, an absolute valuation methodology, whereby we discount back six years of cash flow and then apply an ex-growth, ad infinitum multiple of 10x to steady-state terminal cash flows in FY26 (consistent with using a standardised discount rate of 10%), implies a terminal valuation of US$39.96/share. This (in conjunction with forecast intervening cash flows) discounts back to a current valuation of US$35.66 (C$42.95) per share at the start of FY21 (cf US$35.98 and C$45.08 previously – albeit the decline in the Canadian dollar valuation arises solely from the appreciation of the C$ cf the US$), implying the potential for the share price to appreciate by 48.7% from its current level. Alternatively, applying the same methodology, but using a CAPM-derived discount rate of 6.7% (still conservative, but arguably more appropriate) implies a terminal valuation of US$60.05/share and a current valuation of US$55.39/share, implying 130.9% appreciation potential. In the meantime, Endeavour is trading at a discount to the average multiples of its peers on almost all common valuation measures (see Exhibit 8).

28 May 2021

Price	**C$28.89**
Market cap	**C$7,297m**
	C$1.2045/US$
Net debt (US$m) at end-March 2021*	173.9
*Excludes convertible premium	
Shares in issue (000s)	252,568
Free float	75.2%
Code	EDV
Primary exchange	TSX
Secondary exchange	US OTC

Share price performance

%	1m	3m	12m
Abs	7.8	18.7	(4.7)
Rel (local)	4.5	8.4	(26.4)
52-week high/low		C$38.85	C$23.58

Business description

Following its acquisitions of SEMAFO and Teranga, Endeavour has become one of the top 10 major gold producers globally, with seven mines in Côte d'Ivoire, Burkina Faso and Senegal plus a portfolio of development projects, all in the West African Birimian greenstone belt.

Next events

Capital Markets Day	7 June 2021
LSE listing	c 14 June 2021
Afema maiden resource	H121
Sabodala-Massawa DFS	Q421
Fetekro DFS	Q421

Analyst

Charles Gibson +44 (0)20 3077 5724

mining@edisongroup.com

Edison profile page

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Investment summary

A full analysis of Endeavour's Q121 results relative to our prior forecasts is provided below:

Exhibit 1: Endeavour Mining Q121a cf prior forecasts (as reported and estimated pro forma)

US$000s (unless otherwise indicated)	Prior estimates (Q121e)				Actual	Variance		Est Q121a	Variance	
	Reported	Pro forma	Agbaou	Reported ex-Agbaou	Q121a	(%)	(units)	(pro forma)	(%)	(units)
Houndé production (koz)	56.2	56.2		56.2	66.1	17.5	9.9	66.1	17.5	9.9
Agbaou production (koz)	16.7	16.7	16.7	0.0		N/A	0.0	12.6	-24.6	-4.1
Karma production (koz)	17.3	17.3		17.3	21.6	24.7	4.3	21.6	24.7	4.3
Ity production (koz)	51.2	51.2		51.2	70.9	38.4	19.7	70.9	38.4	19.7
Boungou production (koz)	42.2	42.2		42.2	59.7	41.6	17.5	59.7	41.6	17.5
Mana production (koz)	43.6	43.6		43.6	52.4	20.2	8.8	52.4	20.2	8.8
Sabodala-Massawa	43.4	80.7		43.4	38.9	-10.3	-4.5	75.0	-7.1	-5.7
Wahgnion	22.4	41.7		22.4	24.7	10.1	2.3	43.0	3.1	1.3
Total gold produced (koz)	293.1	349.6		276.3	334.3	21.0	58.0	401.2	14.7	51.6
Total gold sold (koz)	293.1	349.6		276.4	363.5	31.5	87.1	432.0	23.6	82.4
Gold price (US$/oz)	1,768	1,772		1,768	*1,749	-1.1	-19	1,763	-0.5	-9.0
Mine level cash costs (US$/oz)	693	683		693	**794	N/A	N/A	643	-5.9	-40.0
Mine level AISC (US$/oz)	979	956		979	837	-14.5	-142	818	-14.4	-138.0
Revenue										
– Gold revenue	518,302	619,558	29,980	488,322	635,792	30.2	147,470	761,448	22.9	141,890
Cost of sales										
– Operating expenses	203,147	238,839	15,478	187,669	251,112	33.8	63,443	300,140	25.7	61,301
– Royalties	34,276	40,201	1,709	32,567	44,366	36.2	11,799	51,280	27.6	11,079
Gross profit	280,879	340,518	12,793	268,086	340,314	26.9	72,228	410,028	20.4	69,510
Depreciation	(92,030)	(107,875)	(6,522)	(85,508)	(122,611)	43.4	(37,103)	(141,190)	30.9	-33,315
Expenses										
– Corporate costs	(9,833)	(11,168)		(9,833)	(11,409)	16.0	(1,576)	(12,726)	14.0	-1,558
– Impairments	0	0		0		N/A	0	0	N/A	0
– Acquisition etc costs	0	0		0	(12,160)	N/A	(12,160)	(12,160)	N/A	-12,160
– Share based compensation	(8,657)	(10,157)		(8,657)	(7,955)	-8.1	702	(9,436)	-7.1	721
– Exploration costs	(5,625)	(5,625)		(5,625)	(9,810)	74.4	(4,185)	(9,810)	74.4	-4,185
Total expenses	(24,115)	(26,950)		(24,115)	(41,334)	71.4	(17,219)	(44,132)	63.8	-17,182
Earnings from operations	164,733	205,693	6,271	158,462	176,369	11.3	17,907	224,707	9.2	19,014
Interest income				0						0
Interest expense	(14,829)	(14,829)		(14,829)	(12,318)	-16.9	2,511	(16,841)	13.6	-2,012
Net interest	(14,829)	(14,829)		(14,829)	(12,318)	-16.9	2,511	(16,841)	13.6	-2,012
Loss on financial instruments				0	42,077	N/A	42,077	42,077	N/A	42,077
Other expenses				0	(6,290)	N/A	(6,290)	(19,750)	N/A	-19,750
Profit before tax	149,904	190,864	6,271	143,633	199,838	39.1	56,205	230,192	20.6	39,328
Current income tax	45,286	58,886	1,568	43,718	72,148	65.0	28,430	81,321	38.1	22,435
Deferred income tax	0	0	0	0	8,688	N/A	8,688	8,688	N/A	8,688
Total tax	45,286	58,886	1,568	43,718	80,836	84.9	37,118	90,009	52.9	31,123
Effective tax rate (%)	30.2	30.9	25.0	30.4	40.5	32.9	10.0	39.1	26.5	8.2
Profit after tax	104,618	131,978	4,703	99,915	119,002	19.1	19,087	140,183	6.2	8,205
Net profit from discontinued ops.	0	0		4,703	(3,702)	-178.7	-8,405	0	N/A	0
Total net and comprehensive income	104,618	131,978	4,703	104,618	115,300	10.2	10,682	140,183	6.2	8,205
Minority interest	18,032	22,636	705	18,032	25,733	42.7	7,701	29,919	32.2	7,283
Minority interest (%)	17.2	17.2	15.0	17.2	22.3	29.5	5.1	21.3	24.1	4.1
Profit attributable to shareholders	86,586	109,342	3,997	86,586	89,567	3.4	2,981	110,264	0.8	922
Basic EPS from continuing ops (US$)	0.421	0.434	0.016	0.405	0.455	12.5	0.050	0.437	0.6	0.003
Diluted EPS from continuing ops (US$)	0.415	0.428	0.016	0.399	0.453	13.5	0.054	0.434	1.5	0.006
Basic EPS (US$)	0.421	0.434	0.016	0.421	0.431	2.3	0.010	0.437	0.6	0.003
Diluted EPS (US$)	0.415	0.428	0.016	0.415	0.428	3.2	0.013	0.434	1.5	0.006
Norm. basic EPS from cont. ops (US$)	0.421	0.434	0.016	0.405				0.318	-26.7	-0.116
Norm. diluted EPS from cont. ops (US$)	0.415	0.428	0.016	0.399				0.317	-26.0	-0.111
Adj net earnings attributable (US$000s)	93,751	117,757	3,997	89,754	104,686	16.6	14,932	135,156	14.8	17,399
Adj net EPS from continuing ops (US$)	0.456	0.467	0.016	0.437	0.503	15.2	0.066	0.535	14.6	0.068

Source: Endeavour Mining, Edison Investment Research. Note: *Includes adjustment for Karma stream. **Includes royalty payments.

In addition to Endeavour's actual reported Q121 results (in the 'Actual Q121a' column), we have also provided our best estimate regarding the equivalent pro forma results for Q121, in the event that the takeover of Teranga had occurred on 31 December 2020 and Sabodala-Massawa and Wahgnion had therefore contributed to its profit & loss account for the full three-month period, rather than merely the part-period since 10 February. To construct these notional pro forma Q121 results, we have made a number of assumptions, chief among them being that the over-sale of gold relative to production occurring in the period since 10 February also existed in the period from 1 January – that is, there was no corresponding under-sale from 1 January until 10 February. Otherwise, we assumed the unit costs that prevailed from 10 February until 31 March also prevailed during the entire period and that both sustaining capital and non-sustaining capital costs were incurred in the entire period pro rata to the costs incurred in the 10 February to 31 March one. Finally, we treated taxation independently for both Sabodala-Massawa and Wahgnion and added what we believed to have been payable in the period from 1 January to 10 February for both mines to what was otherwise disclosed as paid by the group for the three-month period. For earnings per share calculations, we assumed the quarter-end number of shares in issue of 252.6m shares prevailed over the entire period. All of this is shown in the Est Q121a pro forma column in Exhibit 1. We have also provided our prior estimates with Agbaou both fully consolidated and deconsolidated and shown as a separate line item.

In general, however, regardless of whether 'as reported' or 'pro forma' results are used, Endeavour produced c 20% more gold than our expectations in Q121 and sold c 30% more, giving rise to a positive variance in revenue of approximately 22.9–30.2%. This rise was then offset by a fractionally higher variance in operating expenses relative to our forecasts; however, it is worth noting that operating expenses, in both cases, were inflated by US$22.6m of non-cash operating expenses relating 'to the reversal…of the fair value adjustment of inventory on hand' at Sabodala-Massawa and Wahgnion in particular at the date of their acquisition. If these costs are excluded from the calculation, then the variance in operating expenses relative to our prior forecasts, in both cases, is less than the variance in associated revenues (note, these costs are automatically excluded in the calculation of adjusted net earnings from continuing operations attributable to shareholders). The variance in royalties, depreciation and exploration expenses was also greater than the variance in revenues and production. In the case of royalties, this reflected both higher royalty rates (in part, reflecting the gold price) as well as higher production. In the case of depreciation, this reflected both higher production (since Endeavour depreciates on a 'units of production' basis) and a normalisation of depreciation rates at Mana and Boungou in particular, after both were depressed in Q420 by the decision to retrospectively recognise goodwill in Endeavour's acquisition of SEMAFO and to treat it separately from the depreciation of the underlying assets. All of the above gave rise to a positive variance of 9.2–11.3% in earnings from operations relative to our prior forecasts. Endeavour's effective tax rate too was also higher than our prior expectations. In this case, however, much of the variance could be attributed to the inclusion of a deferred tax charge. If this too is excluded (as well as one-off, non-recurring and exceptional costs), it can be seen that the (positive) variance in adjusted net earnings attributable to shareholders relative to our prior expectations is 16.6% in the case of the 'as reported' numbers (ie with Sabodala-Massawa and Wahgnion included only since the date of their acquisition on 10 February) and 14.8% in the case of our estimate of Endeavour's pro forma results (ie with Sabodala-Massawa and Wahgnion included for the full three-month period).

Items included in the reconciliation between adjusted net earnings attributable and total net and comprehensive earnings are losses from discontinued operations, deferred income tax effects, gains/losses on financial instruments, other expenses, share-based compensation and acquisition costs (all shown independently in the table above), plus the tax impact of adjusting items, non-cash and other adjustments and the minority interest attributable to the adjusting items (not shown independently). Readers are reminded that Endeavour changed its definition of cash costs in Q420 to include royalties. The decision was made so Endeavour may be more consistent in reporting within the context of its peer group. For reasons of comparability with past results, however, as well as ease of forecasting (given that royalties are reported as a discreet item distinct from the balance of operating expenses), we (at least for the moment) are continuing to show total cash costs excluding royalties unless specifically indicated otherwise (eg the 'Actual' Q121a column in Exhibit 1).

As well as exceeding our forecast, at US$0.503/share, actual adjusted net EPS for the quarter were well to the top end of the range of analysts' expectations:

Exhibit 2: Actual Q121 adjusted net EPS from continuing operations vs prior consensus estimate (US$/share)

(US$/share)	Q121e	Q121a
Actual	N/A	0.50
Mean consensus forecast	0.42	N/A
High consensus forecast	0.53	N/A
Low consensus forecast	0.28	N/A

Source: Refinitiv, Edison Investment Research. Note: Consensus priced 12 May 2021.

Full details of each mine's operational performance and outlook are available in Endeavour's press release. As per Exhibit 1, output from each of the company's nine mines, exceeded our expectations, with the exception of Agbaou and (by a fraction) Sabodala-Massawa. Financially, each of them performed in line with, or outperformed, our expectations, with the exceptions of Sabodala-Massawa and Wahgnion – although both experienced material, exceptional costs in the form of 'the reversal…of the fair value adjustment of inventory on hand' at the date of their acquisitions. Agbaou outperformed on an underlying basis, if a US$13.5m loss on disposal is excluded from its results. While a number of factors can be invoked to explain both the operational and financial outperformance of Endeavour's mines relative to our prior expectations, in general, it may be reduced to five main factors:

- Higher ore tonnes mined
- Higher tonnes milled/stacked/processed
- Higher average head grade at Boungou
- A 30koz (9.0%) over-sale of gold relative to production
- Well controlled unit costs across the portfolio (with the only real exception being those recorded at Agbaou)

FY21 guidance versus forecasts

Historically, Endeavour has a good record of meeting its production and cost guidance targets and FY20 was the eighth year in succession in which the company achieved its production cost and AISC targets.

In the wake of Q121 results, Endeavour reiterated production and cost guidance for each of its mines for FY21 as shown in Exhibit 3.

Exhibit 3: Endeavour production cost and AISC guidance, by mine, FY21

	Production (koz)	AISC (US$/oz)
Mine	**FY21e guidance**	**FY21e guidance**
Houndé	240–260	855-905
Karma	80–90	1,220-1,300
Ity CIL	230–250	800-850
Mana	170–190	975-1,050
Boungou	180–200	690-740
Sabodala-Massawa	310-330	690-740
Wahgnion	140-155	940-990
Continuing operations	**1,350–1,475**	**840-890**
Agbaou	15-20	1,050-1,125
Group production	**1,365-1,495**	**850-900**

Source: Endeavour Mining, Edison Investment Research

Readers should note that Endeavour's guidance includes production from Sabodala-Massawa and Wahgnion from 10 February onwards only. They should also note that, for the purposes of our forecasts (below) we have left Agbaou fully consolidated into Endeavour's 'pro forma' accounts. For those who wish to deconsolidate it, Agbaou's profit and loss for the period in which it was under Endeavour ownership in Q121 is reproduced below. All told, however, we would note that its contribution to Endeavour's bottom line was, to all intents and purposes, immaterial during this period.

Exhibit 4: Agbaou profit and loss, Q121 (US$000s unless otherwise indicated)

	Q121
Revenue	25,426
Operating costs	(14,250)
Depreciation & depletion	0
Royalties	(1,418)
Other income/(expenses)	80
Loss on disposal	(13,540)
Earnings/(loss) before tax	(3,702)
Deferred and current income tax expense	0
Net comprehensive earnings/(loss)	(3,702)
Minority interest	1,466
Comprehensive earnings attributable to EDV shareholders	(5,168)
Basic EPS (US$/share)	(0.025)
Diluted EPS (US$/share)	(0.025)

Source: Endeavour Mining

In the meantime, we understand it is not Endeavour's intention, at least for the time being, to reflect Karma as an asset held for sale (despite it now being classified as 'non-core'). With these provisos, our updated forecasts for Endeavour for the remainder of FY21 and in the wake of Q121 results, by quarter, on both an 'as reported' and 'pro forma' basis are as follows:

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Exhibit 5: Endeavour Mining FY21 earnings forecasts, by quarter

US$000s (unless otherwise indicated)	Q121e (reported)	Pro-forma (EDV+TGZ) basis					FY21e (reported)
		Est Q121a	Q221e	Q321e	Q421e	FY21e	
Houndé production (koz)	66.1	66.1	57.7	57.7	74.5	256.0	256.0
Agbaou production (koz)	-	12.6	0	0	0	12.6	-
Karma production (koz)	21.6	21.6	20.0	16.4	23.6	81.6	81.6
Ity production (koz)	70.9	70.9	48.8	48.9	74.7	243.3	243.3
Boungou production (koz)	59.7	59.7	39.8	40.8	51.5	191.9	191.9
Mana production (koz)	52.4	52.4	43.6	41.8	49.0	186.8	186.8
Sabodala-Massawa	38.9	75.0	87.1	81.0	101.9	345.0	308.9
Wahgnion	24.7	43.0	38.0	39.9	39.7	160.6	142.3
Total gold produced (koz)	334.3	401.2	335.1	326.5	415.0	1,477.8	1,410.9
Total gold sold (koz)	363.5	432.0	335.1	326.5	415.0	1,508.5	1,440.1
Gold price (US$/oz)	*1,749	1,763	1,825	1,868	1,868	*1,828	*1,828
Mine level cash costs (US$/oz)	**794	643	716	794	689	704	714
Mine level AISC (US$/oz)	837	818	998	1,091	910	942	965
Revenue							
– Gold revenue	635,792	761,448	611,471	609,976	775,206	2,758,101	2,632,445
Cost of sales							
– Operating expenses	251,112	300,140	239,928	259,313	285,787	1,085,168	1,036,140
– Royalties	44,366	51,280	42,279	42,172	53,336	189,067	182,153
Gross profit	340,314	410,028	329,264	308,490	436,084	1,483,866	1,414,152
Depreciation	(122,611)	(141,190)	-128,254	-126,920	-153,885	-550,250	-531,671
Expenses							
– Corporate costs	(11,409)	(12,726)	-11,168	-8,276	-8,276	-40,446	-39,129
– Impairments		0	0	0	0	0	0
– Acquisition etc costs	(12,160)	(12,160)	0	0	0	-12,160	-12,160
– Share based compensation	(7,955)	(9,436)	-6,907	-6,907	-6,907	-30,157	-28,676
– Exploration costs	(9,810)	(9,810)	-5,625	-5,625	-5,625	-26,685	-26,685
Total expenses	(41,334)	(44,132)	-23,700	-20,808	-20,808	-109,448	-106,650
Earnings from operations	176,369	224,707	177,310	160,762	261,390	824,168	775,831
Interest income						0	0
Interest expense	(12,318)	(16,841)	-9,469	-3,420	1,229	-28,502	-23,979
Net interest	(12,318)	(16,841)	-9,469	-3,420	1,229	-28,502	-23,979
Loss on financial instruments	42,077	42,077				42,077	42,077
Other expenses	(6,290)	(19,750)				-19,750	-6,290
Profit before tax	199,838	230,192	167,840	157,342	262,619	817,993	787,639
Current income tax	72,148	81,321	42,842	38,271	60,614	223,048	213,875
Deferred income tax	8,688	8,688	0	0	0	8,688	8,688
Total tax	80,836	90,009	42,842	38,271	60,614	231,736	222,563
Effective tax rate (%)	40.5	39.1	25.5	24.3	23.1	28.3	28.3
Profit after tax	119,002	140,183	124,998	119,070	202,005	586,257	565,076
Net profit from discontinued ops.	(3,702)	0	0	0	0	0	-3,702
Total net and comprehensive income	115,300	140,183	124,998	119,070	202,005	586,257	561,374
Minority interest	25,733	29,919	17,422	15,675	24,948	87,964	83,778
Minority interest (%)	22.3	21.3	13.9	13.2	12.4	15.0	14.9
Profit attributable to shareholders	89,567	110,264	107,577	103,395	177,057	498,293	477,596
Basic EPS from continuing ops (US$)	0.455	0.437	0.426	0.409	0.701	1.973	2.000
Diluted EPS from continuing ops (US$)	0.453	0.434	0.424	0.407	0.698	1.963	1.990
Basic EPS (US$)	0.431	0.437	0.426	0.409	0.701	1.973	1.978
Diluted EPS (US$)	0.428	0.434	0.424	0.407	0.698	1.963	1.968
Norm. basic EPS from continuing ops (US$)		0.318	0.426	0.409	0.701	1.854	1.870
Norm. diluted EPS from continuing ops (US$)		0.317	0.424	0.407	0.698	1.846	1.860
Adj net earnings attributable (US$000s)	104,686	135,156	113,521	109,393	183,111	541,181	510,711
Adj net EPS from continuing ops (US$)	0.503	0.535	0.449	0.433	0.725	2.143	2.115

Source: Endeavour Mining, Edison Investment Research. Note: Company reported basis. *Includes adjustment for Karma stream. **As reported, including royalty payments (Edison calculates US$629/oz excluding royalty payments).

As before, items included in the reconciliation between adjusted net earnings attributable and total net and comprehensive earnings are losses from discontinued operations, deferred income tax effects, gains/losses on financial instruments, other expenses, share-based compensation and acquisition costs (all shown independently in the table above), plus the tax impact of adjusting items, non-cash and other adjustments and the minority interest attributable to the adjusting items (not shown independently).

Notwithstanding the detailed appearance of our forecasts, readers are cautioned that forecasting on a quarterly basis is prone to large variations between actual and forecast numbers. As such, the exhibits both above and below should be regarded as indicative, rather than prescriptive, particularly with respect to individual quarters. With this caveat, a comparison between our FY21 adjusted net EPS from continuing operations estimates and consensus estimates, by quarter, is as follows:

Exhibit 6: Edison adjusted net EPS from continuing operations estimates vs consensus FY21 by quarter (US$)

(US$/share)	As reported	Pro forma				
	Q121a	Q221e	Q321e	Q421e	Sum Q1-Q421e	FY21e
Edison forecast*	*0.535	0.449	0.433	0.725	2.142	2.143
Mean consensus forecast	0.503	0.560	0.670	0.860	2.593	2.390
High consensus forecast	0.503	0.640	0.800	1.070	3.013	3.710
Low consensus forecast	0.503	0.470	0.550	0.630	2.153	1.160

Source: Refinitiv, Edison Investment Research. Note: *As per Exhibits 1 and 5 on a pro forma basis. Consensus priced 12 May 2021.

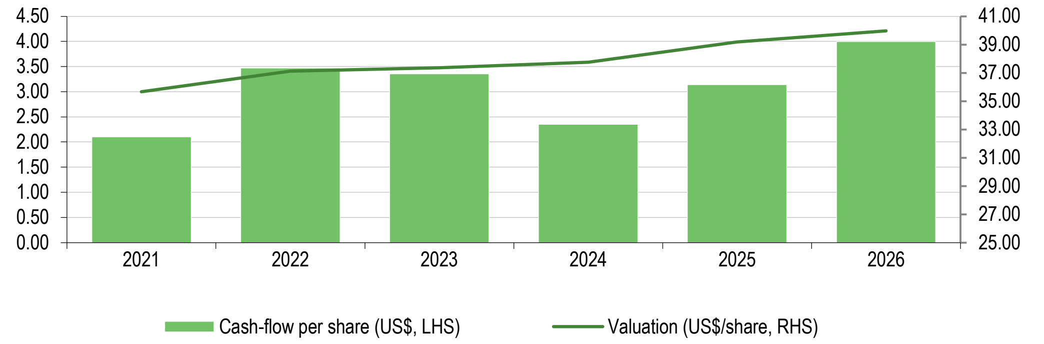
Self-evidently, one of the main assumptions behind Edison's forecasts is that there are no major deleterious effects to ongoing operations as a result of the COVID-19 pandemic. To date, the effect of COVID-19 on Endeavour's operations in West Africa has proven to be negligible and is expected to remain so. Nevertheless, Endeavour has mitigated future risks as far as possible by both setting itself up to operate under level 2 COVID-19 restrictions (see our note, New senior gold major looking to join FTSE 100, published on 17 December 2020) and also by preparing multiple different levels in its pits from which to produce, thereby affording it operational flexibility in event of disruptions.

Valuation

Endeavour is a multi-asset company that has shown a willingness and desire to trade assets to maintain production, reduce costs and maximise returns to shareholders (eg the sale of Youga in FY16, Nzema in FY17, Tabakoto in FY18 and Agbaou in FY20 and the acquisition of SEMAFO in FY20 and Teranga in FY21). Historically, rather than our customary method of discounting maximum potential dividends over the life of operations back to FY21, in the case of Endeavour, we have instead opted to discount six years of forecast cash flows in FY21–26 back to the start of FY21 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 FY26). In the normal course of events, exploration expenditure would have been excluded from such a calculation on the basis that it is an investment. In the case of Endeavour, however, it was included on the grounds that it was a critical component of ongoing business performance in its ability to continually expand and extend the lives of its mines.

In this case, our estimate of cash flows in FY26 is US$4.00/share, giving rise to a terminal valuation of the company at end-FY26 of US$39.96/share (cf US$39.92/share previously), which (in conjunction with forecast intervening cash flows) then discounts back to a valuation of US$35.66/share (cf US$35.98/share previously) at the start of FY21, as shown in the graph below.

Exhibit 7: Endeavour current forecast valuation and cash flow per share, FY20–26e (US$/share)



Source: Edison Investment Research

Given its elevation into the ranks of the world's foremost producers of gold however, we believe that Endeavour can increasingly attract lower cost finance and, as such, a CAPM-derived WACC can also be considered (as discussed in our February 2021 initiation on Newmont Corporation). Long-term nominal equity returns have been 9% and 30-year break-evens are expecting 2.2% inflation. These two measures imply an expected real equity return of 6.7% (1.09/1.022) and applying this to our forecast cash flows would imply a terminal valuation for Endeavour of US$60.05/share (cf US$59.99/`share previously) and a current valuation of US$55.39/share (cf US$55.70/share previously). Readers should note that, given its beta of 0.66 (source: Refinitiv, 15 March 2021), even this (real) discount rate of 6.7% is likely to prove conservative.

In the meantime, Endeavour's valuation remains at a material discount to those of its newly acquired peer group, as shown in Exhibit 8, below.

Relative Endeavour valuation

Endeavour's valuation on a series of commonly used measures, relative to a selection of gold mining majors (the ranks of which it has now joined since its takeovers of SEMAFO and Teranga have been completed), is as follows:

Exhibit 8: Endeavour valuation relative to peers

Company	Ticker	Price/cash flow (x)			EV/EBITDA (x)			Yield (%)		
		Year 1	Year 2	Year 3	Year 1	Year 2	Year 3	Year 1	Year 2	Year 3
Endeavour (Edison)	EDV	6.6	5.0	5.0	4.6	4.2	4.2	1.5	10.2	12.2
Endeavour (consensus)	EDV	4.9	4.5	5.1	4.6	4.3	5.1	1.5	5.3	4.5
Majors										
Barrick	ABX	8.4	8.3	8.3	7.6	7.3	7.3	2.5	1.4	1.7
Newmont	NEM	11.1	10.2	11.7	8.7	8.2	9.2	2.8	2.9	2.7
Newcrest	NCM AU	9.5	9.7	9.7	8.0	8.0	8.2	1.4	1.4	1.6
Kinross	K	6.4	4.7	4.7	5.5	4.2	4.0	1.6	1.6	1.5
Agnico-Eagle	AEM	10.9	9.9	10.2	9.6	8.3	8.6	2.0	2.0	2.0
Eldorado	ELD	5.9	5.2	5.1	4.8	4.4	4.3	0.0	0.0	0.0
Average		**8.7**	**8.0**	**8.3**	**7.4**	**6.7**	**6.9**	**1.7**	**1.5**	**1.6**
Implied EDV share price (US$)		**31.70**	**38.27**	**39.31**	**40.41**	**37.57**	**36.97**	**21.63**	**N/A**	**N/A**
Implied EDV share price (C$)		**38.18**	**46.10**	**47.34**	**48.68**	**45.25**	**44.53**	**26.05**	**N/A**	**N/A**

Source: Edison Investment Research, Refinitiv. Note: *Forecast EV. Consensus and peers priced at 26 May 2021.

Of note is the fact that Endeavour's valuation is materially cheaper than the averages of the majors in all but one of the measures shown in Exhibit 8, regardless of whether consensus or Edison forecasts are used. On an individual basis, it is cheaper than the majors on at least 44 out of 54 (81%) of valuation measures if Edison forecasts are used or 45 out of 54 (83%) if consensus forecasts are used. Reverse engineered, the average valuation measures of its peers imply an average share price for Endeavour of US$35.12, or C$42.31 per share.

Readers should note that Edison's forecast dividend yield in year 2 and year 3 (FY22 and FY23) is notional. When it declared its maiden dividend of US$0.37/share for FY20 in November, Endeavour announced a policy of declaring future dividends on a semi-annual basis with the aim of maintaining an approximate dividend yield of 1.6% until it has reached a targeted net cash position of c US$250m (note, in H122 according to Edison's updated estimates). Thereupon, it will re-assess its capital allocation priorities, which may include augmenting its shareholder return programme. Endeavour's share price is at approximately the same level that it was in November implying, all other things being equal, its FY21 dividend should also be of the same order of magnitude to maintain a yield of 1.6%. However, it could increase to the extent that its share price appreciates above US$23.13, or C$27.85 (being US$0.37/0.016). Given we have no more information than this, however, our dividend 'forecast' for FY22 and FY23 therefore shows the maximum that we estimate Endeavour could distribute to retain a net cash position of US$250m on its balance sheet. This we believe to be unlikely in practice. However, it does indicate that, all other things being equal, Endeavour has plenty of scope to increase dividend distributions to shareholders into the foreseeable future.

Share buyback programme

In tandem with its FY20 results, on 18 March 2021, Endeavour announced a normal course issuer bid (NCIB) or share buyback programme to supplement its policy of augmenting shareholder returns. The NCIB commenced on 22 March and will end on 21 March 2022 and will allow Endeavour to buy up to 12.2m ordinary shares, or approximately 5% of its total issued and outstanding ordinary shares at the time of the announcement, whereupon the purchased shares will be cancelled. At Endeavour's current share price of C$28.89 (US$23.99), the NCIB is worth c US$293m and compares extremely favourably with its FY20 dividend payout of US$60.3m and its forecast US$93.5m payout in FY21. Combined, the NCIB and FY21e dividend distribution together represent c US$386.5m in aggregate returns to shareholders – equivalent to a dividend yield of 5.3% – in FY21.

Note that, owing to the inherent uncertainty surrounding whether purchases are made and at what price under the NCIB, we have not attempted to include potential future share buybacks in our financial forecasts in Exhibit 9, below, but only historical ones. To date in FY21, Endeavour has repurchased a total of 0.6m shares at an average price of C$27.42 resulting in total cash outflows of C$16.2m, or US$13.0m.

Financials

According to its Q121 balance sheet, Endeavour had net debt of US$220.2m post the acquisition of Teranga and the injection of US$200m by La Mancha. This compares with net debt of US$43.3m as at end-FY20 (pre the Teranga acquisition). This figure of US$220.2m includes lease liabilities of US$43.6m and an option premium of US$46.3m. Excluding the latter results in a net debt position of US$173.9m or just 4.3% of the company's balance sheet equity of US$4,007.7m at end-Q121. Note that it differs slightly from the figure of US$161.8m quoted elsewhere in Endeavour's announcements in that the latter excludes US$43.6m in lease liabilities and owing to the discounting, variously, of certain committed future payments to present value.

Note that, for the purposes of its financial modelling (see Exhibit 9, below) and for simplicity's sake, we have assumed the consolidation of Endeavour's and Teranga's balance sheets took place retrospectively on 31 December 2020. In this case, we estimate that Endeavour would have consolidated c US$242.6m in net debt on its balance sheet and c US$349.2m in gross debt as a consequence of its Teranga acquisition. As such, on a pro forma basis, we estimate Endeavour would have had US$323.1m in net debt on its balance sheet at end-FY20, which we calculate would have equated to a gearing (net debt/equity) ratio of just 8.8% and a leverage (net debt/[net debt+equity]) ratio of 8.1% on the group's enlarged equity base.

Exhibit 9: Financial summary

US$'000s	2018	2019	2020	2021e	2022e	2023e
December	IFRS	IFRS	IFRS	IFRS	IFRS	IFRS
PROFIT & LOSS						
Revenue	1,048,636	1,362,121	1,847,894	2,758,101	2,495,073	2,384,441
Cost of Sales	(669,719)	(884,869)	(1,061,891)	(1,383,683)	(1,077,784)	(1,034,014)
Gross Profit	378,917	477,252	786,003	1,374,418	1,417,289	1,350,427
EBITDA	378,917	618,443	910,295	1,386,578	1,417,289	1,350,427
Operating Profit (before amort. and except.)	106,090	281,400	546,072	836,328	930,000	920,276
Intangible Amortisation	0	0	0	0	0	0
Exceptionals	8,035	(199,159)	(201,532)	29,917	0	0
Other	(3,171)	(9,392)	8,886	(19,750)	0	0
Operating Profit	110,954	72,849	353,426	846,495	930,000	920,276
Net Interest	(27,110)	(51,607)	(53,774)	(28,502)	978	2,500
Profit Before Tax (norm)	75,809	220,401	501,184	788,076	930,978	922,776
Profit Before Tax (FRS 3)	83,844	21,242	299,652	817,993	930,978	922,776
Tax	(73,637)	(97,253)	(158,466)	(231,736)	(178,048)	(168,831)
Profit After Tax (norm)	2,172	123,148	342,718	556,340	752,930	753,946
Profit After Tax (FRS 3)	10,207	(76,011)	141,186	586,257	752,930	753,946
Net loss from discontinued operations	(154,795)	(4,394)	0	0	0	0
Minority interests	8,460	33,126	44,719	87,964	110,447	109,000
Net profit	(144,588)	(80,405)	141,186	586,257	752,930	753,946
Net attrib. to shareholders contg. businesses (norm)	(16,292)	90,022	297,998	468,376	642,483	644,946
Net attrib.to shareholders contg. businesses	(8,257)	(109,137)	96,466	498,293	642,483	644,946
Average Number of Shares Outstanding (m)	155.3	157.4	160.8	252.6	252.6	252.6
EPS - normalised ($)	(0.10)	0.57	1.85	1.85	2.54	2.55
EPS - normalised and fully diluted ($)	(0.10)	0.57	1.82	1.83	2.51	2.52
EPS - (IFRS) ($)	(0.99)	(0.72)	0.60	1.97	2.54	2.55
Dividend per share (c)	0	0	37	37	245	287
Gross Margin (%)	36.1	35.0	42.5	49.8	56.8	56.6
EBITDA Margin (%)	36.1	45.4	49.3	50.3	56.8	56.6
Operating Margin (before GW and except.) (%)	10.1	20.7	29.6	30.3	37.3	38.6
BALANCE SHEET						
Fixed Assets	1,594,202	2,330,033	5,093,409	5,111,622	4,996,160	4,918,676
Intangible Assets	4,186	5,498	24,851	24,851	24,851	24,851
Tangible Assets	1,543,842	2,254,476	3,968,746	3,986,959	3,871,498	3,794,014
Investments	46,174	70,059	1,099,812	1,099,812	1,099,812	1,099,812
Current Assets	327,841	652,871	1,168,382	2,004,370	2,084,362	2,053,994
Stocks	126,353	266,451	305,075	530,404	479,822	458,546
Debtors	74,757	83,836	104,545	252,237	230,619	221,525
Cash	124,022	288,186	751,563	1,172,453	1,324,646	1,324,646
Other	2,709	14,398	7,199	49,276	49,276	49,276
Current Liabilities	(248,420)	(354,931)	(661,171)	(801,905)	(698,496)	(683,580)
Creditors	(224,386)	(312,427)	(612,862)	(753,596)	(650,187)	(635,271)
Short term borrowings	(24,034)	(42,504)	(48,309)	(48,309)	(48,309)	(48,309)
Long Term Liabilities	(729,290)	(963,736)	(1,647,799)	(1,647,799)	(1,647,799)	(1,647,799)
Long term borrowings	(618,595)	(770,902)	(1,026,337)	(1,026,337)	(1,026,337)	(1,026,337)
Other long term liabilities	(110,695)	(192,834)	(621,462)	(621,462)	(621,462)	(621,462)
Net Assets	944,333	1,664,237	3,952,821	4,666,288	4,734,227	4,641,291
CASH FLOW						
Operating Cash Flow	394,984	628,617	1,046,370	1,143,850	1,386,081	1,365,879
Net Interest	(26,734)	(35,413)	(53,774)	(28,502)	978	2,500
Tax	(36,140)	(109,494)	(186,332)	(223,048)	(178,048)	(168,831)
Capex	(689,469)	(401,227)	(335,599)	(568,463)	(371,828)	(352,667)
Acquisitions/disposals	33,179	3,654	(19,000)	20,000	40,000	0
Financing	(7,820)	2,402	100,000	187,000	0	0
Dividends	(1,956)	(6,154)	(88,288)	(109,947)	(724,991)	(846,882)
Net Cash Flow	(333,956)	82,385	463,377	420,890	152,193	0
Opening net debt/(cash)	218,140	518,607	525,220	323,083	(97,807)	(250,000)
HP finance leases initiated	0	0	0	0	0	0
Other	33,489	(88,998)	(261,240)	0	0	0
Closing net debt/(cash)	518,607	525,220	323,083	(97,807)	(250,000)	(250,000)

Source: Company sources, Edison Investment Research. Note: Presented on pro forma basis including SEMAFO from FY18 balance sheet and Teranga from FY20 balance sheet. EPS normalised from 2018 to reflect continuing business only. *Excludes restricted cash.

Frankfurt +49 (0)69 78 8076 960
Schumannstrasse 34b
60325 Frankfurt
Germany

London +44 (0)20 3077 5700
280 High Holborn
London, WC1V 7EE
United Kingdom

New York +1 646 653 7026
1185 Avenue of the Americas
3rd Floor, New York, NY 10036
United States of America

Sydney +61 (0)2 8249 8342
Level 4, Office 1205
95 Pitt Street, Sydney
NSW 2000, Australia