

BCP Research: First Majestic Silver (FRCN) - Positive 4Q19 - Softer FY20 Anticipated - Maintain 'Neutral' on Convert

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Summary: Mexico-based silver miner, First Majestic Silver (“Majestic”), released positive 4Q19 results showing substantial y/y improvement in revenue and EBITDA on higher average realized silver prices. FY19 production of 26 mm silver equivalent ounces reached upper-end company guidance, despite lower y/y and q/q production in 4Q19. FCF of US\$28 mm benefitted from stronger EBITDA and WK generation. The company ended the year with a robust cash balance of US\$169 mm and LTM net leverage of 0.3x.

We are encouraged by recent performance, which benefitted from the rally in silver prices. The FY20 forward curve implies this pricing trend will continue, with FY20 gold and silver increasing 2% and 10% from current spot, respectively. Nonetheless, we highlight the medium-to-long term risks faced with only three mines in operation, heavily reliant on San Dimas (FY19: 52% revenues, 54% production), and potential negative impact of policies under the AMLO administration, which pose a particular risk to mining companies in the region. Meanwhile, production decline (Est. -8% to -20% y/y) and capex expansion (Est. +40% y/y) are expected to continue through FY20 as the company focuses on exploration projects, whose efficacy will be highlighted in the company's FY19 reserves report, expected in March.

We evaluate First Majestic at 250 bps and a 100D volatility of 50%. With modest spread (100D 50% v 45% IVOL) and substantial downside risk (2% up v 33% down) at a mid price of 126c v 129c fair value and a bond floor of 95c, we maintain our ‘Swap – Neutral’ rating on the FRCN 1.875% 23s.

	Amt Out (US\$ MM)	Mid Price	Mid YTW	IVOL	Cheap. (par)	Delta (par)	Conv. Price	AG US Price
FRCN 1.875% 3/1/2023	157	125.8	(5.8%)	44.8%	1.9%	68.3%	9.5850c	\$9.92

Source: Equity information sourced from Bloomberg. Convertible pricing as of February 21st 2020.

4Q19 Financial Results:

- Currently, the company has three (3) producing mines, San Dimas, Santa Elena and La Encantada, alongside one (1) additional mine, San Martin, whose operations have been temporarily suspended
 - In addition, the company has six (6) ongoing exploration projects at La Parrilla, Del Toro, La Guitarra, La Luz, La Joya and Plomosas (whose sale is pending)
- Total production decreased 4% y/y and 6% q/q to 6.23 mm silver equivalent ounces as a result of lower gold grades and heavy rains at Santa Elena
 - Nonetheless, the company achieved upper end of production guidance with 26mm silver equivalent ounces produced in FY19, +15% y/y from FY18 at 22.2 mm silver equivalent ounces

- We highlight >50% of total production is derived from newly acquired, lower cash cost profile, San Dimas mine
- Cash cost per oz was 38% lower y/y and 3% lower sequentially at US\$3.73 per payable ounce of silver, benefitting from temporary suspension of operations at La Parrilla
- Revenue of US\$96.5 mm increased 30% y/y on higher average realized silver prices (+21% y/y) and silver equivalent ounces sold (+6% y/y), which was balanced by a slight decrease in revenues q/q (-1%)
- EBITDA increased 178% y/y, again the result of increased prices, ounces sold and reduced operating costs on higher volumes, but decreased 4% q/q to US\$34.2 mm
- EBITDA margins expanded 1,886 bps y/y but contracted 126 bps q/q to 35%
- Free cash flow was positive US\$28.4 mm, substantially improved from prior quarters on higher EBITDA and working capital generation
 - Capex increased 30% q/q to US\$37.2 mm from US\$28.6 mm in 2Q19
 - Working capital was positive US\$16.4 mm, compared to working capital use of US\$0.7 mm in the prior quarter
- Cash and equivalents were US\$169.0 mm at year end, up 42% q/q
- Net debt was down 57% q/q at US\$28.6 mm
- LTM Net leverage contracted to 0.3x

First Majestic Silver (US\$MM)					
Operational Performance:	4Q19	3Q19	4Q18	y-o-y	q-o-q
Total Production (million oz silver equiv.)	6.23	6.64	6.49	(4%)	(6%)
Silver (million oz)	3.35	3.37	3.25	3%	(1%)
Gold (million oz)	0.03	0.04	0.03	(4%)	(7%)
Lead (million lbs)	0.91	1.91	3.29	(72%)	(52%)
Zinc (million lbs)	0.00	1.03	1.47	(100%)	(100%)
Revenue per oz	\$15.48	\$14.61	\$11.43	35%	6%
EBITDA per oz	\$5.49	\$5.37	\$1.90	189%	2%
Cash Cost per oz (USD)	\$3.73	\$3.83	\$6.06	(38%)	(3%)
All-In Sustaining Cash Cost per oz	12.25	10.76	12.83	(5%)	14%
Total Production Cost per tonne	\$78.62	\$78.87	\$65.31	20%	(0%)

First Majestic Silver (US\$MM)					
Financial Performance (US\$MM)	4Q19	3Q19	4Q18	y-o-y	q-o-q
Revenue	96.5	97.0	74.1	30%	(1%)
EBITDA	34.2	35.6	12.3	178%	(4%)
<i>EBITDA margin</i>	35%	37%	17%	1,886 bps	(126 bps)
Working Capital	16.4	(0.7)	(15.0)	-	-
Income Tax Paid	(0.8)	(0.4)	(0.9)	(8%)	120%
Capex	(37.2)	(28.6)	(25.8)	44%	30%
Finance Costs Paid	(0.6)	(2.2)	(0.5)	23%	(72%)
Free Cash Flow	28.4	3.2	(45.0)	-	791%
Gross Debt	197.6	185.5	181.1	9%	7%
Convertible Debentures	156.5	156.5	156.5	0%	0%
Term Loan	-	-	-	-	-
Revolving Credit Facility	19.2	19.1	18.7	3%	1%
Lease Liabilities	21.9	9.9	5.8	275%	121%
Cash and Equivalents	169.0	118.6	57.0	196%	42%
Net Debt	28.6	66.9	124.0	(77%)	(57%)
Gross Leverage (Gross Debt / LQA EBITDA)	1.4x	1.3x	3.7x	(2.2x)	0.1x
Net Leverage (Net Debt / LQA EBITDA)	0.2x	0.5x	2.5x	(2.3x)	(0.3x)
LTM Gross Leverage	1.9x	2.2x	3.0x	(1.1x)	(0.3x)
LTM Net Leverage	0.3x	0.8x	2.0x	(1.8x)	(0.5x)

2020 Guidance:

- FY20 total production is expected to be 21.5 – 24.0 mm silver equivalent ounces, 8-20% lower than FY19 production, which achieved the upper end of guidance at 26.0 mm silver equivalent ounces
 - Lower production is the result of suspension of operations at La Parrilla (expected to continue through 2020) and San Martin, in addition to the wind down of Del Toro's operations
 - The company expects 62% of production will be derived from its San Dimas operations in FY20, as compared to 54% in FY19
- FY20 silver production is expected to be 11.8 – 13.2 mm ounces, accounting for 63% of FY20 revenues, with 55% of total production derived from San Dimas
- Capex is guided to increase 40% y/y to US\$171 mm, with US\$119 mm allocated towards expansionary projects and the remaining US\$53 mm toward sustaining capex

- FY20 capex will include underground development (US\$63 mm), exploration (US\$28 mm), PP&E (US\$33 mm) and corporate projects (US\$47 mm)
 - La Parilla Silver Mine: 19,000 metres of exploration planned, alongside intended restart of mill
 - De Toro Silver Mine: 22,450 metres of exploration planned
- We highlight capex has increased 176% since 2016
- FY20 infrastructure plans include the installation of a high intensity grinder (HIG) mill and autogenous (AG) mill (from standard ball mill), as well as ore bins at San Dimas, which are expected to reduce energy and maintenance costs, as well as improve recoveries
 - The company states production costs at San Dimas have already come down 20% to US\$125/ton since its acquisition

Convertible Description and Valuation

CONVERTIBLE BOND		FIRST MAJESTIC SILVER
Country of Risk		Mexico
Industry Group		Mining
Ticker		FRCN
Coupon		1.88%
Maturity		3/1/2023
Amount Out (mm)		157
Rank		Sr Unsecured
Mid Price		125.8
Mid YTM		(5.8%)
Share Conversion Price		9.58
Parity		104.1
Premium		22.4
EQUITY		AG US
Share Price as of close 02/20/2020 (USD)		10.01
Current Market Cap (US\$ bn)		2.1
Last Reported Earnings		4Q19
Net Leverage (Net Debt / LTM EBITDA)		0.3x
BCP Credit Spread Estimate		250
Realized Share Volatility (100D)		50.3%
Implied Volatility		44.8%
Fair Value (vs 100D realized vol)		128.7
(Rich)/Cheap %		1.9%
Delta		68.3%
Bond Floor		94.5
Implied Share Volatility (ATM 30D listed calls)		51.7%

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Megan E. McDonald
Investment Research Analyst
BCP Securities, LLC

289 Greenwich Avenue, Ste 4
Greenwich, CT 06830
+1-203-629-2185 ext. 312
mmcdonald@bcpsecurities.com
www.bcpsecurities.com

Matias Castagnino, CFA
BCP Securities, LLC

Paseo de la Castellana, 91
28064 Madrid, Spain
+34 91 310 6980
mcastagnino@bcpsecurities.com
www.bcpsecurities.com

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