

Endeavour Silver Corp.

EDR-TSX | EXK-NYSE

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Mining | Precious Metals - Silver

2Q13 - Caught Between El Cubo and a Hard Place

Event

Endeavour released 2Q13 financial and operating results. We have updated our model for the release of 2Q13 financial and operating results. Production and revenue were pre-released.

Recommendation

We continue to rate shares of EDR Market Perform, and have lowered our target price from \$5.00 to \$4.00.

Analysis

2Q13: A Messy Miss – Both CFPS and adjusted EPS disappointed and fell short of expectations. EDR reported operating cash flow (excl. WC) of \$12.4 mln or \$0.12 per share compared with \$18.3 mln or \$0.18 per share estimated and consensus of \$0.13. EDR delivered adjusted EPS (our calculation) of \$0.01 compared with \$0.06 estimated and consensus of \$0.02. The waters were muddied, as we expected, by high production costs, exploration and G&A expenses, and higher than expected taxes. We expect 3Q13 will provide a much better gauge on the profitability of EDR's operations at current prices, given the cost cutting initiatives implemented near the tail end of 2Q.

Balance Sheet: Losing its Shine – EDR's balance sheet has been weakened by dwindling cash and equivalents (\$22.3 mln), inventories (~\$28 mln) and \$39 mln drawn from its \$50 mln credit facility. Lower capital expenditures in 2H13E (\$6.5-\$7.5 mln vs. \$60.4 mln in 1H13), which will hopefully enable a rebuilding of balance sheet strength, as long as metal prices remain at current levels.

El Cubo On a Short Leash - Cutting Target – EDR is now mid-way through a two year operational turnaround at El Cubo. Hampered by weak metal prices and high operating costs (from El Cubo and Guanacevi) positive results are needed in 2H13 or hard decisions will be made. We take a conservative view of El Cubo and have cut back our near-term cash flow expectations for the mine. As result we have elected to cut our target to \$4.00 (from \$5.00 previously).

Valuation

Our \$4.00 target price is derived by applying a 6.0x target multiple to our 2014E CFPS estimate, which we feel adequately captures EDR's 2014E cash flow potential, a weakening balance sheet, the high cost nature of the Guanacevi mine, and economic uncertainties surrounding El Cubo.

CFPS	1Q Mar	2Q Jun	3Q Sep	4Q Dec	Full Year	Revenues (mln)	NAV
2012A	US\$0.29	US\$0.19	US\$0.19	US\$0.19	US\$0.87	US\$208	
Old 2013E	0.25A	0.18	0.06	0.09	0.58	238	C\$5.31
New 2013E	0.25A	0.12A	0.07	0.09	0.53	244	C\$4.44
Old 2014E	0.16	0.17	0.16	0.15	0.64	242	NA
New 2014E	0.12	0.13	0.13	0.11	0.48	232	NA

Source: Raymond James Ltd., Thomson One

August 7, 2013

Company Comment

Rating & Target

Target Price (6-12 mos):	Old: C\$5.00	New: C\$4.00
Current Price (Aug-07-13)		C\$3.60
Total Return to Target		11%
52-Week Range		C\$10.46 - C\$3.03

Suitability

High Risk

Market Data

Market Capitalization (mln)	C\$359
Current Net Debt (mln)	C\$15
Enterprise Value (mln)	C\$374
Shares Outstanding (mln, f.d.)	104.7
10 Day Avg Daily Volume (000s)	163
Dividend/Yield	C\$0.00/0.0%

Key Financial Metrics

	2012A	2013E	2014E
P/CFPS	4.0x	6.5x	7.1x
P/NAV		0.8x	NA
Ag Price (US\$/oz)			
Old	US\$31.16	US\$23.04	US\$23.00
New	US\$31.16	US\$23.50	US\$23.00
Attributable Ag Production (000 oz's)			
Old	4485	5948	6361
New	4485	6109	6285
Ag Cash Cost (US\$/oz)			
Old	US\$7.33	US\$10.13	US\$7.33
New	US\$7.33	US\$10.91	US\$10.49
EPS			
Old	US\$0.44	US\$0.17	US\$0.26
New	US\$0.44	US\$0.13	US\$0.16
P/E	7.8x	27.3x	21.5x

Company Description

Endeavour Silver is an emerging mid-tier silver company with production from three mines in Mexico (Bolanitos, Guanacevi, and El Cubo), focused on growing production and reducing costs.

Financials – A Messy Miss

Overall, 2Q13 financial results were weaker than anticipated (our expectations and consensus). EDR delivered operating cash flow (before WC) of \$12.4 mln or \$0.12 per share compared with \$18.3 mln or \$0.18 per share estimated and consensus of \$0.13. EDR delivered adjusted EPS (our calculation) of \$0.01 compared with \$0.06 estimated and consensus of \$0.02.

The miss vs. our estimates was primarily attributable to higher production costs of goods sold, higher exploration and G&A expenses, and higher than expected taxes. Costs were weighed down by one-time items (severance costs and downward inventory adjustments). Going forward, balance sheet strength and operating costs (from Guanacevi and El Cubo) require a watchful eye, in our view.

Consolidated production results were pre-released. For further analysis on how our estimates stacked up vs. the quarter see our *Brief* from today: [‘2Q13 First Look \(Miss\) - Not a Pretty Picture - As Expected’](#), price \$3.90.

Operations

On consolidated basis, EDR reported production of 1.54 mln oz Ag and 19.9 k oz Au (previously reported) at total cash costs per oz Ag (net of credits) of \$10.53, which was higher than our estimate of \$8.69, and higher than full year guidance range (\$9.00 - \$10.00, based on \$30 Ag, \$1,650 Au). The variance vs. our estimates was largely attributable to lower gold sales (by-product credits). On a cost per tonne milled basis (our preferred cost metric) EDR reported costs of \$96/t which was in-line with our estimate. Low cost tonnes at Bolanitos offset higher cost tonnes at El Cubo.

- ♦ **El Cubo - Another transition quarter.** While we expected a dip in 2Q13 production due to planned downtime, El Cubo needs at start delivering operational improvements in 2H13 by utilizing the recently refurbished mill and plant facility. El Cubo produced ~170 K oz Ag and 2.6 K oz Au at our estimated cash operating cost of ~\$36.00 / oz AgEq. Recoveries were also lower than we anticipated caused by the plant being emptied and re-loaded, as part of the construction process.
- ♦ We have adjusted our grade assumptions downwards for 2H13 and 2014 and adjusted our cost assumptions for 2H13 and 2014 higher. Our revisions lower the profitability of El Cubo to close to breakeven in 2H13E. For 2013 we now estimate 1.9 mln oz AgEq at a total cash cost of ~\$24 / oz AgEq (or ~\$21 / oz AgEq in 2H13).
- ♦ **Bolanitos – EDR’s saving grace.** A combination of better than anticipated mill throughput and grade from Bolanitos helped mitigate damage caused by weak metal prices and high operating costs. Bolanitos produced ~810 K oz Ag and 15,751 oz at our estimated cash operating cost of ~\$13.30 / oz AgEq, which represented 53% and 79% of EDR's consolidated silver and gold production, respectively, during the quarter.
- ♦ Mine throughput averaged 2,225 tpd, well above plant capacity of 1,600 tpd, with the additional ore processed at the leased Las Torres plant at El Cubo (now returned to its owner). In addition, better than expected grades contributed to better than anticipated performance at Bolanitos. We view this positively, as Bolanitos ranks as EDR's most profitable mine. We caution that the processing of Bolanitos ore at a throughput rate of plus-2,200 tpd isn't sustainable in the near-term.
- ♦ We have adjusted our grade and recovery assumptions upwards for 2H13 and 2014 and adjusted our cost assumptions for 2H13 and 2014 higher. We see Bolanitos delivering a ~45% operating margin in 2H13 and 2014.

- ♦ **Guanacevi – High costs remain a concern.** Overall, higher than expected head grades compensated somewhat for the lower than anticipated throughput (due to an unscheduled repair and maintenance issues at the plant) and lower recoveries (due to the higher grade ore from Porvenir Norte). Guanacevi produced ~555 K oz Ag and 1,590 oz Au at our estimated cash operating cost of ~\$17.60 / oz AgEq. We are cautious about Guanacevi's profitability as the mine ranks as EDR's least profitable mine.
- ♦ We have adjusted our sustaining capital assumptions downwards for 2H13 and 2014 higher, prompted by management's decision to limit capital expenditures at the mine to a minimum. We see Guanacevi delivering a ~30% operating margin in 2013 / 2014.

In Summary

A poor 2Q13 for Endeavour Silver and a miss on EPS and CFPS underline our Market Perform rating, which we reiterate until we begin to see improvements in El Cubo and Guanacevi's operating performance.

Key Points to Watch for in 2H13

- ♦ A strengthening balance sheet – (from net debt ~\$15 mln in 2Q13),
- ♦ Close to breakeven financial performance from El Cubo and profitability at Guanacevi,
- ♦ Visibility on an operational turnaround at El Cubo. We continue to look at 2H13 as key for El Cubo – 3Q13 will be a better gauge of success or failure at El Cubo. Given today's metal prices, the leash is increasingly short.

Exhibit 1: Corporate Tearsheet

Endeavour Silver Corp

Rating:	MARKET PERFORM 3
6-12 Mth Target	C\$ 4.00
Projected Return:	11%
	NAVPS \$4.44
	YR-END: 31-Dec

Investment Thesis

Endeavour Silver is an emerging mid-tier silver producer, with an attractive growth profile from existing operations and new acquisitions (El Cubo). The company has a proven track record of increasing production and reducing cash costs.

Key Attributes:

- Turnaround story at El Cubo
- Near term production growth through El Cubo acquisition and organic expansion initiatives
- Self-funded (Mexico) growth agenda
- High quality management team with proven track record of increasing production and reducing costs
- Attractive portfolio of exploration projects (Parral, Arroyo Seco, San Sebastian)

Key Concerns

- Development Risk
- Cost Inflation
- Silver/Gold Price Risk
- Political Risk
- Operational / Labour Risk

Reserves & Resources Profile (Attributable)

(As of Dec-31-12)	Project	Category	Tonnes ('000)	Ag Eq (g/t)	Ag Eq ('000 oz)
Reserves	Bolanitos	P&P	1,761	256	14,486
	Guanacevi	P&P	1,220	261	10,239
	El Cubo	P&P	1,595	259	13,301

Resources	Bolanitos	M&I +Inf.	3,620	248	28,908
	Guanacevi	M&I +Inf.	5,216	274	45,998
	El Cubo	M&I +Inf.	3,831	264	32,487
	Other	M&I +Inf.	8,599	270	74,676
Global Total			27,860	264	236,241

Operating Summary	2012	2013E	2014E	2015E
Production - Ag Eq (k oz) - 100% basis				
Bolanitos	3,058	5,430	4,699	4,521
Guanacevi	2,939	2,828	2,969	2,997
El Cubo	567	1,877	2,408	2,846
Total	6,564	10,135	10,076	10,364
Op. Cash Costs (US\$/AgEq oz)				
Bolanitos	10.82	12.53	13.18	13.84
Guanacevi	14.95	17.04	16.40	15.47
El Cubo	10.51	24.06	17.65	14.69
	12.64	15.92	15.20	13.57

Year	El Cubo Prod'n (k oz's)	Bolanitos Prod'n (k oz's)	Guanacevi Prod'n (k oz's)	Op. Cash Costs (US\$/AgEq oz)	R/L Silver Forecast US\$/oz
2012	567	3,058	2,939	12.64	~28
2013E	1,877	5,430	2,828	15.92	~25
2014E	2,408	4,699	2,969	15.20	~25
2015E	2,846	4,521	2,997	13.57	~25

R/L Covered Silver's P/2014E CFPS Multiples

Producer	Current P/2014E CFPS	Target P/2014E CFPS
MND	~4.0x	~6.0x
SVL	~5.0x	~8.0x
SVM	~6.0x	~11.0x
PAA	~7.0x	~10.0x
FVI	~8.0x	~10.0x
EDR	~9.0x	~8.0x
SCZ	~10.0x	~10.0x
THO	~11.0x	~12.0x
FR	~12.0x	~13.0x
SLW	~14.0x	~24.0x

RAYMOND JAMES LTD. RESEARCH

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Associate: Brian Martin 604 654 1236

Reporting Currency: US

Management	% Ownership	Institutional Shareholders	% Ownership
Cooke, Bradford James	1.1	Van Eck Associates Corp	8.0
Szotlender, Mario D.	0.2	Renaissance Technologies	3.5
Walton, Godfrey J.	0.2	Connor, Clark & Lunn Inves.	3.1

Market Statistics

Share Price	C\$ 3.60	Shares Basic (mln)	99.7
52 Week High/Low (C\$)	10.46-3.03	Shares Fully Diluted (mln)	104.7
Market Cap. (mln)	\$359	Adj. Shares used in NAV calc (mln)	104.7
Enterprise Value (mln)	\$374	Avg Daily Volume:	207

Financial Metrics	2011	2012	2013E	2014E	2015E
Cash & Equiv. (mlns)	75	19	32	46	53
Working capital (mlns)	142	51	25	59	92
Current ratio (x)	12.3x	2.1x	1.4x	2.2x	4.2x
LT Debt (mlns)	-	9	39	19	-
Common Equity (mln's)	200	340	351	371	399
Price/book (x)	1.5x	1.0x	1.0x	1.0x	0.9x
ROE	9%	12%	4%	4%	6%
CFO (\$mln)	48.8	76.0	44.7	49.7	50.6
CFI (\$mln)	(59.8)	(144.3)	(63.7)	(18.2)	(29.6)
FCF (\$mln)	1.9	9.8	(23.6)	31.6	21.1

Earnings/Cash Flow	2011	2012	2013E	2014E	2015E
R/L Silver Forecast US\$/oz	35.36	31.16	23.50	23.00	23.00
Revenue (\$mln)	128.0	208.1	244.5	231.8	238.4
Corporate EBITDA (\$mln)	59.1	91.4	64.6	60.6	71.6
EBITDA margin (%)	46%	44%	26%	26%	30%
EV/EBITDA (x)	6.3	4.1	5.8	6.2	5.2
Corporate EBIT (\$mln)	35.6	60.1	22.8	28.5	37.0
Net earnings (\$mln)	18.8	42.1	12.8	16.4	23.0
EPS (US\$)	0.22	0.44	0.13	0.16	0.22
P/E (x)	15.8x	7.8x	27.3x	21.5x	15.3x
CFPS (US\$)	0.74	0.87	0.53	0.48	0.56
P/CF (x)	4.6x	4.0x	6.5x	7.1x	6.1x
Capex (\$mln)	(47)	(66)	(68)	(18)	(30)

Valuation (C\$)	2012	2013E	2014E	2015E
Cash Flow				
CFPS (C\$)	\$0.90	\$0.55	\$0.50	\$0.58
Target Multiple			6.0x	
Value			\$3.04	
Development and Exploration Credits				
	Value (\$mlns)	Per Share		
Parral (100%)	\$26,309	\$0.25		
Guadalupe y Calvo (100%)	\$16,145	\$0.15		
San Sebastian (100%)	\$42,437	\$0.41		
Total Exploration	\$84,892	\$0.81		
Target Price		\$4.00		
Projected Return to Target		11%		
Valuation Measures				
	Target Multiple	Current Multiple		
Price/2014E CFPS	8.3x	7.1x		
P/NAV	0.9x	0.8x		

Producer	Current P/NAV	Target P/NAV
SVM	~0.65x	~1.15x
SCZ	~0.68x	~0.95x
SVL	~0.70x	~1.10x
PAA	~0.75x	~1.15x
THO	~0.78x	~0.95x
FVI	~0.80x	~1.15x
EDR	~0.82x	~0.95x
MND	~0.85x	~1.25x
FR	~0.88x	~1.15x
SLW	~0.90x	~1.50x

Source: Raymond James Ltd.

Company Citations						
Company Name	Ticker	Exchange	Currency	Closing Price	RJ Rating	RJ Entity
First Majestic Silver	FR	TSX	C\$	11.95	2	RJ LTD.
Fortuna Silver Mines Inc.	FVI	TSX	C\$	3.34	2	RJ LTD.
Mandalay Resources Corp.	MND	TSX	C\$	0.77	2	RJ LTD.
Pan American Silver	PAAS	NASDAQ	US\$	11.66	2	RJ LTD.
Santacruz Silver Mining Ltd.	SCZ	TSXV	C\$	1.30	2	RJ LTD.
Silver Wheaton	SLW	NYSE	US\$	20.93	2	RJ LTD.
Silvercorp Metals Inc.	SVM	NYSE	US\$	2.73	2	RJ LTD.
SilverCrest Mines Inc.	SVL	TSXV	C\$	1.55	2	RJ LTD.
Tahoe Resources Inc.	THO	TSX	C\$	14.76	2	RJ LTD.

Notes: Prices are as of the most recent close on the indicated exchange and may not be in US\$. See Disclosure section for rating definitions. Stocks that do not trade on a U.S. national exchange may not be registered for sale in all U.S. states. NC=not covered.

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Venture Risk (VR) Companies with a short or unprofitable operating history, limited or less predictable revenues, very high risk associated with success, and a substantial risk of principal.

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	Coverage Universe Rating Distribution				Investment Banking Distribution			
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Strong Buy and Outperform (Buy)	62%	50%	43%	46%	31%	25%	0%	0%
Market Perform (Hold)	37%	44%	57%	34%	27%	9%	0%	0%
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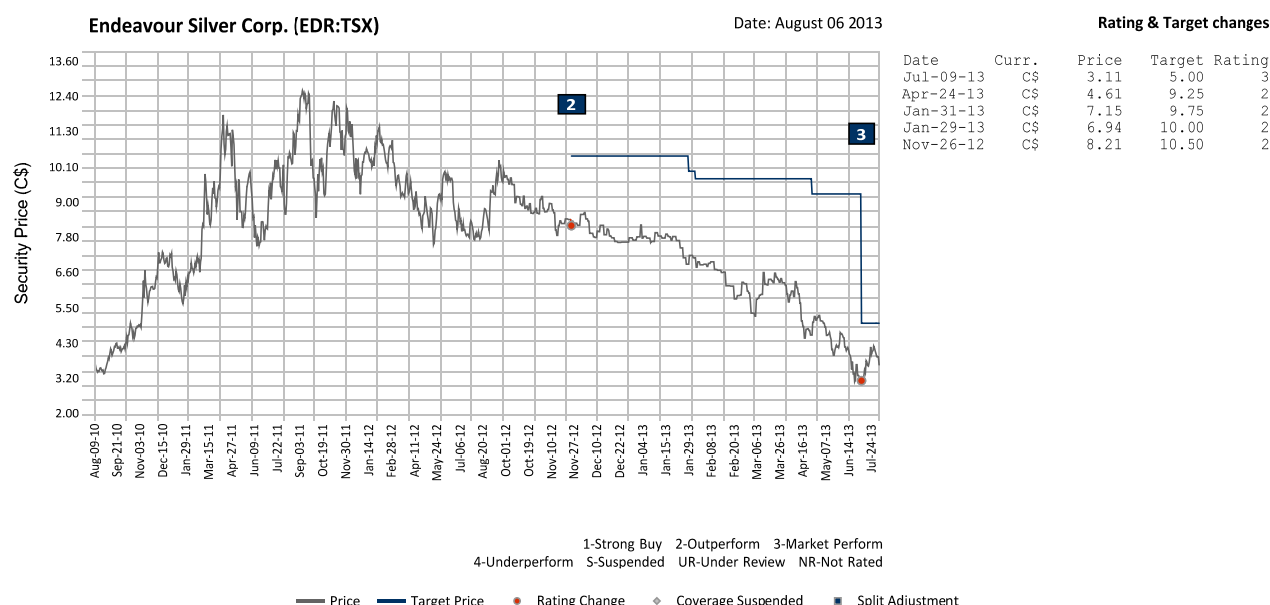
Company Name	Disclosure
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Company Name	Disclosure
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Stock Charts, Target Prices, and Valuation Methodologies

Valuation Methodology: The Raymond James methodology for assigning ratings and target prices includes a number of qualitative and quantitative factors including an assessment of industry size, structure, business trends and overall attractiveness; management effectiveness; competition; visibility; financial condition, and expected total return, among other factors. These factors are subject to change depending on overall economic conditions or industry- or company-specific occurrences.

Target Prices: The information below indicates our target price and rating changes for EDR stock over the past three years.



Valuation Methodology: We value Endeavour Silver on a CFPS-multiple basis versus comparable silver producers, with additional credit given for non-cash flowing assets.

Risk Factors

General Risk Factors: Following are some general risk factors that pertain to the projected target prices included on Raymond James research: (1) Industry fundamentals with respect to customer demand or product / service pricing could change and adversely impact expected revenues and earnings; (2) Issues relating to major competitors or market shares or new product expectations could change investor attitudes toward the sector or this stock; (3) Unforeseen developments with respect to the management, financial condition or accounting policies or practices could alter the prospective valuation.

Risks - Endeavour Silver Corp.

- **Development Risk.** 2013 is a critical year for Endeavour Silver as it improves on operational efficiencies, re-develops the El Cubo mine and plant, and contemplates another plant and mine expansion at the Bolanitos mine. Key catalysts for El Cubo are a successful program of resource to reserve conversion; complemented by the successful commissioning of new crushing, conveying, grinding, and flotation circuits as an alternative to renewing the operating lease for the Las Torres mill complex. Key catalysts for Bolanitos are the successful delivery of ore from new vein discoveries (Karina/Daniela/Lana veins) and a successful ramp-up in plant throughput to ~1,600 tpd by early 2013E.
- **Political Risk.** Endeavour Silver's production asset base is located in Mexico. The Guanajuato mining district (Bolanitos/El Cubo) is a safe and pro-mining district which has enjoyed over 100 years of mining history. The Guanacevi location in Durango State necessitates a heightened level of caution to mitigate the negative effects associated with narcotics and drug cartels in this region.
- **Silver Price Risk.** A drop in the silver price could cause deterioration in Endeavour Silver's ability to fund its development project pipeline, which Raymond James Ltd. estimates will be financed via cash flow.
- **Cost Inflation Risk.** Our outlook assumes certain future capital and operating costs for development projects. Although we apply conservative estimates to these assumptions there is a risk that we have understated these costs or that these costs may increase in the future.
- **Operational and Labour Risk.** There is a risk that Endeavour Silver's operations suffer accidents or disruptions to production or development which could impair the value of the assets. Risks of labour disruptions, especially at El Cubo due to potential strike action, may also impact production and profitability.

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