

June 16, 2010

# ***O B Research***

## **Orvana Minerals -**

**Getting those golden profits while others struggle**



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## **Orvana Minerals.**

(TSX ORV)

**Recommendation: Buy**  
**12 month target: C\$ 3.20**

# **A Golden Opportunity in Spain**

## **Introduction**

The Gold universe is small and so is the world of analysts influencing the valuations of companies.

OceanaGold that we recommended December 4, 2009 provided us with a double in less than 6 months (and is still seriously undervalued). While we believe that the north American analysts and investors are superior to others when it comes to valuing these types of companies, we also believe that these opportunities appear because many analysts and investors in Canada and the USA prefer companies "closer to home" e.g. North & South America, and therefore are slower to react to successful companies in other parts of the world.

We think this is a mistake the coming year due to the very important issue of currencies and cost inflation. As much as this is a recommendation of a European low cost producer, it is also a reminder to you as a reader that Canadian and US producers, and soon to be producers, will struggle with high cash cost becoming even higher and feasibility studies faces cost overruns.

We therefore prefer producers in stable jurisdictions like New Zealand and Spain, with falling currencies and falling cost environment. Add to that a much lower valuation to start with and we believe that we are again set to do very well.

## **Orvana Minerals**

Orvana Minerals is a company we have followed for over a year and patiently been waiting for the perfect moment to bring to your knowledge. We believe that time is now as the company is emerging to produce >120.000 ounce gold, as well as 23 million pounds of copper and 750.000 ounces of silver. About 84% of the gold production will come from Spain with the remaining part from Bolivia. We would advice you not to worry too much about the Bolivian part, keeping in mind that large companies like Pan American Silver successfully operates there, be it under high taxes (45%). It provides nice cash flow to Orvana but it is less than 10% of the value in the new Spanish Orvana.

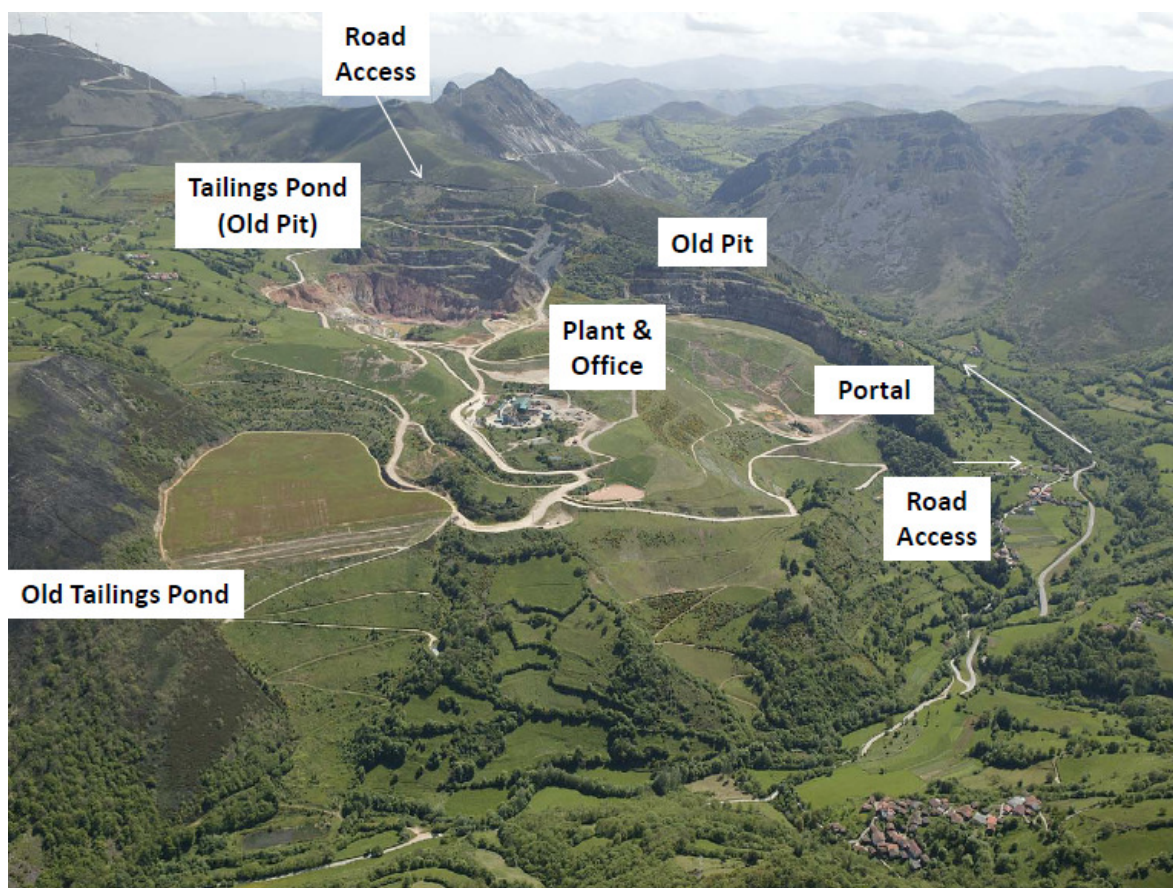
## **Our assumptions**

In the assumptions made, we have calculated with the by-products copper and silver as credit to the gold production costs at 2.8 & 18 usd for the year 2011. We have also used an exchange rate of 1.23 USD/Euro to derive the company's cash cost to 450 usd/ounce produced gold. Further we estimate that the company will manage at least a 65% conversion ratio from M&I into P&P when the feasibility study for EVBC Spain is presented in a couple of weeks.

Our calculations are based on the belief that Orvana Spain will be fully up and running by March 1<sup>st</sup> 2011, giving us 10 months of production in Spain and 12 months from Bolivia that year for a total of 100,000 ounces of gold.

We initiate our coverage with a price target of C\$ 3.20 and consider the company seriously undervalued compared to Canadian peers, both from net present value (NPV) of future profits, p/e multiple and valuation of resources & reserves in the ground. About 90% of the value we assign to Orvana is derived from Orvana Spain but one cannot ignore the annual steady profits from Orvana Bolivia completely.

We think that the market has yet to fully notice Orvana and we believe that Spain, with high unemployment and a weak Euro (or possibly even a return to the Pesetas), is the perfect place to restart this mine. Something that is already visible through great support from authorities and locals. No wonder since about 200 well paid full time jobs are created in this rural area in Northern Spain.



Above: El Valle-Boinás/Carlés mine (called EVBC below)

## Valuation, key production and financial statistics of Orvana Minerals:

**Mcap:** C\$152 million at share price C\$1.31

**Basic Shares:** 115.6 million

**Warrants/options:** 3.3 million

**Fully diluted shares:** 119 million

### Income Statement<sup>1</sup>

Year (calendar year)	2010E	2011E <sup>2</sup>	2012E	2012E <sup>3</sup>
Production (koz)	22	100	125	125
Realized price (US\$)	1200	1200	1250	1400
Cash cost oz (US\$)	750	450	460 <sup>4</sup>	460
Revenue (US\$m)	26.5	120	156	175
Operating Cost (US\$m)	-16.5	-45	-58	-58
General & adm expenses	-7	-8	-8	-8
EBITDA (US\$m)	3	67	90	109
Depreciation	-3	-17	-22	-23
Interest expense (net)	0	-2	0	-2
Tax (average 33%)	-1	-16	-23	-28
Net income after tax (US\$m)	-1	32	45	56
EPS C\$ cent (1.04:1 US\$)	0	28	40.5	50.4
P/E	n/a	4.7	3.3	2.6

<sup>1</sup> We use calendar year while the company's fiscal year 2011 starts October 1, 2010

<sup>2</sup> 10 months production

<sup>3</sup> Case 1400 usd gold

<sup>4</sup> USD/Euro 1.23 Crude 75 usd

**The company, where it has been and what 2011 will look like**

Orvana is not a new gold producer. It has actually been one of those few companies that consistently delivered rich profits from gold production to its shareholders for many years. But it is fair to say that despite this, Orvana has not been a market darling at all. The reason is of course that those rich profits came from Bolivia, a country that scares investors so much that Orvana were actually valued below its 2009 treasury of 100 musd for much of that year, this despite still being a profitable gold producer.

What investors also have missed completely, is that we are talking of an experienced mine team that has produced low cost underground mined gold ounces for almost 10 years, and has recently put one open pit mine into production and is about to start another one in Bolivia in October. How does one value such experience and track record?

The new and silently emerging Orvana used half its treasury to buy a former mine in Spain, including a fully equipped 2000 tpd mill and 2 million ounces of resources (+ rich copper credits), of which we estimate that 1 million ounces (EVBC 0,8+UMZ 0,2) will soon be converted into reserves and more will follow thereafter as infill drilling is done.

Orvana paid 45 US\$ million and will spend a further 50 million to put EVBC into production starting January 2011. We expect the falling Euro to make it easier for them to stay on budget. Still the company has indicated that it will seek additional project financing through European banks. We assume an additional 20 US\$ million will be borrowed during 2010, which we expect to be fully paid off the following year from cash flow as the gold price stays strong.

**Balance sheet, end of year**

<b>Year</b>	<b>March 2010</b>	<b>2010E</b>	<b>2011E</b>	<b>2012E<sup>5</sup></b>
Cash	51	10	18	25
Other assets	85.5	146	146	184
Interest bearing debts	-4.5	-24	0	0
Other non interest obligations <sup>6</sup>	-22	-22	-22	-22
Shareholders equity (US\$)	110	110	142	187
Shareholder equity/share C\$ (1.04:1)	0.99	0.99	1.28	1.68

**Reserves & Resources<sup>7</sup>**

- M&I resources (incl P&P est) Spain+Bolivia: 1.2+0.3 m ounces, expected to grow faster than production.
- P&P reserves (est) Spain+Bolivia: 0.8+0.2 m ounces, expected to grow faster than production.
- Inferred resources Spain: 1.5 m ounces
- Total Spain resources 2.7 m ounces and growing. The EVBC Mill & mines are “long life assets”.
- UMZ Bolivia P&P+M&I: 0.2 + 0.1 m ounces. (copper not included)
- All categories resources: 3 m ounces and growing
- Valuation/ all ounces P&P+M&I = US\$104 (US\$52 including inferred resources)

**Orvana compared to peers in North America  
Peer group Mcap**

- Orvana at C\$ 1.31: C\$m: **152**
- San Gold C\$ 4.40: C\$m: **1208**
- Aurizon C\$ 5.11: C\$m: **800**
- Minefinders C\$ 9.38: C\$m: **602**

<sup>5</sup> 1250 usd gold

<sup>6</sup> Other debt is mainly future tax liabilities and accounts payable

<sup>7</sup> O B Research estimate a conversion ratio of 65% of the current M&I resources.

### **Expected production and cash cost for Orvana & American peer group 2011**

- Orvana: 100,000 ounces at 450 usd (only gold) (annualized basis 120.000 March 2011)
- SanGold 80,000 ounces at 750 usd
- Aurizon Mines 155.000 ounces at 470 usd
- Minefinders: 170,000 ounces at 490 usd (gold + silver)

### **Reserves & Resources in producing or soon to be producing mines for Orvana & North American Peers**

#### **Orvana<sup>8</sup>:**

M&I (incl P&P): 1.5 m ounces

P&P: 1 m ounces (expected to increase faster than production)

Inferred: 1.5 m ounces

Non producing mines (2011) P&P+M&I: 0

Valuation/ounce P&P+M&I = US\$ 101 (incl. inferred 50 usd)

#### **SanGold:**

M&I (incl P&P): 0.83 m ounces

P&P: 0.34 m ounces

Inferred: 2.26 m ounces

Non producing mines P&P+M&I: 0

Valuation/ounce P&P+M&I = US\$ 1400

Comment: SanGold is all about dreams that has not yet been proven according to 43-101 and that needs extensive investments once they might be proven. The valuation seems very rich and there has to be a lot of further excellent drill results to justify a Mcap worthy of mid tier producers with million of ounces of reserves.

#### **Minefinders:**

M&I (incl P&P): 6.7 m ounces

P&P: 4.5 m ounces (includes gold+silver but only 3 million expected to be recovered)

Non producing mines P&P+M&I: 0.3

Valuation/ounce P&P+M&I = US\$ 86

Comment: Minefinders seems cheap from a reserve basis but has consistently been under delivering and faces high additional investments and cost pressure as they try to increase production. Minefinders are not growing their reserves. OceanaGold is still a much better alternative for investors looking for cheap ounces. Minefinders is a fully valued producer in our view, receiving a premium due to rich reserves.

#### **Aurizon Mines:**

M&I (incl P&P): 1.9 m ounces

P&P: 1 m ounces

Non producing mines P&P+M&I: 1.5

Valuation/ounce P&P+M&I = US\$ 222

Comment: No expansion of production until 2013. The company has seen a lot of cost pressure resulting in higher cash costs. Being a Canadian producer we expect that to continue.

#### **Debt**

- Orvana: 10 MUSD
- San Gold: 141 MUSD
- Aurizon: 84 MUSD
- Minefinders: 89 MUSD

<sup>8</sup> O B Research estimate a conversion ratio of 65% of the current M&I resources.

### **Coming trigger events for Orvana**

- June 30, mine-plan, reserve statement EVBC and estimated cash costs
- Summer 2010, feasibility study, mine plan and reserve statement UMZ Bolivia
- Summer 2010, scoping study Copperwood
- October 1, 2010: Start up of UMZ
- January 1 2011: Start up of EVBC Spain
- Continued conversion of inferred resources into M&I and further to P&P at EVBC.

### **The Copperwood project and UMZ Bolivia**

Orvana consist of three parts, of which we mainly focus on the EVBC mine in Spain. The Bolivia assets provide the government with a high tax rate of 45% and are situated in a remote area, we have no indication that this relatively small operation would be a target for nationalization anytime soon. Still, high taxes mean lower net profits, and the risk of government folly can not be ignored. We therefore value ounces in Bolivia to less than half of Spanish ounces, which means that Bolivia adds between 5 and 10% of the company's fair value.

Regarding the Copperwood project in the USA, we understand that some investors see it as a strange project for a gold company. But one should remember that many of the most successful gold companies in the world, like Yamana and Goldcorp, are in fact gold and copper producers. We could see this project spun out into a separate attractive entity for shareholders once we are in production.

We believe that the management of Orvana, who have been producing metals for almost 10 years, simply saw an outstanding opportunity to acquire an excellent near production project at a very low cost. While we do not assign any significant value to this project at the moment, we expect that to change as resources and eventually reserves are proven up and production comes closer. This is after all, a high grade 43-101 resource of almost a billion pounds of copper that is likely to double, as older non compliant resources are proven up. A scoping study is expected in a few months.

### **Valuation and recommendation**

#### **Price/Earning valuation:**

Our view is that the company during the calendar year 2011 will generate around C\$ 0.28 EPS or C\$ 0.34 on an annualized basis at a gold price of 1200 usd, with copper and silver credits at 2.8 & 18 usd. Applying a conservative multiple of 10 for the earnings provides us with a target price of C\$ 3.40.

### **Valuation of P&P+M&I gold reserves/resources in the ground**

#### **Spain:**

P&P entering production: 250 US\$/ounce  
M&I entering production excl P&P: 125 US\$/ounce  
Inferred: 60 US\$/ounce  
Total value Spain: US\$ 338 million (C\$ 383)

#### **Bolivia:**

P&P entering production: 100 US\$/ounce  
M&I entering production excl P&P: 50 US\$/ounce  
Inferred: 20 US\$/ounce  
Total value Bolivia: US\$ 20 million  
Valuing reserves and resources this way gives us a total contribution/share of C\$ 3 from Spain and C\$ 0.2 from Bolivia for a total of C\$ 3.2.

### **Discounted cash flow valuation to derive NAV**

If NAV of DCF should be used, Orvana should have a multiple of around 1.5x NAV as they will soon be a profitable and growing gold producer in a safe jurisdiction, with plenty of room to grow reserves and production.

We think that a proper discount rate for Orvana Spain at this stage would be 5% and for Orvana Bolivia 8%.

A valuation of 1.5x NAV calculated on discounted cash flows at reasonable discount rates also well supports our price target.

### **Conclusion and recommendation**

Orvana is seriously undervalued compared to North American peers in terms of expected profitability during 2011. They are less undervalued when one compare reserves. That does not worry us since Orvana has a large amount of resources that is expected to be converted into reserves as soon as cash flow can be directed towards further infill drilling. We do in fact expect the company to focus on growing its reserves as soon as production has ramped up.

Why is it undervalued? Well, this used to be a Bolivian producer, now it is a Spanish producer. It takes time to change an image and that in itself, together with the Euro depreciation, creates our opportunity.

What we believe is key to understand, is that European producers will surprise most investors by having lower cash cost and better profitability than expected.

As these facts become written in stone, we expect analysts to revalue North American producers down and companies like Orvana Minerals and OceanaGold upwards.

We therefore believe that this is the time to start accumulating shares to be able to profit as the currency advantages/disadvantages become apparent for the mainstream analysts.

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##### About O B Research:

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We publish independent research on an irregular basis when we see exceptional value. If you are interested in receiving future research from us, please send an e-mail to: [obresearch@ymail.com](mailto:obresearch@ymail.com)

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