Transcript of Fortuna Silver Mines Inc
2017 Year-End Financial and Operational Results
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Participants

Carlos Baca - Manager of IR
Jorge Ganoza - President & CEO
Luis Ganoza - CFO

Presentation

Operator
Greetings and welcome to Fortuna Silver Mines 2017 Year-End Financial & Operational Results. At this time, all participants are in a listen-only mode. [Operator Instructions]. As a reminder, this conference is being recorded.

I would now like to turn the conference over to your host, Carlos Baca. Please begin.

Carlos Baca - Manager of IR
Thank you, Dana. Good morning, ladies and gentlemen. I would like to welcome you all to Fortuna Silver Mines and to our Fourth Quarter 2017 and Full Year 2017 Financial and Operational Results Call. Today, we will be using a webcast presentation, which will be controlled by us. You can download the presentation at our website. Please click on the Investors tab then click on Financials. It's under Q4, click on Earnings Call webcast.

Jorge Alberto Ganoza, President, CEO and Director; and Luis Dario Ganoza, CFO, will be hosting the call from Lima, Peru.

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 a 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 a conclusion or making a forecast or projection, as reflected in the forward-looking information, is contained in the Company's Annual Information Form, which is publicly available on SEDAR.

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

Jorge Ganoza - President & CEO
Thank you, Carlos, and good morning to all. I will give you a brief introduction to our year-end results, and then turn the call to Luis, who will take you through the financial statements. After that, we'll open the call for questions and answers.

The 2017 results show record production in both silver and gold. On a consolidated basis, silver production was 8.5 million ounces and our gold production was 56,400 ounces, 15% and 21% above 2016 as shown in slide 4 of the presentation. When compared against our annual guidance, silver was up 4% and gold production up 8%.

In slide 5, we show that precious metals contribution to sales was 73% in the year. The balance is comprised by base metals. Year-over-year, realized prices for silver and gold remained essentially the same. It was a different story with our zinc and lead by-products, higher metal prices for both metals and improved commercial terms for the sale of concentrates meant a year-over-year increment of net realized prices of 71% for zinc and 47% for lead. This was particularly relevant for the economic performance of our Caylloma mine this year.

In slide 6, 2017 shows a record financial performance across our main financial metrics. Sales were $268.1 million, 27% above the prior year. Net income of $66.3 million, 270% above the prior year, while earnings per share were $0.42 compared to $0.13 in 2016. Adjusted EBITDA was $122 million yielding an EBITDA margin of 46% and 40% above EBITDA over the prior year.

Our net income carries a $31 million impairment reversal at Caylloma derived from successful exploration programs which led to the expansion of resources. Adjusted net income was $48.6 million for the year.

In slide 7, our consolidated all-in sustaining cash cost per ounce of silver net of by-product credits was $6.40 a reduction of 24% compared to the prior year and also 35% below our 2017 guidance. Our all-in sustaining cost benefitted mainly from higher precious metals production, higher base metal prices and improved commercial terms for the sale of our concentrates.

Moving on to capital investments in slide 8. Our consolidated CapEx for the year was $49.4 million. This includes $11.4 million of non-sustaining CapEx comprised mainly of $9 million for Lindero Project reconstruction, $10.1 million of brownfields explorations and $28 million of sustaining capital at our mines.

In slide 10, in our Lindero Project is in the early stages of construction and shows 7% progress at the end of February 2018 against the target of 10%. Our main milestones are detailed engineering, which is advancing according to schedule and purchase orders for mine fleet and other key equipment has been placed in January. The municipal construction permit from Tolar Grande was granted in February and [indiscernible] for initial work is scheduled to be completed at the end of March.

In slide 11, the Lindero Project remains on track for commissioning through the second quarter of 2019. Start of mass earthworks has been reprogrammed for April to allow local contractors to participate via contortion in this large and significant activity of the project. This was a strategic consideration for the project and there is no impact on our critical task for commissioning in Q2 2019.

In slide 12, our brownfields exploration programs at Caylloma and San Jose carried 54,000 of meters drilling in 2017 at a cost of approximately $10 million. It is worth noting, our focus on San Jose drilling for 2018, we're expanding the program from 25,000 meters in 2017 to 45,000 meters in 2018.

In 2018, you will see us active in new exploration, new project initiatives through our strategic investments and the rig [ph] exploration in Mexico, Argentina and Serbia. In Mexico, through investment in Prospero Silver, we retained the option to select the property for a joint venture. We are satisfied with the work carried by Prospero throughout 2017 which has led to the identification of a large gold and silver at the thermal system at the Pachuca project.

In Serbia, in joint venture with Medgold, we're waiting for surface access to initiate drilling the spring at the Tlamino project in the central Macedonian belt. And in Argentina, we're very active in early stage exploration with focus in the province of Salta. Here we have already auctioned two properties from private local parties, where we aim to drill this first half of the year at the thermal, silver and gold targets.

So, with that, I'll let Luis take your through the financial statements now.

Luis Ganoza - CFO
Thank you, Jorge. I'm starting with slide 14 and the result for the quarter. In the fourth quarter of 2017, we recorded net sales of $75.4 million, up 30% from the prior year driven by higher precious metals production, higher metals prices for our by-products and improved commercial terms on our mineral concentrate products. We reported net income of $34.1 million compared to $6.5 million in 2016 and adjusted net income of $12.3 million compared to $7.1 million.

The largest component of the adjustment to net income is the impairment reversal at the Caylloma mine as Jorge mentioned of $31.1 million before tax or $21.9 million after tax. Earnings per share was $0.21 and adjusted earnings per share was $0.08. Cash provided by operating activities was $29 million, up 12% from 2016. Adjusted EBITDA was a quarterly record of $34.8 million, up 19% and free cash flow was $14.5 million compared to $18.3 million in 2016, as the bulk of capital expenditures in 2016 took place in the first three quarters of the year. Cash and short-term investments, as at the end of the period was $212.6 million dollars.

On slide 15, for the full year 2017, as Jorge has mentioned we recorded net sales of $268 million, 27% above the prior year. The same factors driving our sales in the last quarter of 2017 were present throughout the full year. We reported net income of $66.3 million compared to $17.9 million in 2016 and adjusted net income of $48.6 million compared to $18.1 million in 2016. Earnings per share was $0.42 cents and the adjusted earnings per share was $0.31 and our EBITDA was a record $122 million as Jorge pointed out, up 47% percent from the prior year and free cash flow was positive $24.4 million compared to negative [ph] $4.9 million in 2016.

On slide 16, when breaking down our sales performance for the quarter, we can see the highest impact came from higher silver and gold sold. Higher metal prices for zinc and lead were also a strong contributor to higher sales as well as improved treatment and refining charges. We should expect to see treatment and refining charges further improving in 2018 when compared to the already stable returns [ph] of 2017.

On slide 17, a quick glance at the year, we show the sales breakdown for 2017 with a very similar pattern in terms of our contributing factors to the increase in sales.

So, moving on to slide 18. We see our performance of operating income and adjusted EBITDA for the quarter and the full year. Operating income excluding the reversal of impairment at Caylloma would have been $26.5 million for the quarter, that's 51% year-over-year, and it would have been $79.2 million for the full year, that is 53% year-over-year. Adjusted EBITDA margin both for the quarter and the full year was 46%. And in the fourth quarter, the increase over 2016, which shows up 51% margin, is the result of a $2.2 million credit or recovery in 2016 on share-based payments compared to a $3 million charge in 2017.

On slide 19, we see both our operations, Caylloma and San Jose, had strong EBITDA growth in the fourth quarter. In terms of cash cost performance, at Caylloma cash cost per ton was 15% above the fourth quarter of 2016, although in line with the updated guidance we provided in our earnings call of Q2 2017. We expect cash costs to remain on average at around $81 per ton in 2018. At San Jose, cash cost per ton in the fourth quarter was 5% over the prior year. We expect cash costs of around $61 per ton in 2018.

We'll jump all the way to slide 21. On slide 21, we have a higher G&A expense both at the operating mines and at corporate. The levels we see for the operating mines for the fourth quarter of 2017 are in line with what we expect moving forward as we upgrade our capacities at the different jurisdictions in which we operate to meet a higher level of autonomy, compliance, best practices and internal controls.

For corporate G&A, we should expect a quarterly range between $2.8 million and $3 million moving forward. This should represent a somewhat lower corporate G&A on an annual basis, compared to $11.8 million, we saw in 2017, as 2017 was affected by large non-recurring items, related to events facing the first half of the year, which have been discussed in the prior calls.

Our effective tax rate for the full year was 37% and 39% when calculated based on adjusted net income. This is below what we typically expect and is a result to a large extent of appreciation of the Mexican Peso throughout the year given the impact this has today on our consolidated figures.

On slide 22, we show the evolution of our quarterly cash position reflecting consisting cash accumulation throughout the year. Our total liquidity stands close to $300 million with the closing of our expanded credit facility of $120 million. We believe this, along with our positive free cash flow, puts us in a comfortable position to meet the funding requirements of the Lindero construction.

On slide 23, we show our expected liquidity and financing plan throughout the construction phase at Lindero. The bars represent our projected cash balances on a quarterly basis over the construction period scheduled to conclude in mid-2019. This has been estimated based on our base case metals price scenario as shown in the slide.

We expect we will draw on the facility in the latter part of this year. The dotted lines in yellow and red show that sensitivities of our projected cash balances were the lowest point in our treasury at stressed metal prices. So as indicated before, we expect even under such stressed metal price scenarios, we can meet our funding requirements for the Lindero construction.

And with that, I conclude my presentation. And back to you Carlos.

Carlos Baca - Manager of IR
Thank you, Luis. We would now like to turn the call over to any questions that you may have.

Operator
Thank you. [Operator instructions]. There are no questions at this time.

Carlos Baca - Manager of IR
Thank you, Dana. If there are no further questions. I would like to thank everyone for listening to today's earnings call and we look forward to you joining us next quarter. Have a good day.