



# BEACON ROCK RESEARCH

OCTOBER 16, 2009  
RESEARCH NOTE

## ETRUSCAN RESOURCES INC. (TSX: EET, C\$0.56)

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Disclosures 1,2,3,4

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### Endeavour Financial Recognizes Upside in Etruscan's Assets

Etruscan Resources Inc. (TSX: EET) was among our half dozen 2009 Precious Metals Picks for resource developers published on January 1, 2009. At that time, Etruscan had exceeded its anticipated gold production levels at their Youga gold project in Burkina Faso with good potential to extend the life of the mine by drilling known satellite deposits including the new Ouare' target only 35 km to the north. The likelihood for increased gold production, mine life, and gold reserves appeared good.

At the beginning of 2009, it seemed that resource developers and junior producers without profitable operations were indiscriminately priced by the market as if they were going out of business. Companies with solid assets such as Etruscan we believed had good potential to acquire capital and remain viable. "Unless the world was coming to an end," we assumed that speculators would come in at low valuations and markets would stabilize. It appeared that even with additional dilution, following an historic market sell off, existing shareholders or new investors with the courage to ante up near 52-week lows would be rewarded by the end of the year.

Etruscan had a number of assets that could be monetized by joint venture or sale. Etruscan controls about 10,000 sq. km, the largest land position of any mining company in West Africa, and consequently may be best positioned for exploration success. Etruscan also has rare earth targets in Namibia, and interests in alluvial diamond operations in South Africa. In addition to Youga, an operating gold mine, Etruscan reported a gold resource of over three million ounces in West Africa and had recently produced a Feasibility Study for its Agbaou project in Côte d'Ivoire. Lastly, Etruscan management and its exploration team had worked together through metal cycles and had a history of experience in the countries in which it is operated.

We were correct inasmuch as the world did not end, and consequently our half dozen picks were up an average of 73.4%, 111.3%, and 113.7% from the beginning of 2009 through the end of March, June and September, respectively. Whereas most of the picks enjoyed the greatest appreciation in the first quarter of 2009, Etruscan trailed the pack, declining to US\$0.16 per share on July 8, 2009 after starting the year at US\$0.43 per share. Following the announcement on September 23, 2009 of the equity financing by Endeavour Financial Corporation (TSX: EDV), Etruscan appreciated to a high of US\$0.49 per share. A shareholder's meeting has been scheduled for October 22, 2009 for a vote on the private placement by Endeavour.

The placement is anticipated to result in a comprehensive restructure of the bank debt and to relieve significant financial pressures that may jeopardize Etruscan as a going concern. The financial backing by Endeavour allowed for the reduction of the hedge book and deferment of principal repayment, providing an immediate increase in cash flow from existing operations. The placement will provide increased working capital for both the Youga operation and at the corporate level, important for preserving and maximizing other opportunities. At closing, Endeavour will own about 54% of Etruscan, with Etruscan being the first acquisition in its roll up strategy to create an intermediate size gold company.

### **Etruscan's Challenges Enhanced by Under-Capitalization**

Etruscan was undercapitalized at the start of 2009 and needed to raise funds for working capital while gold production operations were optimized. In February of 2009, Etruscan raised essential working capital of C\$10.5 million (for 26,315,789 common shares and 6,890,741 warrants) from Maxim Finskiy, the CEO of LLC MC Intergeo, the mining and exploration arm of the private Russian investment fund Onexim Group. Prior to that position, Finskiy was the Deputy General Director and Deputy Chairman of the Management Board of MMC Norilsk Nickel from 2001 to 2009.

The investment by Finskiy was consistent with our investment thesis that companies with good assets would attract speculators. It followed our conviction that profit maximizing investors would make capital available, assure investors, and erase the discount in the market for uncertain company viability. This should allow both the stock price to return to levels prior to the sell off and permit management to maximize its inherent opportunities. Finskiy fit the bill, even though the cash infusion did not adequately capitalize Etruscan. Finskiy took part in a later US\$5 million debt financing and brought in Stephen Stine to become the new Chief Operating Officer and assume responsibility for on-site operations at Youga.

Stine had over 37 years of mining experience, at all levels in a wide variety of settings. It was apparent to us that Stine's level of interest to Youga at this advanced stage in his career was consistent with our opinion of the project's potential. Youga produced only 3,626 ounces of gold in May (Stine having taken over at the end of April), which increased to 5,127 ounces in June and 6,093 ounces in July with a target of 7,000 ounces for September. In anticipation of weaker than anticipated performance in its second quarter, Etruscan's stock price declined to the low for the year. Production continued to improve to 6,526 ounces and 6,600 for August and September, respectively.

It would appear that Stine was important for improving production through September. Part of the failure to meet the September goal of 7,000 ounces may be attributed to the temporary suspension of operations to connect with grid power with the electric utility in Burkina Faso (SONABEL) in partnership with the Volta River Authority (VRA), a Ghanaian power utility. The initial rate for grid power is US\$0.13/kwh compared to US\$0.33/kwh for diesel generated power. This represents a monthly cost savings of US\$250,000 to US\$300,000 or roughly \$50 per ounce. In addition to reduced costs, the connection to the grid provides a consistent and more reliable source of power than relying on the diesel generators, which were originally intended for back-up power only. Overall, it would appear that operations at Youga are stabilizing, and at current gold prices, with restructuring of debt and the hedge book, the project should be profitable.

### **Endeavour Financing and Restructure to Fully Capitalize Operations**

Maxim Finskiy's investment in Etruscan was important in order for Etruscan to remain viable in early 2009. The investment was insufficient, however, to meet bank working capital requirements. Eventually Finskiy traded out of Etruscan by selling his position to Endeavour, who agreed to invest an additional US\$43 million as part of a US\$48 million capital restructuring. The US\$5 million balance includes conversion of debt to equity of US\$3 million by the project financier RMB/Macquarie, and US\$2 million by bridge lender Conus Partners. The placement and conversion were completed at US\$0.30 per share.

Funds from the restructuring will retire the US\$10.5 million bridge loan and reduce project debt financing by US\$3 million to \$30 million. The restructure is scheduled to provide US\$5 million in working capital and improvements to the Youga operation and US\$6.5 million for corporate working capital. The remaining US\$23 million will re-purchase about 50% of the hedge book subject to gold prices. At this level it is anticipated that the hedge book would be reduced to less than 20% of production over the scheduled 6.6 year mine life. While additional working capital and project cash flow should increase gold resources and extend the mine life, at record gold prices, the reduction in the hedge book at about US\$700 per ounce should provide an immediate boost to cash flow.

The reduction in risk to the project lenders by completion of the placement will align the bank's interests with Etruscan more as a partner than an adversary. Principal payments on the debt will be deferred 15 months until the end of 2010, when quarterly payments of US\$2.3 million will commence. The final repayment date for the debt may be extended, dependent upon a revised mine plan. The US\$3 million in debt converted to equity will provide increased interest in Youga's success in the long-run rather than in capturing cash flow and paying the loan down in the short term. Overall, it is expected that the benefits to the bank, by both reducing risk and increasing upside, will lead to more flexible covenants and elimination of defaults for noncompliance.

There are presently about 159,141,915 shares of Etruscan outstanding. Upon completion of the placement, Endeavour will have 153,123,000 shares plus the 26,315,789 shares acquired from Finskiy, bringing its total shares to 179,438,789. Conversion of US\$2.0 million of the bridge loan and US\$3.0 million of the project financing will add an additional 19,700,000 shares. Endeavour will hold 54% of the 331,938,065 shares outstanding and four seats of seven on Etruscan's board of directors. Endeavour has indicated that their nominees will be Neil Woodyer (Endeavour Financial CEO), Frank Giustra (President and CEO of Fiore Financial Corporation, exclusive advisor to Endeavour Financial), Gordon Keep (EVP Fiore Financial Corporation) and David Street (Endeavour Financial, managing director, debt finance).

While Etruscan's existing shareholders will suffer significant dilution of their positions, the placement will eliminate concerns about company viability, place the company on an immediate course of value creation, and provide upside through inclusion in a larger organization during a period of rising gold prices.

### **Endeavour Placement Provides Long-Term Upside**

Endeavour has a long history of success in value creation in the mining industry. They have a good track record of financing and restructuring companies such as Wheaton River Mineral Ltd., Northern Orion Resources Inc., UrAsia Energy Ltd., Bema Gold Corp. and Pacific Rubiales Energy Corp. Many of these financings were completed in early stages of development at periods of lower metal prices, benefiting investors by upward re-rating of assets during periods of rising metal prices.

Endeavour provided numerous financings to Wheaton River Minerals, accommodating the acquisition of the Luismin gold-silver mine in Mexico, 25% of the Alumbreira copper-gold mine in Argentina, and the Peak Gold mine in Australia. Silver Wheaton was created from the Luismin silver-stream spin out, and the remaining assets of Silver Wheaton Minerals were combined with Goldcorp in a transaction valued at C\$2.5 billion.

Endeavour also financed Bema Gold Corporation's Refugio Mine in Chile, and the Julietta and Kupol Mines in Russia. The US\$442 million loan facility for construction of the Kupol Mine was awarded "Mining Deal of the Year" by the Project Financing International Awards 2005. Bema was later sold to Kinross for US\$3.3 billion.

The placement in Etruscan is part of a larger strategy by Endeavour to acquire attractive gold assets with both exploration and production upside to build an intermediate size gold company. They have established a US\$150 million cash dedicated to the current gold strategy to make select acquisitions, and Etruscan is their first investment. In addition to financial backing, Endeavour will make available the expertise of its teams, which appear to complement Etruscan's management team. We would expect that the fund will be expanded and Endeavour will make additional select acquisitions in the near term.

Shareholders of both Endeavour and Etruscan may expect the placement to be accretive to both companies as operations stabilize at Youga, exploration and development projects are advanced or monetized, and the assets enjoy upside from re-rating, potentially as a larger going concern with exposure to higher gold prices.

### **Postscript on Mix of Cultures**

It would appear on the surface that Endeavour's acquisition of a controlling interest was premised on the fundamentals of the Youga gold mine relative to Etruscan's market cap during a period of rising gold prices. It is not clear if Endeavour has placed much value on Etruscan's other assets, including the Agbaou project in Côte d'Ivoire, exploration targets in West Africa, or other rare earth or diamond interests in southern Africa. As the market cap of Etruscan was less than the cost of construction on its balance sheet, it can be argued the market was not giving value to these very real assets. It is interesting to us that the quality of Etruscan's management team cannot be captured in the investment price either.

Etruscan management has enjoyed tremendous success in building the largest exploration package in West Africa. This is the result of decades of investment in a part of the world that is too easily overlooked during periods when, for economic or political reasons, the return or risk reduces its appeal. This required that management invest both their careers and personal lives to create wealth, and consequently improve the living standards in the countries and communities in which Etruscan has operated.

October 16, 2009

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It should be noted that Frank Giustra (President and CEO of Fiore Financial Corporation, exclusive advisor to Endeavour Financial), who is credited with the success of Silver Wheaton Minerals, is a partner in the Clinton Giustra Sustainable Growth Initiative (CGSGI), an initiative launched by President Bill Clinton and Frank Giustra in June 2007. CGSGI is the vehicle in which Endeavour pursues corporate social responsibility. While CGSGI appears to be most active in South America, the investment in Etruscan with the work accomplished by Etruscan CEO Gerry McConnell and his team will be interesting to follow.

Endeavour's inclusion of Etruscan in their strategy suggests an unexpectedly positive combination of cultures. While this does not show up in analyst models, it has a very real impact on improving feasibility and profitability of projects. This potential creation of well being is consistent with our view of the importance of responsible mining companies in the natural resource sector providing greater opportunity for wealth in some of the most forgotten and remote locations in the world.



**Etruscan's Youga Gold Mine**

Source: Etruscan

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