Mike Parkin, (416) 869-6766, mike.parkin@nbc.ca
Associate: Jonathan Egilo, (416) 507-8177, jonathan.egilo@nbc.ca
Associate: James Duncan, (416) 869-8511, james.duncan@nbc.ca

November 25, 2019

Kirkland Lake Gold Ltd.

KL (TSX; NYSE): C$53.62; US$40.36

Stock Rating: Sector Perform

Target: C$66.00

Risk Rating: Above Average

Kirkland Buying Detour - Where Does the Premium Multiple Go?

This morning before market open, Kirkland Lake announced it entered into a definitive agreement with Detour Gold (DGC: TSX, Outperform, C$27.00 target) whereby Kirkland Lake would acquire all of the outstanding shares of Detour, at an offer price equivalent to C$27.50 per share of Detour based on Friday's close. The all-stock transaction represents a 24% premium to Detour's closing prices as of November 22 (29% premium to the 20 day VWAP), which based on our estimates represents a price paid of 1.27x NAV. On an 2020 EV/EBITDA basis, the price paid represents a 9.9x multiple. The deal is accretive on both metrics to Kirkland Lake, due to its trading premiums commanded by a portfolio of high grade mines, which we believe this deal could begin to put pressure on. The deal is anticipated to close in January 2020.

In our view, a key attribute that drives Kirkland's premium valuation is the extremely high-grade nature of its Fosterville mine (reserve grade of 31.17 gpt) and the potential to add significantly to the current 4.5 year reserve life as of Dec. 31st, 2018. Fosterville accounts for 53.5% of our NAV for Kirkland. We view it necessary to show further exploration success at similar or better grades at Fosterville to sustain the high multiple on NAV (2.55x as of Friday's close). It is important to note that our base case valuation for Fosterville assumes exploration success in 2019 is achieved through the addition of 1.1Mt grading in line with the current reserve grade, which is a little over a 40% bump in overall reserve tonnage. Kirkland is planning to release an exploration update on Fosterville later this quarter, which is a key indicator to this potential, but also a key risk if it proves to fall under our target. Our target is based on past success rates relative to the exploration budget. With the addition of the Detour Lake mine and the likely restart of the Cosmo mine (reaffirmed by management on today's conference call) in the Northern Territories, we believe we could see Kirkland's sector best valuation drift down to something more in line with other highly regarded miners in the senior space, like Agnico Eagle (AEM: TSX, Outperform, C $99.00 target), as the significance of Fosterville is diluted. Agnico Eagle closed Friday at 1.51x NAV and 11.1x 2020 EBITDA on an EV/EBITDA basis.

Figure 1: Key Transaction Metrics

	DGC	KL	NewCo
Share Price as of Nov. 22 (US$)[1]	16.70	47.62	47.62
Shares O/S (M)	177.4	210.9	287.9
Market Cap (US$M)	2,962	10,043	13,712
Cash (US$M)[2]	249	849	1,098
Debt (US$M)[2]	0	0	0
Enterprise Value (US$M)	2,713	9,194	12,613
NAV (US$M)[3]	2,927	4,417	7,565
NAVPS (US$)	16.50	20.94	26.27
P/NAV (x)[4]	0.95	2.55	1.95
2020 CFPS (US$M)[5]	2.11	3.29	3.79
2020 P/CF (x)	7.9	14.5	12.6
2020 EBITDA (US$M)[5]	369	987	1,380
2020 EV/EBITDA (x)	7.4	9.3	9.1

Notes: 1. DGC share price calculated using CAD rate of 1.33
2. Cash and debt are NBF's 3Q20 estimates
3. NewCo NAV calculated excluding DGC long term G&A expenses
4. P/NAV calculated net of cash, investments, and G&A
5. 2020 NewCo CFPS and EBITDA excludes DGC G&A and includes US$10M in acquisition fees, and assumes KL 100% ownership begins January 1, 2020

Source: National Bank Financial, Company reports

Under the terms of the transaction, Kirkland Lake is to acquire all of the outstanding shares of Detour through an all-stock exchange of 0.4343 Kirkland Lake shares for each Detour share, implying a price paid of C$27.50 per Detour share and a deal value of ~C$4.9 billion. We value Detour at C$21.72 per share on a NAV basis. If we exclude our 10-year corporate G&A expense, our NAVPS increases to C$23.37, implying a cash-adjusted P/NAV price paid of 1.19x (assumes the closure of Detour's head office and other corporate expenses). Our NAV estimates are based on a forward 12 month basis, meaning the B/S items are taken as of 3Q20 and our DCF valuations begin with 4Q20 and go forward. We do this as our target price is based on a forward 12 month basis. With Kirkland Lake trading at a significant premium to NAV, based on our early estimates, the deal proves about 25% accretive to NAV (see Figure 1 above). We also anticipate accretion on an EV/EBITDA and P/CF multiple basis, a function of Kirkland Lake trading at a premium relative to Detour Lake as seen in Figure 1.

Kirkland Lake is guiding to pre-tax synergies of US$75 - 100 million per year. Detour's annual G&A expense is roughly US $30 million per year, implying ~US$45 - 70 million in operational synergies. Management indicated on the call that these savings could come from supply chain synergies and operational improvements beyond that identified by Detour. Kirkland Lake management has stated its anticipates it can expand the milling rates from current operating levels of ~61,000 tpd, which Detour management has already indicated through a permit amendment. Detour's management is calling for milling rates sustainable at around 80-85ktpd with no capital infusion required. Detour management expects to be able to keep the mill full at these higher rates if the mine continues to realize the 20+% positive tonnage reconciliation to the block model. When asked on the call, Kirkland's management team indicated the expansion it references in the news release would be beyond this, requiring a capital infusion to achieve it. Kirkland also acknowledged plans to ramp up exploration activities at the Detour Lake mine and surrounding area. Detour holds over 1,000 square kilometres, with minimal exploration work conducted on it to date, with total exploration spending from the beginning totaling US$38 million. Kirkland implied the ~US$5 million per year budget would be increased considerably once the deal closes. Termination fees are set at US$148 million payable to Kirkland and US$202 million payable to Detour.

We derive our C$66.00 target price for Kirkland Lake from a 100% weighted 9.00x NTM EV/EBITDA target multiple, which implies a P/NAV valuation of 2.60x. As of Friday's close, KL was trading at 9.54x and 9.45x our 2019 and 2020 estimates on an EV/EBITDA basis and 2.55x NAV on a cash adjusted basis.

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