

BCP Research: First Majestic Silver (FRCN)- 2Q20 Results, Weak-Fairly Valued, maintain 'Neutral'

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Summary: Mexico-based silver miner, First Majestic Silver ("Majestic"), released weak 2Q20 results, in line with expectations, with lower production driven by a 13-day union strike at San Dimas, and production closures in April and May due to COVID-19 government mandates. Lower revenues, together with increased costs, led to negative US\$6 mm EBITDA in the quarter. Cash burn of US\$41 mm was driven by weak profitability, capex and working capital use. The company ended 2Q20 with US\$95 mm in cash and US\$91 mm in net debt at LTM net leverage of 1.0x. Inventory stockpiled in 2Q20 was subsequently sold in 3Q20, expected to generate US\$25 mm in additional revenues. As of August '20 the company reported a US\$128 mm cash position.

Bonds are currently in the money, with First Majestic equity (AG US) trading above the strike (US\$9.59) at US\$12.46 or 29x TEV / LTM EBITDA (based on reported cash at Aug '20). Evaluating FRCN '23s at 400 bps credit spread and volatility of 50% implies bonds are fairly valued at 143c mid v. a bond floor of 94c. Assuming the current metals price environment leads to ramping up of 2021 production to 2019 levels, we see EBITDA potential of over US\$300 mm. We estimate 2021 TEV/EBITDA of ~7x and FCF yield on the shares of under 10%. Given lack of upside and limited spread between implied vol (51%) v. 100D (69%) and listed calls (70%) we remain neutral on the FRCN 1.875% '23s.

	Amt Out (US\$ MM)	Mid Price	Mid YTW	Implied Vol	Cheapness (par)	Delta (par)	Conv. Price	AG US Price
FRCN 1.875% 3/1/2023	157	142.5	(12.39%)	51.21%	(0.29%)	73.41%	9.59c	\$12.46

Source: Equity information sourced from Bloomberg. Convertible pricing as of September 15th 2020.

2Q20 Financial and Operating Results:

- As of 2Q20, three mines are producing (San Dimas, Santa Elena, La Encantada) and four mines are in suspension (San Martin, Del Toro, La Parilla, La Guitarra), with several development and exploration stage projects ongoing
 - Operations at Sane Dimas, Santa Elena and La Encantada were suspended from April 3rd to May 18th following a mandate from the Mexican Ministry of Health requiring suspension of non-essential business activities in response to COVID-19
 - Several other operations were suspended prior to COVID-19 (San Martin, La Parilla and La Guitarra) and re-designated as "exploration projects." However, following record silver and gold price performance, the company is now contemplating restarting certain operations from this group
- Total production decreased 45% y/y and 43% q/q to 3.51 mm silver equivalent ounces, the result of a 13-day union strike at San Dimas and the ramp down of San Dimas, Santa Elena and La Encantada mines, following the COVID-19 government mandates
- Cash cost US\$6.73 per payable ounce of silver was 2% lower y/y but 30% higher q/q, driven primarily by lower by-product credits at San Dimas and Santa Elena as a result of ~3,900 oz of gold shipped but not yet sold in the quarter, partially offset by lower production costs as a result of weaker f/x of the Mexican Peso v. USD
- All in Sustaining Costs ("AISC") were US\$18.57 per oz, up 26% y/y and 43% q/q reflecting lower fixed cost dilution on lower production

First Majestic Operational Performance	2Q20	1Q20	4Q19	3Q19	2Q19	y/y	q/q
Production							
Silver (Moz)	1.83	3.15	3.35	3.37	3.19	(43%)	(42%)
Gold (Moz)	0.02	0.03	0.03	0.04	0.03	(53%)	(51%)
Lead (mm lbs)	-	-	0.91	1.91	2.45	(100%)	-
Zinc (mm lbs)	-	-	-	1.03	1.40	(100%)	-
Total Production (mm silver equiv. ounces)	3.51	6.20	6.23	6.64	6.41	(45%)	(43%)
Revenue per oz (USD)	\$9.94	\$13.89	\$15.48	\$14.61	\$13.05	(24%)	(28%)
EBITDA per oz (USD)	(1.68)	4.75	5.49	5.37	2.40	(170%)	(135%)
Cash Cost per oz (USD)	6.73	5.16	3.73	3.83	6.84	(2%)	30%
All-In Sustaining Cash Cost per oz (USD)	18.57	12.99	12.25	10.76	14.76	26%	43%
Total Production Cost per tonne (USD)	\$78.78	\$82.41	\$78.62	\$78.87	\$77.93	1%	(4%)

- Revenue of US\$34.9 mm decreased 58% y/y and 60% q/q on reduced production following suspension of non-essential business operations in response to COVID-19, and stockpiling of metal inventory in the quarter to maximize future profits
 - We highlight the company held ~970,000 ounces of silver and 6,000 ounces of gold in metal inventory, which were sold post-2Q20 and will contribute US\$25 mm in revenue in 3Q20
- EBITDA turned negative US\$5.9 mm on lower profitability resulting from shutdowns and stockpiling of metal inventory, which reduced revenue and increased standby costs
- Cash burn of US\$41.3 mm increased 23% q/q, driven primarily by negative EBITDA, and – albeit reduced – capex and working capital use
 - Working capital use contracted 50% q/q to US\$7.7 mm, with the majority derived from the increase in inventories of US\$9.4 mm relating to the stockpiling of metal inventories mentioned above
 - Capex decreased 47% q/q to US\$16.0 mm, broken down between San Dimas (US\$5.2 mm), Santa Elena (US\$4.0 mm), La Encantada (US\$1.3 mm) and strategic projects (US\$5.5 mm)
- Gross debt was flat q/q US\$186.4 mm at 2.0x LTM gross leverage, one turn below the RCF maintenance covenant threshold
- Cash and equivalents decreased 34% q/q to US\$95.2 mm
 - At end-2Q20, US\$65.5 mm of First Majestic’s US\$75 mm senior secured RCF remained undrawn, resulting in a total US\$162.2 mm in liquidity (cash and equivalents, ST A/R, undrawn RCF)
 - We highlight the sr. secured RCF is guaranteed by certain subsidiaries of the company and secured by a first priority charge against the assets of the company, as well as a first priority pledge of shares of the company
 - Maintenance covenants include LTM leverage of $\leq 3x$, LTM interest coverage ratio of $\geq 4x$, tangible net worth of \geq US\$563.5 mm + 50% of positive earnings
 - In addition, a negative covenant exists allowing for the company to enter into finance leases up to US\$30 mm
 - As of August 4th 2020, the company had US\$128 mm in cash and equivalents
- Net debt increased 117% q/q to US\$91.2 mm on reduced cash, while LTM net leverage expanded to 1.0x

First Majestic Financial Performance (US\$MM)	2Q20	1Q20	4Q19	3Q19	2Q19	y/y	q/q
Revenue	34.9	86.1	96.5	97.0	83.7	(58%)	(60%)
EBIT	(13.6)	14.8	16.3	21.1	(1.8)	-	-
Depreciation and Amortization	7.7	14.6	17.9	14.5	17.1	(55%)	(47%)
EBITDA	(5.9)	29.5	34.2	35.6	15.4	-	-
<i>EBITDA margin</i>	<i>(17%)</i>	<i>34%</i>	<i>35%</i>	<i>37%</i>	<i>18%</i>	-	-
Working Capital	(7.7)	(15.3)	16.4	(0.7)	(3.9)	97%	(50%)
Income Tax Paid	(3.8)	(0.5)	(0.8)	(0.4)	(3.8)	0%	658%
Capex	(16.0)	(30.1)	(37.2)	(28.6)	(29.7)	(46%)	(47%)
Repayment of lease liabilities	(1.6)	(1.8)	(1.9)	(1.3)	(1.0)	57%	(8%)
Finance Costs Paid	(0.3)	(2.0)	(0.6)	(2.2)	(0.6)	(55%)	(85%)
Free Cash Flow	(41.3)	(33.7)	28.4	3.2	(26.6)	56%	23%
Gross Debt	186.4	187.3	197.6	185.5	184.0	1%	(0%)
Convertible Debentures	156.5	156.5	156.5	156.5	156.5	0%	0%
Revolving Credit Facility	9.5	9.4	19.2	19.1	19.0	(50%)	1%
Lease Liabilities	20.4	21.4	21.9	9.9	8.5	140%	(5%)
Cash and Equivalents	95.2	145.2	169.0	118.6	94.5	1%	(34%)
Net Debt	91.2	42.1	28.6	66.9	89.5	2%	117%
LTM EBITDA	93.4	114.7	106.6	84.7	68.4	37%	(19%)
LTM Gross Leverage	2.0x	1.6x	1.9x	2.2x	2.7x	(0.7x)	0.4x
LTM Net Leverage	1.0x	0.4x	0.3x	0.8x	1.3x	(0.3x)	0.6x

FY20 Guidance:

- Production guidance is expected to be 10-15% lower y/y at 21.4 – 22.9 mm silver equivalent ounces (v. FY19: 25.5 mm silver equivalent ounces) as a result of the impact of COVID-19 on operations, particularly in 2Q20 as a result of suspension of non-essential business activities by the Mexican Ministry of Health during the period
- Cash costs are expected to be 11-24% lower y/y, averaging US\$3.95 – US\$4.59 per oz (v. FY19: US\$5.19 per oz)
- All in sustaining costs guidance is in the range of US\$12.29 to US\$13.45 per oz, 3% lower to 6% higher y/y (v. FY19: US\$12.67 per oz)
- Capex guidance is US\$132 mm for FY20, 6% higher y/y v. FY19 (US\$124 mm)
 - Capex allocation includes US\$54 mm for u/g development, US\$21 mm for exploration, US\$27 mm for PP&E and US\$29 mm for corporate projects

Mine	Silver (Moz)	Gold (Koz)	Silver Equiv. (Moz)	Cash Costs (\$)	AISC (\$)
San Dimas	6.0 - 6.4	75 - 80	13.5 - 14.4	0.75 - 1.49	7.09 - 8.22
Santa Elena	1.9 - 2.0	31 - 33	4.8 - 5.2	3.60 - 4.38	8.33 - 9.43
La Encantada	3.1 - 3.3	-	3.1 - 3.3	10.42 - 10.77	12.59 - 13.07
Total	11.0 - 11.7	106 - 113	21.4 - 22.9	\$3.95 - \$4.59	\$12.29 - \$13.45

Pro-Forma Estimates and Convertible Valuation:

Assuming the current metals price environment leads to ramping up of 2021 production to 2019 levels, we see EBITDA potential of over US\$300 mm. We estimate 2021 TEV/EBITDA of ~7x and FCF yield on the shares of under 10%.

First Majestic - Pro-Forma FY21 (US\$MM)	FY19	Change % y/y	FY21
Total Volumes Produced (mm silver equivalent ounces)	25.6	0%	25.6
Silver production (Moz)	13.2	18%	15.6
Gold production (Moz)	0.13	0%	0.13
<i>% Production of Silver (1)</i>	-	-	61%
<i>% Production of Gold (1)</i>	-	-	39%
Average Silver Price (USD/oz) (2)	16.21	71%	27.69
Average Gold Price (USD/oz) (2)	1,393	42%	1,976
Silver - Revenue/oz (USD)	16.26	71%	27.77
Gold - Revenue/oz (USD)	1,063	42%	1,507
Silver Revenue	215	101%	433
Gold Revenue	143	42%	203
Other revenue (lead & zinc)	11	-	0
Total Revenues	364	75%	636
<i>Margin</i>	29%		59%
EBITDA	107	252%	376
Taxes Paid (3)	(6)	39%	(9)
Capex (1)	(124)	0%	(124)
Repayment of finance and lease obligation (3)	(5)	31%	(7)
Interest Paid (3)	(6)	(21%)	(4)
Free Cash Flow (before WK)	(35)	-	232

(1) Based on management guidance FY20

(2) Source: Bloomberg silver spot USD/oz (XAG) and gold spot USD/oz (XAU)

(3) 1H20 annualized

Equity Upside/(Downside) (US\$MM)	No Dilution	Diluted
Current Market Cap	2,624	2,827
Current Enterprise Value (EV)	2,715	2,918
Current EV / EBITDA	29.1x	31.2x
Scenario 1:		
FY21 EV / EBITDA	7.1x	7.3x
Pro-Forma FY21 EBITDA	376	376
EV	2,682	2,729
Pro-Forma Net Debt (1)	58	(98)
Implied Market Cap	2,624	2,827
Upside/(Downside) Potential	0%	0%
FCF Yield	8.8%	8.8%

(1) Prices sourced from Bloomberg as of 9/15/20

(2) Based on August '20 reported cash balance of US\$128

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