

WESTPEAK RESEARCH ASSOCIATION

Roxgold – Target (TSX: ROXG)

Fortuna Silver Mines – Acquirer (TSX: FVI)

Natural Resources – Oil & Gas

Fortuna acquires Roxgold: Was this the right call?

December 7, 2021

Fortuna and Roxgold combine to create a global premier growth-oriented intermediate gold and silver producer. Fortuna acquires all the issued and outstanding securities of Roxgold and expands their operations into West Africa. Investor confidence and share price fall as a result ...

Strategic Objectives

Fortuna Silver Mines aimed to achieve two main goals through completing this acquisition: diversification / expansion into West Africa and a strengthening of their balance sheet. The combined company looked to be in a stronger position to accelerate development of Roxgold's Séguéla gold project, and ramp-up exploration in West Africa and Latin America. Alongside this, the acquisition looked to create an enlarged company with a strong balance sheet, significantly higher liquidity, greater scale, and enhanced capital markets relevance.

Synergies

There is an apparent lack of synergies associated with this deal and Fortuna's subpar stock performance goes to show this. The word "synergy" is not included in the press release, and it is difficult to identify how this deal made sense from a financial point of view apart from a strengthened balance sheet and lower cost of capital.

Industry Analysis

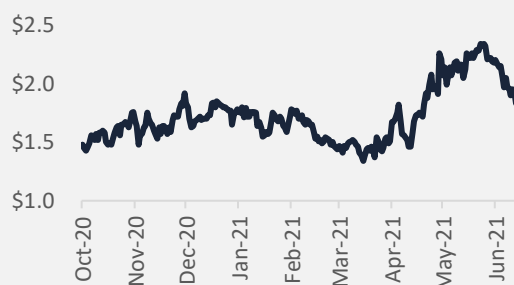
Mining companies have been increasingly focused on bolstering their ESG initiatives and reducing carbon footprints as investors have become increasingly focused on ESG. In addition, mining companies must work to win back the trust they lost during the peak of the last cycle when numerous deals destroyed value rather than creating it.

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Key Statistics - Roxgold

52 Week H/L	\$1.34/\$2.35
Market Capitalization	\$712M
Average Daily Trading Volume	2.5M
Net Debt	-27.3M
Enterprise Value	684.7M
Net Debt/EBITDA	-0.25x
Diluted Shares Outstanding	375M
Dividend Yield	N/A

1-Year Price Performance



Key Statistics – Fortuna

52 Week H/L	\$12.6/\$4.36
Market Capitalization	\$1.3B
Average Daily Trading Volume	1.05M
Net Debt	\$83.2M
Enterprise Value	\$1.45B
Net Debt/EBITDA	0.17x
Diluted Shares Outstanding	291.6M
Dividend Yield	N/A

1-Year Price Performance

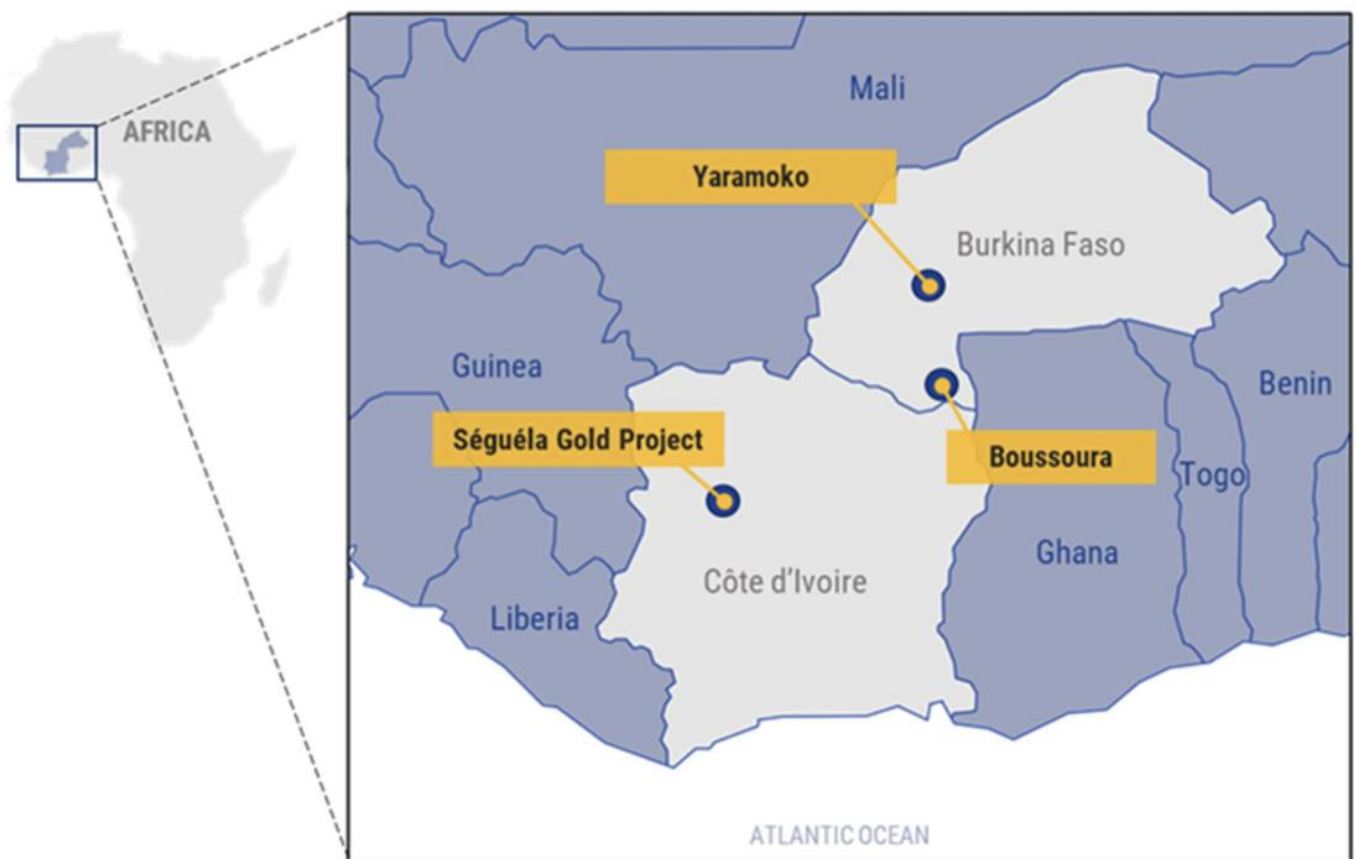


Business Overview – Roxgold

Company Overview

Roxgold is a Canadian-based gold mining company with assets located in West Africa. They own and operate the high-grade Yaramoko Gold Mine located on the Hounde greenstone belt in Burkina Faso and are also advancing the development and exploration of the Séguéla Gold Project located in Cote d'Ivoire. These mines and projects are now under the control of Fortuna Silver Mines because of the acquisition.

Overview of Mines and Projects: Roxgold took over ownership of the *Yaramoko Gold Mine* in September 2012 and have been operating it ever since. The mine is located in Burkina Faso and comprises of two deposits, with the main deposit referred to as the 55 Zone and the satellite deposit known as the Bagassi South zone. In 2020, Yaramoko produced 133,940 ounces of gold. Roxgold acquired the *Séguéla Gold Project* in April 2019 and have been exploring and drilling various areas of the project since. As of November 2020, they estimated there to be approximately 12,780 tonnes of gold spread across 5 different locations because of their exploration efforts. Roxgold also held the permit to explore the *Boussoura* property located in the southern portion of the Hounde Greenstone Belt, where they conducted a drilling program in early 2020.



Source: Company Filings

Company Strategy

Creating Long Term Sustainable Value

A key part of Roxgold's corporate strategy is reinvesting into the business to advance projects, grow resource production, and have successful explorations. In terms of project advancement, Roxgold had initial production 5 years after the initial discovery of Yaramoko and is continuing to expand the Yaramoko processing plant and Bagassi South deposit. Along with this they successfully acquired their Séguéla property in April 2019 for \$20M in cash which had a PEA (preliminary economic assessment) NPV of \$268M at \$1,450/oz Au as of April 2020. Since 2016, they have spent \$140M in accretive growth expenditures on projects such as Séguéla drilling and studies, Greenfield Exploration, and the expansion of the Yaramoko project.

	VALUE ACCRETIVE GROWTH SPEND					
	2016	2017	2018	2019	2020	Total
Acquisition of Séguéla				\$21		
Séguéla drilling and study costs				\$6	\$25	
Yaramoko resource drilling	\$3	\$1	\$8	\$3	\$4	
Yaramoko expansion - Bagassi South		\$10	\$27	\$18		
Greenfield exploration		\$1	\$3	\$5	\$5	
Total Growth spend	\$3	\$12	\$38	\$54	\$34	\$140

Source: Company Presentation

Strong Focus placed on ESG

Roxgold's ESG strategy stems around 3 main pillars: employee health and safety, community development, and environmental stewardship. Between 2017-2019, they provided 51,709 hours of training to their contractors and employees and only suffered one Lost Time Injury (LTI) in 7.16M hours worked. On top of this, 91% of Roxgold employees are from Burkina Faso and they have devoted \$1.9M towards investment in community activities. Finally, Roxgold has planted 100,000 trees in their reforestation campaign since 2015 and recycled 570,000 m³ of water from their tailing's facility between 2017 to 2019. Roxgold's impressive ESG strategy was one of the few attractive pieces of this acquisition, directly in line with an industry shift towards ESG.

Business Overview – Fortuna Silver Mines

Company Overview

Fortuna Silver Mines is a Vancouver based, Canadian precious metals and mining company with four operating mines in Argentina, Mexico, Peru, Burkina Faso, and a development project in Cote d'Ivoire. Their focus is on producing silver and gold to generate shared value over the long term for their stakeholders.

Overview of Mines and Projects: As mentioned previously, Fortuna's portfolio consists of four operating mines and one development project. Their *Caylloma Mine* in Arequipa, Peru, has produced silver, gold, lead and zinc since 2006. The

Lindero Mine in Salta, Argentina, poured its first gold in October 2020 and is Fortuna's leading producer, and the *San Jose Mine* in Oaxaca, Mexico, has produced silver and gold since 2011. The *Yaramoko Mine* in Burkina Faso has been producing gold since 2016. The *Séguéla Gold Project* in Côte d'Ivoire is an advanced development project with near-surface defined Mineral Reserves.



Source: Company Website

2020 Highlights



7.1 M

ounces of silver produced



50,300

ounces of gold produced



16

years in operation



3,200

employees and contractors



20%

women employees



100%

mines with closure plans

Source: Company Website

Company Strategy

Growth-Oriented Intermediate Mining Company

Fortuna Silver Mines has a growth-oriented asset portfolio based out of two premier mining regions. The company is led by a highly experienced management team that has a track record of value creation in West Africa's and the Americas focused on driving sustainable growth. The integration of Roxgold's executive leadership has bolstered the company's existing management team and added unique experience and perspective in the West Africa region. Fortuna is well positioned to capitalize on their existing operating mines and fully funded development and exploration pipeline in the surrounding areas.



Source: Company Presentation

Sustainability

Fortuna Silver Mines is committed to integrating sustainability into their business strategy, organizational culture, and day-to-day operations. In 2019, they developed a five-year sustainability plan containing short, medium, and long-term commitments and integrated key performance indicators (KPIs) related to sustainability into the management of our business. Some of these goals include achieving a target of zero fatalities, improving their OHS programs, and reducing the freshwater collection rate by identifying opportunities for improvement. They have been very successful in achieving many of the goals they set in 2019 and are continuing to set an example for the rest of the industry.

The core to their approach to is Governance, Their People, and Their Environment. Along with this they have six pillars to support their core fundamentals: financial performance, human rights and ethics, communities, occupational health and safety, human resources, and the environment. Fortuna received a 27.9 ESG risk rating score from Sustainalytics, placing them 17th out of 125 rated precious metals peers and well ahead of close peers such as Osisko Mining and Silvercorp Metals.

Industry Analysis

Market Size & Growth

As of December 7, 2021, the global top 25 metals and mining companies had a cumulative value of \$995.7B. This represents an increase of \$87.34B (8.8%) since December 2020. The top 25 companies represent a large percentage of the total industry's market capitalization due to strong operational value attained through economies of scale. Fortuna Silver Mines ranks 65th in the world with a market capitalization of approximately 1B.

Key Industry Metrics

Price to Cash Flow (P/CF): Valuation in the mining industry is heavily dependent on commodity prices which leads to high earnings volatility and frequent impairment expenses which can cause the typical price-earnings (P/E) multiple too often be misleading. P/CF is a more commonly used multiple in the space as it tells investors how much cash flow is generated relative to the share price. Prior to the acquisition of Roxgold, Fortuna traded at a P/CF multiple of 5.76x as of March 2021 and are currently trading at a 3.99x multiple as of December 2021. They are trading at a much lower multiple than industry peers such as First Majestic Silver (12.74x) and Pan American Silver Corp (8.19x). This provides me with some hope that investors may have overreacted to the lack of synergies present in the deal and that Fortuna may be undervalued compared to industry peers.

Price to Net Asset Value (P/NAV): P/NAV is a very common multiple in the mining and metals space and assesses the current trading price of a mining company relative to their implied intrinsic value (NAV). As of November 2021, Fortuna was trading at a 1.3x P/NAV multiple and is currently trading at even lower multiple given the recent drop in their share price. If they can regain investor confidence and execute successfully at their various sites they have the potential for multiple expansion as they currently trade at a discount to many industry peers.

Key Industry Trends

Environmental, Social, and Corporate Governance (ESG)

Mining companies have been increasingly focused on bolstering their ESG initiatives and reducing carbon footprints as investors have become increasingly focused on ESG. High-profile investors such as BlackRock and Goldman Sachs have been divesting from select natural resource companies, reflecting the increased pressure for the mining industry to meet ESG targets. As mentioned previously, sustainability is at the forefront of Fortuna's company strategy and something they view with the upmost importance. Roxgold also places a strong emphasis on ESG, making this deal accretive from an ESG standpoint and offering one of the few benefits to this deal.

M&A in an altered world

As mining companies look to strengthen their portfolios and grow in a semi-post pandemic world, merger and acquisition activity has picked up. However, to finance these M&A deals, companies must work to win back the trust they lost during the peak of the last cycle when numerous deals destroyed value rather than creating it. To win back investor confidence,

miners must participate in deals that deliver constant shareholder returns, enhance ESG performance, and improve capital and operational discipline. In the case of this acquisition, this is far from the case. There was an immediate negative reaction upon the announcement of the deal as investors believed Fortuna overpaid for Roxgold and that this acquisition brings no value or synergies to Fortuna. Investor confidence has remained extremely negative and Fortuna's share price has plummeted.

Competitive Landscape

The global mining industry is dominated by large players, with Rio Tinto and BHP standing out as clear leaders in the space. Larger mining companies of this nature benefit from diverse product offerings, economies of scale in production, and vertically integrated operations. Smaller mining companies are typically considered a riskier investment as they lack the economies of scale and vertical integration seen in larger players. They typically rely on the success of a few mining operations and if these fail the companies value sees a sharp decline. In relation to this deal, I believe it would have made more sense for Roxgold to have combined with another smaller mining company in the West Africa region which could have created more synergies that would have improved operational efficiency.

M&A Rationale

Strategic Objectives

Diversification / Expansion into West Africa

Upside: One of the main objectives of this acquisition was to diversify jurisdictions into Burkina Faso and Cote d'Ivoire, located in West Africa, approximately 8,000 kilometers from Fortuna's current operations. This placed the combined company in a stronger position to accelerate development of Roxgold's Séguéla gold project, and ramp-up exploration in West Africa and Latin America. Along with this, the acquisition brought together two highly experienced management teams with track records of value creation in the Americas and in West Africa, allowing Fortuna to benefit from the in-region operating experience of key members of Roxgold's team. Lastly it provided Fortuna with a robust pipeline of high-upside exploration assets: Boussoura, a gold exploration project with a maiden resource expected in the second half of 2021, over twenty satellite targets identified at Séguéla, and an extensive portfolio of early-stage exploration assets in Côte d'Ivoire and Mexico.

Potential Criticisms:

- Roxgold is successful in West Africa, but this is considered a second-tier jurisdiction and ranks below Mexico and Peru in several categories on the 2020 Fraser Institute Annual Survey of Mining Companies.
- Fortuna is a leading precious metals miner in the Americas, operating the San Jose Mine in Mexico, the Caylloma Mine in Peru, and the Lindero Mine in Argentina, producing both gold and silver, as well as zinc and lead. It is confusing why they would not continue to build assets in this part of the world, such as Peru, Brazil, the United States or Canada.

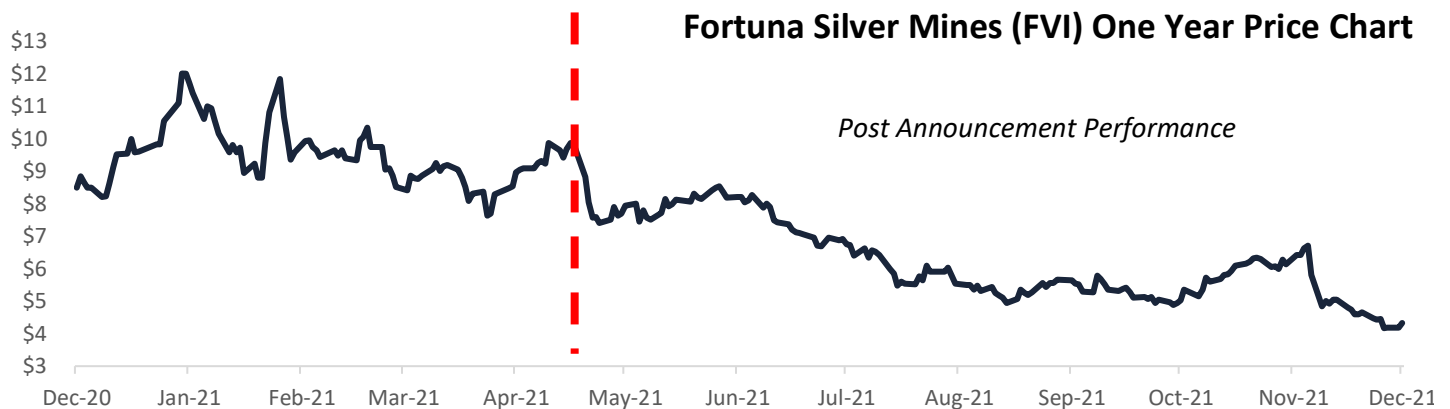
- Roxgold could have found a better acquirer, that would have created synergies between the two and the opportunity for accelerated growth. A potential option could have been a junior gold miner with experience in West Africa, or perhaps in a different part of the continent.
- It's simply a merger of two miners located in completely different parts of the world, and it's difficult to see how this merger adds value, other than creating a larger company which will have greater access to capital and higher trading liquidity.

Enlarged Company with Strong Balance Sheet

The other main benefit of this acquisition is the creation of an enlarged company with a strong balance sheet, significantly higher liquidity, greater scale, and enhanced capital markets relevance. The lower cost of capital and stronger balance sheet will help to fund Séguéla construction and Boussoura's development. Along with this, the combined company has the flexibility to pursue other organic and external growth opportunities.

Synergies

There is an apparent lack of synergies associated with this deal and Fortuna's subpar stock performance goes to show this. Their share price has dropped from \$9.64 on April 23rd, 2021 (day before deal was announced) to \$4.32 as of December 6th, 2021. Investors have lacked confidence in this acquisition since day one and it is clear that this sentiment has remained. The word "synergy" is not included in the press release, and it is difficult to identify how this deal made sense from a financial point of view apart from a strengthened balance sheet and lower cost of capital.



Source: Yahoo Finance

Valuation

Precedent Transactions Analysis

Fortuna Silver Mines acquisition of Roxgold was priced at a 6.4x EV/EBITDA multiple based on a purchase price of \$884M CAD and Roxgold's EBITDA of 138M CAD. Compared to other recent deals, we see that Fortuna completed this acquisition at a discount to its peers which had an average of 8.2x EV/EBITDA. Much of this can be attributed to Roxgold's abnormally high EBITDA compared to industry peers of a similar size.

Date	Target	Buyer	Transaction Value (\$M)	EV/EBITDA
14-Mar-21	Battle North Gold Corporation	Evolution Mining	343	14.3x
11-Nov-21	Pretium Resources	Newcrest	3500	9.2x
11-Feb-21	Teranga Gold	Endeavour Mining	2440	9.4x
06-Jan-21	TMAC Resources	Aginco Eagle Mines	287	3.3x
25-Oct-21	Fiore Gold	Calibre Mining	178	4.6x
Average				8.2x
Median				9.2x

Risks

Commodity Price Risk

Valuation in the metals and mining industry is based off cash flows that are derived from predictions on commodity prices. If future commodity prices take a steep drop, company's valuation's drop severely and this presents a risk for all acquisitions in the industry. Gold prices saw a sharp increase in 2020 reaching a high of around \$1900/oz, and industry professionals are forecasting prices to decrease to around \$1500/oz by 2025. This means that any acquisitions that were valued based off higher forecasts of commodity prices may have overvalued their target.

Failure to execute on exploration and development projects

A key part of this acquisition was acquiring further property to accelerate Fortuna's growth pipeline, with the major project being the Séguéla Gold project in Cote D'Ivoire. If Fortuna is unable to execute at this location and at other exploration sites, they will have greatly overpaid for Roxgold and fail to deliver value to shareholders.

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