

BCP Research: First Majestic Silver (FRCN)- 3Q20 Results, Positive – Fairly Valued, Maintain Neutral

Published: November 13, 2020

Summary: Mexico-based silver miner, First Majestic Silver (“Majestic”), released strong 2Q20 results, reflecting ramp-up in production following prior quarter COVID-related shutdowns, and reduced production costs. Revenue increased substantially y/y and q/q on higher metal prices and production, and the sale metal inventory stockpiled from the prior quarter. EBITDA turned positive US\$61 mm, nearly 2x prior year levels, and EBITDA margins expanded to 48%. Cash flow turned positive US\$46 mm on higher profitability and working capital inflow, balanced by the return of capex to normalized levels. Cash increased to US\$266 mm (78% cash to LTM revenue) following cash inflow and the receipt of US\$136 mm in net proceeds from a prospectus offering (US\$126 mm) and the exercising of stock options (US\$10 mm). We highlight US\$58 mm of the US\$126 mm in proceeds from the prospectus offering was provided by Eric Sprott, a renowned precious metals investor. Gross debt was US\$185 mm and LTM gross leverage contracted to 1.6x. Pro-forma liquidity, following the repayment of the company’s RCF is estimated to be US\$ 346 mm at pro-forma liquidity to LTM revenue of US\$101%.

Bonds are currently in the money, with First Majestic equity (AG US) trading above the strike (US\$9.59) at US\$10.88 or 19.7x TEV / LTM EBITDA. Evaluating FRCN ‘23s at 400 bps credit spread and volatility of 50% implies bonds are slightly rich at 131c mid v. FV of 130c and a bond floor of 95c. Assuming the current metals price environment leads to ramping up of 2021 production to 2019 levels, we see EBITDA potential of ~US\$285 mm. We estimate 2021 TEV/EBITDA of ~8.2x and FCF yield on the shares of under 10%. Given lack of upside and limited spread between implied vol (55%) v. 100D (69%) and listed calls (61%) 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	130.8	(9.78%)	55.20%	(1.24%)	60.12%	\$9.59	\$10.88

Source: Equity information sourced from Bloomberg. Convertible pricing as of November 13, 2020.

3Q20 Financial and Operating Results:

- As of 3Q20, 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
- Total production decreased 22% y/y but increased 48% q/q to 5.20 mm silver equivalent ounces, with all three of First Majestic’s operating mines (San Dimas, Santa Elena and La Encantada) returning to normal operations following temporary shutdowns related to COVID-19 in the prior quarter
 - Silver production was down 6% y/y, but increased 72% q/q to 3.16 mm oz.
 - Silver production YTD of 8.1 mm oz reflects ~72% of the company’s 2020 guidance midpoint
 - Gold production was down 23% y/y, but increased 63% q/q to 0.3 mm oz
 - Gold production YTD of 0.8 mm oz reflects ~67% of the company’s 2020 guidance midpoint
- Cash cost declined significantly to US\$2.49 per payable ounce of silver (-35% y/y, - 63% q/q), driven primarily by increased production and higher by-product credits, reflecting higher gold sales from finished goods inventory rollover from the prior quarter
 - Rollover of gold inventory contributed an additional US\$7.4 mm or US\$2.34/oz in by-product credits in 3Q20, which was partially offset by higher production costs related to ore development strengthening of the Mexican Peso v. USD

- Cash costs YTD of US\$4.79 appear to be nearing guidance the upper end of FY20 guidance of US\$3.95 – US\$4.59 per oz (v. FY19: US\$5.19 per oz)
- All in Sustaining Costs (“AISC”) were also significantly reduced to US\$9.94 per oz (-8% y/y, -46% q/q), reflecting higher production levels,
 - As with cash costs, AISC appears on track to YTD (US\$13.83) to meet the upper end of FY20 guidance of US\$12.29 - 13.45 per oz (v. FY19: US\$12.67 per oz)

First Majestic Operational Performance	3Q20	2Q20	1Q20	4Q19	3Q19	y-o-y	q-o-q
Production							
Silver (Moz)	3.16	1.83	3.15	3.35	3.37	(6%)	72%
Gold (Moz)	0.03	0.02	0.03	0.03	0.04	(28%)	63%
Lead (mm lbs)	-	-	-	0.91	1.91	-	-
Zinc (mm lbs)	-	-	-	-	1.03	-	-
Total Production (mm silver equiv. ounces)	5.20	3.51	6.20	6.23	6.64	(22%)	48%
Revenue per oz (USD)	\$24.20	\$9.94	\$13.89	\$15.48	\$14.61	66%	143%
EBITDA per oz (USD)	13.68	(1.68)	4.75	5.49	5.37	155%	(916%)
Cash Cost per oz (USD)	2.49	6.73	5.16	3.73	3.83	(35%)	(63%)
All-In Sustaining Cash Cost per oz (USD)	9.94	18.57	12.99	12.25	10.76	(8%)	(46%)
Total Production Cost per tonne (USD)	\$71.56	\$78.78	\$82.41	\$78.62	\$78.87	(9%)	(9%)

FY20 Guidance					
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

- Revenue increased 30% y/y and nearly 4x q/q to US\$125.9 mm on higher metal prices, increased production, and the sale of ~970,000 ounces of silver and 6,000 ounces of gold inventory stockpiled in the prior quarter and sold in 3Q20 for net proceeds of US\$25 mm
- EBITDA increased 70% y/y and turned positive US\$60.6 mm in the quarter on higher revenues and the delayed sale of inventory
- EBITDA margins expanded 1,139 bps y/y to 48%
- Free cash flow also turned positive, reaching US\$45.7 mm on improved profitability and working capital inflow, which outweighed the 2x+ increase in capex
 - Working capital inflow was US\$11.5 mm, mainly reflecting a US\$9.6 mm decrease in inventories, reflecting collections from the sale of stockpiled inventories, a US\$3 mm increase in T/R, and a US\$4 mm decrease in unearned revenue
 - Income tax payments decreased 79% q/q to US\$0.8 mm
 - Capex increased 120% q/q to US\$35.3 mm, broken down between San Dimas (US\$11.6 mm), Santa Elena (US\$8.5 mm), La Encantada (US\$3.1 mm), strategic projects (US\$5.6 mm) and Springpole Silver Stream acquisition costs (US\$4.4 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
 - YTD, capex totaled US\$81.4 mm, less than half of management’s guided US\$132 mm for the year
 - Lease liability payments increased 10% q/q to US\$1.8 mm
 - Finance cost payments increased 511% q/q to US\$1.7 mm

- Cash (cash and equivalents + marketable securities) increased 138% q/q to US\$266.1 mm, reflecting cash inflow and proceeds from the prospectus offering alongside exercised stock options
 - A prospectus offering was executed in 3Q20, providing net proceeds of US\$126.2 mm, with the lions share (US\$58.3 mm) contributed by Eric Sprott, a renowned precious metals investor
 - An additional US\$10.2 mm of net proceeds was received following the company's exercising of stock options
 - This was balanced by the repayment of US\$10 mm of First Majestic's debt facility
- Liquidity was US\$336.5 mm at end-3Q20, including cash (US\$266.1 mm), T/R (US\$5.1 mm) and First Majestic's US\$65.3 mm undrawn senior secured RCF
 - Pro-forma liquidity is estimated to be US\$346.2 mm following repayment of the secured RCF, leaving the entirety (US\$75 mm) available for drawdown
- Gross debt decreased 1% q/q US\$185.3 mm at 1.6x LTM gross leverage
- The company ended the quarter with net cash of US\$80.7 mm

First Majestic Financial Performance (US\$MM)	3Q20	2Q20	1Q20	4Q19	3Q19	y-o-y	q-o-q
Revenue	125.9	34.9	86.1	96.5	97.0	30%	261%
EBIT	42.5	(13.6)	14.8	16.3	21.1	101%	-
Depreciation and Amortization	18.0	7.7	14.6	17.9	14.5	25%	133%
EBITDA	60.6	(5.9)	29.5	34.2	35.6	70%	-
<i>EBITDA margin</i>	<i>48.1%</i>	<i>(16.9%)</i>	<i>34.2%</i>	<i>35.5%</i>	<i>36.7%</i>	<i>1,139 bps</i>	<i>-</i>
Working Capital	11.5	(7.7)	(15.3)	16.4	(0.7)	-	-
Income Tax Paid	(0.8)	(3.8)	(0.5)	(0.8)	(0.4)	113%	(79%)
Capex	(35.3)	(16.0)	(30.1)	(37.2)	(28.6)	23%	120%
Repayment of lease liabilities	(1.8)	(1.6)	(1.8)	(1.9)	(1.3)	41%	10%
Finance Costs Paid	(1.7)	(0.3)	(2.0)	(0.6)	(2.2)	(19%)	511%
Free Cash Flow	45.7	(41.3)	(33.7)	28.4	3.2	1335%	-
Cash and equivalents	232.4	95.2	145.2	169.0	118.6	96%	144%
Marketable securities	33.6	16.7	6.9	6.5	6.4	422%	102%
Cash	266.1	111.9	152.1	175.5	125.1	113%	138%
Trade receivables	5.1	1.5	3.5	4.3	6.9	(26%)	241%
Undrawn facilities	65.3	65.3	65.0	55.0	55.0	19%	0%
Liquidity	336.5	178.7	220.6	234.8	187.0	80%	88%
Convertible Debentures	156.5	156.5	156.5	156.5	156.5	0%	0%
Revolving Credit Facility	9.7	9.5	9.4	19.2	19.1	(49%)	2%
Lease Liabilities	19.2	20.4	21.4	21.9	9.9	93%	(6%)
Gross Debt	185.3	186.4	187.3	197.6	185.5	(0%)	(1%)
Net Debt	(80.7)	74.5	35.2	22.1	60.4	-	-
LTM EBITDA	118.4	93.4	114.7	106.6	84.7	40%	27%
LTM Gross Leverage	1.6x	2.0x	1.6x	1.9x	2.2x	(0.6x)	(0.4x)
LTM Net Leverage	NM	1.0x	0.4x	0.3x	0.8x	-	-
Cash to LTM Revenue	78%	36%	42%	48%	37%	4,089 bps	4,191 bps
Liquidity to LTM Revenue	98%	57%	61%	65%	55%	4,328 bps	4,118 bps

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\$285 mm. We estimate 2021 TEV/EBITDA of ~8.2x and FCF yield on the shares of under 10%.

First Majestic (mm silver equivalent oz)	FY19	FY21E	FY21 v. FY19 (% change)
Total Volumes Produced	25.5	25.5	0%
Silver	13.2	14.0	6%
Gold	11.6	11.6	0%
Lead	0.4	-	
Zinc	0.3	-	
<i>% Production of Silver</i>	52%	55%	286 bps
<i>% Production of Gold</i>	45%	45%	0 bps
Average Silver Price (USD/oz) (1)	16.21	24.92	54%
Average Gold Price (USD/oz) (1)	1,393	1,906	37%
Silver - Revenue/oz (USD)	16.26	25.00	54%
Gold - Revenue/oz (USD)	12.36	16.90	37%

First Majestic (US\$MM)	FY19	FY21E	FY21 v. FY19 (% change)
Silver Revenue	215	349	62%
Gold Revenue	143	196	37%
Other revenue (lead & zinc)	11	-	-
Total Revenues	364	545	50%
<i>Margin</i>	29%	52%	2,299 bps
EBITDA	107	285	167%
Taxes Paid (2)	(6)	(6)	(5%)
Capex (3)	(124)	(132)	6%
Repayment of finance and lease obligation (2)	(5)	(7)	36%
Interest Paid (2)	(6)	(5)	(19%)
Free Cash Flow (before WK)	(35)	136	-

(1) Source: Bloomberg

(2) Based on reported LTM 3Q20 results

(3) Based on revised FY20 management guidance (3Q20 results)

Equity Upside/(Downside) (US\$MM)(1)	No Dilution	Diluted
Current Market Cap	2,407	2,585
Current Enterprise Value (EV)	2,326	2,347
Current EV / EBITDA	19.7x	19.8x
Scenario 1:		
FY21 EV / EBITDA	8.2x	8.3x
Pro-Forma FY21 EBITDA	285	285
EV	2,339	2,360
Pro-Forma Net Debt (2)	(74)	(231)
Implied Market Cap	2,413	2,591
Upside/(Downside) Potential	0%	0%
Current FCF Yield	(1.4%)	(1.3%)
Pro-Forma FY21 FCF Yield	5.6%	5.2%

(1) Prices sourced from Bloomberg as of November 13, 2020

(2) Assumes pro-forma increase in shares (valued at US\$6.25 mm) and pro-forma decrease in cash (US\$6.25 mm) related Springpole Silver Stream agreement

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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