Transcript of
Fortuna Silver Mines, Inc.
Q1 2022 Conference Call
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Participants

Carlos Baca - Director, Investor Relations
Jorge Alberto Ganoza - President and Chief Executive Officer
Cesar Velasco - Chief Operating Officer, Latin America
Paul Criddle - Chief Operating Officer, West Africa
Luis Dario Ganoza - Chief Financial Officer

Analysts

Trevor Turnbull - Scotiabank
Don DeMarco - National Bank Financial

Presentation

Operator
Good afternoon, ladies and gentlemen, and welcome to the Fortuna Silver Mines Q1 2022 Financial and Operational Results Call. At this time, all participants have been placed on a listen-only mode, and the floor will be open for questions and comments after the presentation.

It is now my pleasure to turn the floor over to your host, Carlos Baca. Sir, the floor is yours.

Carlos Baca - Director, Investor Relations
Thank you, Jenny. Good morning, ladies and gentlemen. I would like to welcome you to Fortuna Silver Mines and to our financial and operations result call for the first quarter of 2022. Hosting the call today on behalf of Fortuna will be; Jorge Alberto Ganoza, President and Chief Executive Officer; Luis Dario Ganoza, Chief Financial Officer; Cesar Velasco, Chief Operating Officer, Latin America and; Paul Criddle, Chief Operating Officer, West Africa.

Today's earnings call presentation is available on the featured presentation box on our homepage at fortunasilver.com. As a reminder, statements made during this call are subject to the reader advisories included in yesterday's news release and in the earnings call presentation. Financial figures contained in the presentation and discussed in today's call are presented in US dollars, unless otherwise stated.

Before I turn over the call to Jorge, I would like to indicate that this earnings call contains forward-looking information that is based on the company's current expectations, estimates and beliefs. This forward-looking information is subject to a number of risks, uncertainties and other factors. Actual results could differ materially from a conclusion, forecast or projection in the forward-looking information.

Certain material factors or assumptions were applied in drawing our conclusion or making a forecast or projection as reflected in the forward-looking information. Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing our conclusion or making a forecast or projection as reflected in the forward-looking information, is contained in the company's annual information form and MD&A, which are publicly available on SEDAR. The company assumes no obligation to update such forward-looking information in the future, except as required by law.

I would now like to turn the call over to Jorge Alberto Ganoza, Co-Founder of Fortuna.

Jorge Alberto Ganoza - President and Chief Executive Officer

Thank you, Carlos. And good morning to all. Thanks for joining us today. Our business performed very well in the first quarter of the year. We realized the silver price of $24 per ounce and $1,884 per ounce of gold. We recorded net income of $27 million or $0.09 per share.

After adjustments for unrealized losses on derivative contracts for a portion of our byproduct, zinc production and the write-down of exploration investments at our prospect in Central Mexico or net income – adjusted net income came in at a record $33 million or $0.11 per share, beating analyst consensus of $0.10 per share. Our adjusted EBITDA was $80 million with a robust margin of our sales of 44% as of the end of the quarter, the company maintained the strong balance sheet with low debt leverage and liquidity available of $150 million which is more than adequate to meet all our capital and growth plan.

With respect to our key growth project, Seguela, Paul Criddle, our Chief Operating Officer for West Africa will be providing an update for you in a minute. But I can advance, the construction is 48% complete as of the end of March, and also the latest report provided to me as of the end of April, completion is at 55%. The project remains on time and on budget for our first gold pour in mid-2023.

Of note, that Seguela as well, is the Maiden Inferred Mineral Resource for the Sunbird discovery comprising 3.5 million tonnes, averaging 3.2 grams of gold per tonne containing 350,000 ounces of gold, we made the news release of these on March 15. Sunbird remains open with high grade gold intercept in multiple directions. We plan to continue drilling sample, another targets at Seguela for all of these years. The sample discovery is incremental to what is already a mine in the making, with gold reserves for a decade of production.

Looking at our consolidated production, all our mines performed well and in line with our annual guidance projections were 6.2 million to 6.9 million ounces of silver and 244,000 to 280,000 ounces of gold. During the quarter, we produced 67,000 ounces of gold and 1.7 million ounces of silver. Compared to the first quarter of last year, we show a significant increase of 93% in gold production. The increase is driven by contributions from the Yaramoko mine and the ramp up completion of our Lindero mine in the Province of South Argentina.

Silver production declined by 13% and this is explained by lower head grades at our San Jose mine, these lower grades are in line with the reserves and mine trends. In the quarter, gold accounted for 71% of sales and silver for 19% of sales. The 10% balance is made of byproduct lead and zinc out of The Caylloma Mine in Peru.

On the side of costs, all our mines performed within the ranges provided for in our annual guidance. Our costs are quite competitive at all our mines, giving the company resilience as we navigate through the precious metals price cycle and short-term price mix. Lindero produce gold at all-in sustaining cost of $1,038 and Yaramoko at an all-in sustaining cost of $1,147 per ounce. At our silver mine, Caylloma produced silver at an all-in sustaining cost of $17.08 and the San Jose at $15 per ounce.

With 4 million ounces of gold equivalents in mineral reserves, diversified production from mines located in two of the most important mining regions in the world. Competitive cost, short-term growth in the pipeline and a healthy balance sheet, Fortuna is well positioned to continue harvesting high value opportunities within the portfolio as we advance our business.

The company has put in place the non-course issuer bid program for the repurchase of up to 5% of the shares issued and outstanding, we intend to make use of the program this year and doing so management will be considering the timing of capital requirements of our growth project and of course assessing the value of the company.

With that now, we can have Cesar provide us a quick glance of our LatAm operations. Cesar?

Cesar Velasco - Chief Operating Officer, Latin America
Thank you. And as Jorge mentioned earlier, the company’s three operating mines in Latin America delivered a solid first quarter. We had a high COVID activities in January in all operations, but in spite of that, operations managed to deliver according to plan. Costs are well contained within guidance for all operations.

At the Lindero mine in Argentina, gold production exceeded 30,000 ounces for the second consecutive quarter. Compared to a year ago, Lindero delivered 35% higher gold production, which is explained by the increased in performance of the three stage crushing and stacking circuits, along with a 7% higher head grades for the quarter. We are delivering according to our guidance projection.

The San Jose mine in Mexico delivered a lower silver and gold production versus comparable quarter, but it is fair to mention that it is in line with the mineral reserve estimates. And finally, the Caylloma mine in Peru delivered a 17% higher silver production and 12% higher lead production as we enter a higher grade portion of the reserves in level 16, the deepest level of the mine. Production at the Caylloma is on track to achieve the upper range of guidance.

Back to you, Jorge.

Jorge Alberto Ganoza - President and Chief Executive Officer
Thank you. Paul, do you want to give us an update on West African operations?

Paul Criddle - Chief Operating Officer, West Africa

Thank you, Jorge. Operations in our project in West Africa was solid in the first quarter and in line with guidance for the period. The effect of COVID and the variant and that now affect our production at Yaramoko, we'll progress at the Seguela project.

At Yaramoko, production for the quarter was 2% grown than the plan at 28,000 ounces of gold in the mid to upper end of guidance in the period. While costs were contained at below the low end of the guidance range, at 1,147 ounces – $1,147 per ounce for the period. Greater ore production realized from development from the western extent of the 55 zone and good grade reconciliation in the period contribute to the solid production outcome.

Moving to Seguela. Since commencing in Q3 of last year, the Seguela project continues to progress steadily in Cote d'Ivoire. Today, the overall project completion sits at 48% as of the end of Q1, with nearly $76 million spent to end of the quarter and over $130 million committed, the project is well placed to be derisked in the challenging environment in which we're developing the mine today.

Progress and costs are in line with the plan and we're forecasting the project to be completed on time and on budget in Q2 of 2023. We previously got the headcount today, given the schedule and inflationary pressures we see in the market today. Works underground are proceeding well and in line with the schedule, with critical path items they involve across the property as well as in the procurement space.

Items of note, in Q1 are the ongoing and steady progress of bulk earthworks in the plant side and TSF areas ahead of the approaching wet season. The mobilization of the EPC contractor Lycopodium to site and the commencement of the processing plant facilities.

The commencement of the – direction of the tower steel for the high voltage powerline, broadening the execution of the mining services agreement with Mota-Engil and the ongoing expediting a key supplier items such as the SAG mill and high speed transformers, which both remain on schedule. We're extremely pleased with the reconciliation of progress against their plants at present and look forward of bringing you further update as that develops.

Jorge Alberto Ganoza - President and Chief Executive Officer
Thank you. And we'll ask Luis now to give us a run with the financial results and then also expand on the topical issue which is inflation. So, Luis?

Luis Dario Ganoza - Chief Financial Officer
Yeah, thank you. So as was mentioned, sales for the quarter were $182.3 million, this is an increase of 55% compared to Q1 of 2021. The higher sales were driven by the contribution of Yaramoko with $55.4 million of sales in the quarter and sales has been little of $54.1 million which was 48% higher than Q1 2021 and represented an additional $18.1 million prices to our top line. This was partially offset by lower sales at San Jose of 17%, representing a decrease of $9.4 million in sales, the features has been mentioned by Jorge and Cesar was driven by lower production and was broadly in line with our guidance for 2022.

Year-over-year, our key financial metrics reflect the expanded size of our business. Adjusted net income of – $33.4 million was up 21% and adjusted EBITDA of $80.3 million was up 32%. Free cash flow from operations of $9.6 million was impacting the quarter by negative changes in working capital of $27.9 million and timing of taxes paid. The working capital changes are to a large extent rebated to short-term timing effect which we expect to revert in the next quarter or two. Our EBITDA margin in the quarter was 44% compared to 52% in Q1 2021.

The lower margins were the result of a decrease in margins at the San Jose mine and higher general and administration expenses of $8.3 million. This was comprised of $4 million of higher share based payments when compared to the first quarter of 2021 for which we recorded a credit of $0.4 million. And $4 million higher G&A between the sites and corporate. We did have some non-recurring expenses in the quarter in the order of $1.5 million.

Moving forward, we expect quarterly G&A and corporate between $6 million and $6.5 million excluding share based payments. An additional item worth noting on the income statement is a $4.2 million loss on derivatives of which $3.5 million was unrealized. The unrealized portion was comprised of $4.1 million of zinc and lead derivative contracts, offset by $1 million of unrealized gains from diesel hedges.

Moving on, we have provided a comment on the news release and in our MD&A on inflation effects so far. We are seeing rise in prices for certain key consumables including cyanide, explosives and steel components at our operations, and of course, fuel. In Q1, the total impact with respect to our cost guidance has been modest, we have seen however a trend throughout the quarter and into April for some of these items. We should expect the higher impact in Q2, but based on the more recent data points we expect all-in sustaining costs at our operations to remain within the range of annual guidance. We are monitoring these trends closely and the outlook could certainly change.

In the case of Lindero in particular, diesel is a significant portion of our cost structure, between 16% and 18%, it is worth nothing, we have a hedge approximately 55% of diesel consumption for 2022 at levels that are 30% below the average prices we saw in March, and 50% below spot prices we were seeing in April.

On the balance sheet and liquidity requirements, as Jorge pointed out, we closed the quarter with $110 million of cash and cash equivalents and liquidity of $150 million which includes $40 million that remained undrawn at the end of the quarter under our $200 million revolving credit facility. Our total net debt, including the outstanding convertible debenture of $46 million is $96 million which provides from very modest debt leverage. On the Seguela construction, we have funded $35 million in the quarter and close to $70 million on a cumulative basis, our expected spend for 2022 remains approximately $110 million.

Back to you, Jorge.

Jorge Alberto Ganoza - President and Chief Executive Officer
Thank you. Carlos?

Carlos Baca - Director, Investor Relations
We would now like to turn the call over to any questions that you may have.

Operator
Ladies and gentlemen, the floor is now open for questions. [Operator Instructions] Thank you. Your first question is coming from Trevor Turnbull. Trevor, you may ask your question.

Q: Great, thank you. In my model, it would appear that your operating cash flow is set up to offset the capital expenditures you've got planned for the rest of the year. And so my question was about the drawdown of the line of credit in Q1 and then subsequent to quarter end, a bit more. I was just wondering if this is insurance against the potential inflation or operating risk. Or perhaps was this somehow related to having extra cash on hand for the share buyback program?

Luis Dario Ganoza - Chief Financial Officer
No, it really has to do with more of a timing of our treasury, Trevor and we – I mean faced the alternative of drawing down on the facility or repatriating from the sites, the bulk of the cash sits in the sites. And we will always be assessing the use of our facility as opposed to moving cash which creates friction, right can in most cases, trigger tax events. So that's really the logic behind the drawdown you have seen.

Q: Right. I guess I didn't have that visibility into exactly when the CapEx is going to get spent and forgetting that you do have to move money around. When you talk about repatriation, is that kind of specifically with respect to Lindero that you talk about the most, having the effective friction?

Luis Dario Ganoza - Chief Financial Officer
It would be beyond Lindero, right. Lindero is – as repatriation is built into our intercompany funding plan. So, the drawdown of Q1 is above and beyond Lindero funding that's already taking place.

Q: Okay. And then, I guess also just sort of related to funding while I've got you, Luis. Do you have a minimum cash balance target while you are under construction that you are thinking about?

Luis Dario Ganoza - Chief Financial Officer
I would say $100 million is a figure with which we feel comfortable.

Q: Okay. And then my last question, still kind of on this theme. Have you thought about any forward gold sales? I've seen some of your peers do very short-term you know 1 year, 18 month forward sales and they have had pretty good luck I think with the timing of that. Is that something that Fortuna has considered?

Luis Dario Ganoza - Chief Financial Officer
Honestly, we have not. We typically – I mean as you know, we'll not engage in forward sales of either silver and gold and up to now that hasn't changed, Trevor.

Q: Okay. Well that's all I had. Thank you. Thank you very much, Luis.

Operator

Thank you. Your next question is coming from Don DeMarco of National Bank Financial. Don, please pose your question.

Q: Hi. Thank you, operator and good morning, gentlemen. My first question has to do with the spend at Seguela. I think that we – in our model per previous messaging, we are looking at about $110 million to be spent in 2022. We've just allocated this equally between quarters. But I see that in Q1 you're a little bit ahead of say, a 25% per quarter spend rate. Can you just give us an update, are you still expecting to spend about $110 million in 2022 and how should we allocate that across quarters?

Luis Dario Ganoza - Chief Financial Officer

Yes. The expectation on the total amount hasn't changed. I mean, the quarterly spend can be a bit volatile sometimes depending on different factors. And we expect it to be the balance to be spent relatively even over next three quarters. But again, that can vary a bit, not necessarily due to variations in execution, but rather just management of payables and certain advances right to contractors.

Q: Okay, okay. Thanks for that. And my next question has to do with Yaramoko. And Paul, congratulations on a strong improvement in costs quarter-over-quarter in Q4. AISC improved quite a bit into Q1. But I'm reading in the MD&A that the – you are expecting Yaramoko to be on track for the high end of the cost guidance, yet Q1 was below the lower end of the cost guidance. So can you just maybe add a little bit more color on you know what drove those low costs in Q1? Maybe was there some fuel subsidies in country or something? And then what our expectations should be in order for the cost to sort of you know climb to be within guidance or at the high end of the guidance range for the rest of the year? Thank you.

Paul Criddle - Chief Operating Officer, West Africa

Hey, Don. I think Q4 was anomalous. You know and I think we had a tough quarter there from a production perspective, and that obviously reflected in the cost. As the nature of the hard grade that drove the project and Q1 is a good start to be, you're right. And there was a component in the cost specifically, whereby there has been some sustaining capital deferred and then the small amounts removed as well that have helped things there. But you know I think projecting forward for the whole year, you know the costs remain in the guideline for guidance. We hope to continue on the path that we've had for Q1, but you know I think it's probably this is a fair way to go in yet.

Q: Okay, great. Okay, well thanks for that. Appreciate it. And good luck with coming quarters. That's all from me.

Operator

Thank you. Your next question is coming from [Ernie Molassey] [ph] who is a Private Investor. Ernie, over to you.

Q: Yes, I'm curious about how your SART plant is doing at Lindero? And specifically, on the financial side, you count copper in your financials as a byproduct. And then secondly, how much cyanide is being recovered through the SART plant? And is that lowering your cost there at Lindero?

Cesar Velasco - Chief Operating Officer, Latin America

Yeah, thank you. SART plant is operating as planned. We have been able to recover cyanide significantly, making up or introducing some savings. And we expect to capture some of those benefits along the year which will offset at some point some pressure you know inflation pressure on prices for cyanide.

Q: And then the second question I have is, your heap leach is running at 400 cubic meters per hour right now, when do you plan to go to 600 and do you feel that a 600 cubic meter per hour flow rate would increase your recovery?

Jorge Alberto Ganoza - President and Chief Executive Officer

Yeah, Ernie. Yes, we're running the system at 400 cubic meters per hour. And yes, we see the opportunity to increase a drawdown of inventory in the pile by increasing flow. Remember that we're just in the second lift right now. And not – we are continuing expanding the liner on the first phase. So we'll likely be operating at 400 for the remaining of the year. And the inventories are not an issue at this stage. Not in the design, the expansion was a benefit that we saw in the transition from year two into year three which would be something in 2023, right.

Q: Okay. Thank you very much.

Jorge Alberto Ganoza - President and Chief Executive Officer

Thank you, sir.

Operator

[Operator Instructions] Okay. Next question is coming from [Don Moran] [ph], who is a Private Investor. Don, over to you.

Q: Any follow-up on the permitting concerns at San Jose. And I'm also, secondly, curious why we haven't seen more drill results from the Seguela? It's something I've always looked forward to. Anyway, any comments are welcome. Thank you.

Jorge Alberto Ganoza - President and Chief Executive Officer

With the permit at San Jose, you know the mine is operating under the permits granted in the – month of December. So and we have nothing new to report on that front you know. So we have our permit in hand and operating regularly under the permit.

With respect to Seguela drilling, we are incrementing drill rigs at Seguela, we're bringing an additional drill rig. And the program is being expanded. Not we're allocating additional funding to continue pursuing the open areas that we still have in Sunbird and other targets. We're looking to provide an exploration as the need to – in the second half of this month. So look forward to that please.

Q: Thanks very much.

Jorge Alberto Ganoza - President and Chief Executive Officer
Thank you, sir.

Operator
Thank you. There are no more questions in the queue. And I'm going to hand back over to Carlos for his closing remarks.

Carlos Baca - Director, Investor Relations
Thank you, Jenny. If there are no further questions, we would like to thank everyone for listening to today's earnings call. We look forward you to joining us next quarter. Have a good day.

Operator
Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time and have a wonderful day. Thank you for your participation.