

**FORACO INTERNATIONAL S.A.**

**MANAGEMENT'S DISCUSSION & ANALYSIS**

**Three-month period ended March 31, 2020**



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### **MANAGEMENT'S DISCUSSION AND ANALYSIS**

The following Management's Discussion and Analysis ("MD&A") relates to the results of operations, liquidity and capital resources of Foraco International S.A. ("Foraco" or the "Company"). This report has been prepared by Management and should be read in conjunction with the Company's unaudited condensed interim consolidated financial statements for the three-month period ended March 31, 2020, including the notes thereto. These quarterly unaudited interim financial statements were prepared in accordance with International Financial Reporting Standards ("IFRS"). Following the decision taken by the Accounting Standards Board, IFRS became the accounting standards for all issuers in Canada on January 1, 2011. The Company adopted IFRS and made an explicit and unreserved statement that its consolidated financial statements comply with IFRS in 2004.

Except as otherwise stated in Note 2 to the unaudited interim condensed consolidated financial statements, these quarterly unaudited condensed interim consolidated financial statements were prepared using accounting policies and methods consistent with those used in the preparation of the Company's audited consolidated financial statements for the year ended December 31, 2019. Except when otherwise stated, all amounts presented in this MD&A are denominated in US Dollars ("US\$"). The discussion and analysis within this MD&A are as of April 30, 2020.

#### **Caution concerning forward-looking statements**

This document may contain "forward-looking statements" and "forward-looking information" within the meaning of applicable securities laws. These statements and information include estimates, forecasts, information and statements as to Management's expectations with respect to, among other things, the future financial or operating performance of the Company and capital and operating expenditures. Often, but not always, forward-looking statements and information can be identified by the use of words such as "may", "will", "should", "plans", "expects", "intends", "anticipates", "believes", "budget", and "scheduled" or the negative thereof or variations thereon or similar terminology. Forward-looking statements and information are necessarily based upon a number of estimates and assumptions that, while considered reasonable by management, are inherently subject to significant business, economic and competitive uncertainties and contingencies. Readers are cautioned that any such forward-looking statements and information are not guarantees and there can be no assurance that such statements and information will prove to be accurate and actual results and future events could differ materially from those anticipated in such statements. Important factors that could cause actual results to differ materially from the Company's expectations are disclosed under the heading "Risk Factors" in the Company's Annual Information Form dated March 30, 2020, which is filed with Canadian regulators on SEDAR ([www.sedar.com](http://www.sedar.com)). The Company expressly disclaims any intention or obligation to update or revise any forward-looking statements and information whether as a result of new information, future events or otherwise. All written and oral forward-looking statements and information attributable to Foraco or persons acting on our behalf are expressly qualified in their entirety by the foregoing cautionary statements.

**This MD&A is presented in the following sections:**

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## **Business Overview**

Headquartered in Marseille, France, Foraco is a worldwide drilling service provider with presence in 22 countries and 5 continents. On March 31, 2020, the Company had 1,946 employees and operated 302 drill rigs worldwide, providing a diverse range of drilling services to its customer base. The Company has developed and acquired significant expertise in destructive and non-destructive drilling, as well as proprietary drill rig design capabilities. These capabilities allow Foraco to tailor solutions to meet the specific conditions and drilling requirements of certain customers, such as mining companies, governmental organizations and international development funds. Through its global operations the Company services a range of industries focusing on mining and water.

Foraco specializes in drilling in harsh environments and isolated locations including arctic, desert and mountainous regions, generally under conditions where operations are challenged by logistical matters and geographic barriers. The Company's engineers and technicians have developed special drilling methods which respond to the requirements of certain areas in which geology prevents the use of standard techniques and equipment. The Company has specialized equipment for, among other uses, helicopter-based drilling campaigns, combination rigs able to perform multi-drilling technique contracts, desert-suited rigs and large diameter core sampling systems.

## Interim Consolidated Financial Highlights

### Financial highlights

(In thousands of US\$) (unaudited)	Three-month period ended March 31,	
	2020	2019
<b>Revenue</b>	<b>49,671</b>	<b>45,201</b>
<b>Gross profit / (loss) (1)</b>	<b>5,263</b>	<b>4,237</b>
<i>As a percentage of sales</i>	<i>10.6%</i>	<i>9.4%</i>
<b>EBITDA</b>	<b>4,465</b>	<b>3,444</b>
<i>As a percentage of sales</i>	<i>9.0%</i>	<i>7.6%</i>
<b>Operating profit / (loss)</b>	<b>124</b>	<b>(926)</b>
<i>As a percentage of sales</i>	<i>0.2%</i>	<i>-2.0%</i>
<b>Profit / (loss) for the period</b>	<b>(2,064)</b>	<b>(3,933)</b>
Attributable to:		
Equity holders of the Company	(2,042)	(3,979)
Non-controlling interests	(22)	46
<b>EPS (in US cents)</b>		
Basic	(2.27)	(4.43)
Diluted	(2.27)	(4.43)

(1) includes amortization and depreciation expenses related to operations.

### Three-month period ended March 31, 2020 – Q1 2020

#### Revenue

- Q1 2020 revenue amounted to US\$ 49.7 million compared to US\$ 45.2 million in Q1 2019, an increase of 10%. The Q1 2020 revenue increased by 16% after adjusting for currency fluctuations.
- The rigs utilization rate was 42% in Q1 2020 compared to 46% in Q1 2019. The evolution of the Q1 2020 utilization rate compared to Q1 2019 can be explained by the increased contribution of water activity with high added value.

#### Profitability

- The Q1 2020 gross margin including depreciation within cost of sales was US\$ 5.3 million (or 10.6% of revenue) compared to US\$ 4.2 million (or 9.4% of revenue) in Q1 2019. This increase is due to improved performance on contracts and continued effective cost control over our operating expenses.
- During the quarter, EBITDA amounted to US\$ 4.5 million (or 9.0% of revenue), a 30% increase compared to US\$ 3.4 million (or 7.6% of revenue) for the same quarter last year.

#### Net debt

- The net debt excluding the impact of the implementation of IFRS 16 was US\$ 131.3 million as at March 31, 2020 compared to US\$ 128.9 million as at December 31, 2019. This increase is mainly linked to the negative free cash flow generated during the period (US\$ 1.6 million) and to the capitalized interest (US\$ 5.5 million).

The net debt including the impact of IFRS 16 is US\$ 135.0 million as at March 31, 2020.

## Covid-19

The Covid-19 pandemic has significantly impacted the world economy in the beginning of 2020. The impact of the pandemic on the Company's activity in Q1 2020 was relatively limited in its main operations centers. Other less significant countries for the Company's operations have been affected where the governments enacted restrictive emergency measures. Some customers postponed certain contracts but did not cancel their orders.

## Results of Operations

### *Comparison of the three-month periods ended March 31, 2020 and March 31, 2019*

#### *Revenue*

The following table provides a breakdown of the Company's revenue for Q1 2020 and Q1 2019 by reporting segment and geographic region:

(In thousands of US\$) - <i>(unaudited)</i>	<b><u>Q1 2020</u></b>	<b><u>% change</u></b>	<b><u>Q1 2019</u></b>
<b><u>Reporting segment</u></b>			
Mining .....	40,380	-3%	41,465
Water .....	<u>9,291</u>	<u>n/a</u>	<u>3,736</u>
<b>Total revenue</b> .....	<b><u>49,671</u></b>	<b><u>10%</u></b>	<b><u>45,201</u></b>
<b><u>Geographic region</u></b>			
Europe, Middle East and Africa .....	15,106	64%	9,197
South America .....	9,085	-7%	9,758
North America .....	18,275	-4%	19,092
Asia Pacific .....	<u>7,204</u>	<u>1%</u>	<u>7,154</u>
<b>Total revenue</b> .....	<b><u>49,671</u></b>	<b><u>10%</u></b>	<b><u>45,201</u></b>

Revenue of the quarter increased from US\$ 45.2 million in Q1 2019 to US\$ 49.7 million in Q1 2020 (+10%).

The long-standing presence of the Company in the water segment enabled it to develop unique applications for the mining sector. These applications which require the use of certain specific assets and which now represent a growing part of the Company's revenue led the management to assess the performance of these activities separately from the mining sector. These activities which include the mining dewatering are now classified in the water segment. The historical figures presented in the table above have been restated to present comparative data in a homogeneous manner.

The 149% increase in revenue in the water segment is the result of the leveraging of the Company's expertise applied to mining dewatering.

In EMEA revenue for the quarter was US\$ 15.6 million compared to US\$ 9.2 million in Q1 2019, an increase of 64%. Each area showed improved activity. In Africa, new deep-water wells contracts mobilized in 2019 continued in Q1 2020 and will continue through 2020. In Russia, activity increased by 58% with new significant contracts secured during Q1 2020.

Revenue in South America decreased by 7% at US\$ 9.1 million in Q1 2020 (US\$ 9.8 million in Q1 2019). The activity in the region was impacted by adverse foreign exchange rate. Without this impact, activity increased by 9% compared to Q1 2019.

Activity in North America slightly decreased with revenue at US\$ 18.3 million in Q1 2020 compared to US\$ 19.1

million in Q1 2019. As explained above, this decrease is mainly due to disruptions affecting a limited number of contracts linked to the Covid 19 pandemic. The activities postponed are due to resume in Q2 2020.

In Asia Pacific, Q1 2020 revenue amounted to US\$ 7.2 million, stable compared to the same period last year. Using Q1 2019 foreign exchange rates, revenue increased by 9%.

### Gross Profit

The following table provides a breakdown of the Company's gross profit by reporting segment for Q1 2020 and Q1 2019:

(In thousands of US\$) - (unaudited)	<b><u>Q1 2020</u></b>	<b><u>% change</u></b>	<b><u>Q1 2019</u></b>
<b><u>Reporting segment</u></b>			
Mining .....	3,519	-10%	3,874
Water.....	<u>1,744</u>	n/a	<u>363</u>
<b>Total gross profit / (loss) .....</b>	<b><u>5,263</u></b>	<b><u>24%</u></b>	<b><u>4,237</u></b>

The Q1 2020 gross margin including depreciation within cost of sales was US\$ 5.3 million (or 10.6% of revenue) compared to US\$ 4.2 million (or 9.4% of revenue) in Q1 2019. This increase is due to improved performance on contracts and continued effective cost control over our operating expenses.

### Selling, General and Administrative Expenses

The following table provides an analysis of the selling, general and administrative expenses (SG&A):

(In thousands of US\$) - (unaudited)	<b><u>Q1 2020</u></b>	<b><u>% change</u></b>	<b><u>Q1 2019</u></b>
Selling, general and administrative expenses	5,139	0%	5,163

SG&A was stable compared to the same quarter last year.

### Operating result

The following table provides a breakdown of the Company's operating result for Q1 2020 and Q1 2019 by reporting segment:

(In thousands of US\$) - (unaudited)	<b><u>Q1 2020</u></b>	<b><u>% change</u></b>	<b><u>Q1 2019</u></b>
<b><u>Reporting segment</u></b>			
Mining .....	(659)	n/a	(953)
Water .....	<u>783</u>	n/a	<u>27</u>
<b>Total operating profit (loss) .....</b>	<b><u>124</u></b>	<b><u>n/a</u></b>	<b><u>(926)</u></b>

The operating profit was US\$ 0.1 million, a US\$ 1.1 million improvement as a result of increased activity, improved gross margin and controlled SG&A expenses.

### Finance costs

Net financial expenses were stable at US\$ 2.4 million in Q1 2020 compared to US\$ 2.3 million in Q1 2019.

## Income tax

In Q1 2020, the corporate income tax was a profit of US\$ 0.2 million compared to a charge of US\$ 0.7 million in the same period for the previous year. The income tax expense is recognized based on Management's best estimate of the average annual income tax rate expected for the full financial year on a tax jurisdiction by tax jurisdiction basis.

## Seasonality

The worldwide presence of the Company reduces its overall exposure to seasonality and its influence on business activity, the first quarter being the weakest. In West Africa, most of the Company's operations are suspended between July and October due to the rainy season. In Canada, seasonal slow periods occur during the winter freeze and spring thaw or break-up periods. Depending on the latitude, this can occur anytime from October until late December (freezing) and from mid-April through to mid-June (break-up). Operations at mining sites continue throughout the year. Russia is also affected by the winter period during which operations are suspended. In Asia Pacific and in South America, where the Company operates exclusively in the Mining segment, a seasonal slowdown in activity occurs around year-end during the vacation period. Certain contracts are also affected in Chile in July and August when the winter season peaks.

## Effect of Exchange Rates

The Company operates in a very large number of countries with functional currencies (Euros, Canadian Dollars, Australian Dollars, Chilean Pesos, Brazilian Reals and Russian Rubles) different than the US Dollar, the presentation currency of the Group. The significant variation of the US Dollar over the last quarters has had a substantial impact on the Company's financial statements. The impact of exchange rates on each significant line item of the income statement is reported above.

However, the Company mitigates its net exposure to foreign currency fluctuations by balancing its costs, revenues and financing in local currencies, resulting in a natural hedge.

The exchange rates against the US\$ for the periods under review are as follows:

	Average Q1 2020	% change	Average Q1 2019	Closing Q1 2020	% change	Closing Q4 2019
€	0.91	3%	0.88	0.90	1%	0.89
CAD	1.34	1%	1.33	1.41	6%	1.31
AUD	1.52	8%	1.40	1.63	15%	1.43
CLP	803	20%	667	843	24%	745
BRL	4.45	18%	3.77	5.13	32%	4.03
RUB	66.79	1%	65.97	79.53	21%	61.94

Please note that the first quarter 2020 was marked by significant exchange rate fluctuations and that this affected most currencies.

## Liquidity and Capital Resources

The following table provides a summary of the Company's cash flows for Q1 2020 and Q1 2019:

(In thousands of US\$)	<u>Q1 2020</u>	<u>Q1 2019</u>
<b>Cash generated by operations before working capital requirements</b>	<b>4,466</b>	<b>3,445</b>
Working capital requirements	(1,976)	1,489
Income tax paid	(688)	(903)
Purchase of equipment in cash	(2,777)	(3,025)
<b>Free Cash Flow before debt servicing</b>	<b>(975)</b>	<b>1,006</b>
Debt variance	(1,942)	(1,143)
Interests paid	(627)	(800)
Acquisition of treasury shares	-	(5)
Dividends paid to non-controlling interests	(676)	-
<b>Net cash generated / (used in) financing activities</b>	<b>(3,245)</b>	<b>(1,948)</b>
<b>Net cash variation</b>	<b>(4,220)</b>	<b>(942)</b>
Foreign exchange differences	(541)	(273)
<b>Variation in cash and cash equivalents</b>	<b><u>(4,761)</u></b>	<b><u>(1,215)</u></b>
<b>Cash and cash equivalents at the end of the period</b>	<b><u>11,292</u></b>	<b><u>9,874</u></b>

In Q1 2020, the cash generated from operations before working capital requirements amounted to US\$ 4.5 million compared to US\$ 3.4 million in Q1 2019.

In Q1 2020, the working capital requirement was US\$2.0 million compared to a positive US\$ 1.5 million in the same period last year.

During the period, the Capex was US\$ 2.8 million in cash, a stable amount compared to Q1 2019. The Capex mainly relates to major rigs overhauls, ancillary equipment and rods.

Free cash flow before debt servicing was US\$ (1.0) million in Q1 2020 compared to US\$ 1.0 million in Q1 2019.

As at March 31, 2020, cash and cash equivalents totaled US\$ 11.3 million compared to US\$ 16.1 million as at December 31, 2019. Cash and cash equivalents are mainly held at or invested within top tier financial institutions.

As at March 31, 2020, net debt excluding IFRS 16 implementation amounted to US\$ 131.3 million (US\$ 128.9 million as at December 31, 2019).

Bank guarantees as at March 31, 2020 totaled US\$ 9.0 million compared to US\$ 6.5 million as at December 31, 2019. The Company benefits from a confirmed contract guarantee line of € 12.7 million (US\$ 14.0 million).



### *Going concern*

As at March 31, 2020, the Company met its financial covenants. However, given the current economic uncertainties, management has taken a number of operational and financial measures to protect the Company's cash position including (i) adapting the cost structure to the current environment (ii) postponing non-essential expenditures (iii) applying for loans guaranteed by governments and other incentives and (iv) entering into negotiation with its lenders to implement a standstill period for the debt service and revisit the covenants applicable to the forthcoming quarters. On the basis of the above, the Company believes that it will have adequate financial resources to continue in operation for a period of at least twelve months.

### *Impairment testing*

As at December 31, 2019, the Company conducted impairment testing for goodwill at the level of each geographic region using the expected discounted cash flows method. Based on the internal forecasts and projections made, the expected discounted future cash flows generally exceeded, and sometimes significantly, the goodwill carrying amounts. As at March 31, 2020, the Company reperformed an impairment testing for the regions which presented a lower headroom. As mentioned in the preceding section, there is considerable uncertainty regarding the business impacts of the Covid-19 pandemic. However, based on the current information available including customers' feedback and the Company's backlog there were no indications of impairment.

### *Cash Transfer Restrictions*

Foraco operates in a number of different countries where cash transfer restrictions may exist. The Company organizes its business so as to ensure that the majority of payments are collected in countries where there are no such restrictions. No excess cash is held in countries where cash transfer restrictions exist.

## Related-Party Transactions

For details of related-party transactions, please refer to Note 14 of the unaudited condensed interim consolidated financial statements.

## Capital Stock

As at March 31, 2020, the capital stock of the Company amounted to US\$ 1,772 thousand, divided into 89,951,798 common shares. The common shares of the Company are distributed as follows:

	Number of shares	%
Common shares held directly or indirectly by principal shareholders	37,594,498	41.79%
Common shares held directly or indirectly by individuals in their capacity as members of the Board of Directors *	1,164,754	1.29%
Common shares held by the Company**	74,769	0.08%
Common shares held by the public	51,117,777	56.83%
<b>Total common shares issued and outstanding</b>	<b>89,951,798</b>	
Common shares held by the Company	(74,769)	
<b>Total common shares issued and outstanding excluding shares held by the Company</b>	<b>89,877,029</b>	

*\*In the table above, the shares owned indirectly are presented as an amount corresponding to the pro rata of the ownership interest*

*\*\*74,769 common shares are held by the Company to meet the Company's obligations under the employee free share plan and for the purposes of potential acquisitions.*

## Critical Accounting Estimates

The unaudited condensed interim consolidated financial statements have been prepared in accordance with IFRS. The Company's significant accounting policies are described in Note 2 to the annual and unaudited condensed interim consolidated financial statements. As required by IAS 1, the depreciation of property, plant and equipment related to operations is included within cost of sales.

## Non-IFRS measures

EBITDA represents Net income before interest expense, income taxes, depreciation, amortization and non-cash share based compensation expenses. EBITDA is a non-IFRS quantitative measure used to assist in the assessment of the Company's ability to generate cash from its operations. The Company believes that the presentation of EBITDA is useful to investors because it is frequently used by securities analysts, investors and other interested parties in the evaluation of companies in the drilling industry. EBITDA is not defined in IFRS and should not be considered to be an alternative to Profit for the period or Operating profit or any other financial metric required by such accounting principles.

Net debt corresponds to the current and non-current portions of borrowings and the consideration payable related to acquisitions, net of cash and cash equivalents. The lease obligations is not included in the net debt calculation.

Reconciliation of EBITDA is as follows:

(In thousands of US\$) ( <i>unaudited</i> )	<u>Q1 2020</u>	<u>Q1 2019</u>
Operating profit / (loss).....	124	(926)
Depreciation expense .....	4,296	4,325
Non-cash employee share-based compensation.....	45	45
<b>EBITDA</b> .....	<b><u>4,465</u></b>	<b><u>3,444</u></b>

### **Litigation and claims**

Generally, the Company is subject to legal proceedings, claims and legal action arising in the ordinary course of business. The Company's Management does not expect that the ultimate costs to resolve these matters will have a material adverse effect on the Company's consolidated financial position, results of operations or cash flows.

### **Subsequent Events**

There are no significant post balance sheet events.

### **Strategy**

The Company's strategy is to become a leading actor in the mineral drilling services sector, assisting its customers to explore or manage their deposits throughout the whole cycle, with a special focus on life of mines extension activity. The Company intends to develop and grow its services offered across the world with a focus on stable jurisdictions, high tech drilling services, optimal commodities mix - with a significant involvement in water related drilling services and choose carefully its customers. The Company expects it will execute its strategy primarily through organic growth in the near future.

### **Risk Factors**

For a comprehensive discussion of the important factors that could impact the Company's operating results, please refer to the Company's Annual Information Form dated March 30, 2020, under the heading "Risk Factors", which has been filed with Canadian regulators on SEDAR ([www.sedar.com](http://www.sedar.com)).