Transcript of
Fortuna Silver Mines Inc.
First Quarter 2019 Financial and Operational Results
May 15, 2019

Participants

Carlos Baca - IR Manager
Jorge Alberto Ganoza - President, CEO and Director
Luis Dario Ganoza - CFO

Analysts

Chris Thompson - PI Financial
Adrian Day - Adrian Day Asset Management

Presentation

Operator
Good day, ladies and gentlemen, and welcome to the Fortuna Silver Mines' First Quarter 2019 Financial and Operational Results Call. All lines have been placed in a listen-only mode and the floor will open for your questions and comments following the presentation. [Operator instructions].

At this time, it's my pleasure to turn the floor over to Mr. Carlos Baca, Investor Relations Manager. Sir, the floor is yours.

Carlos Baca - IR Manager
Thank you, Tom. Good morning, ladies and gentlemen. I would like to welcome you to Fortuna Silver Mines and to our financial and operational results call for the first quarter of 2019.

Today, we will be using a webcast presentation which will be controlled by us. To download the presentation, please go to our website at www.fortunasilver.com. Click on the Investors tab, then click on the Financials sub-tab and under Q1 2019, click on Earnings Call Webcast link. Jorge Alberto Ganoza, President, CEO, and Director; and Luis Dario Ganoza, CFO will be hosting the call.

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 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, President, CEO and Co-Founder of Fortuna.

Jorge Alberto Ganoza - President, CEO and Director
Thank you, Carlos and good morning to all. I'll be presenting an introduction to our quarter results and progress on the Lindero Gold mine construction in Argentina, and then turn the call over to Luis who will take you through the financial statements. After that we'll open the call for questions.

On Slide 4, today we show a solid track record of organic growth and profitability from our mines in Mexico and Peru which underpins our business but investors' attention is focused now on our execution at Lindero. Lindero will be our third operating mine and it's a strategic asset to the company. This mine has reserves for 15 years of gold production and is accretive to the strong consolidated EBITDA margins of our business.

Slide 5 please, Q1 2019 highlights, our adjusted EBITDA for the first quarter was $23.8 million representing a robust 40% margin over sales. Liquidity available stands at $193 million which includes our available credit lines while keeping a modest debt to EBITDA ratio of 0.7 at the end of the quarter. The main theme for us now until Q1 of next year is a successful completion of Lindero. As of the end of April, we have a 47% advance towards completion, 97% of direct capital costs have been committed and remaining construction capital to completion is estimated at $115 million.

Apart from the typical quarterly updates and construction news releases, we're producing a series of monthly videos that help us show our advance on a regular basis. The construction videos can be found on our website and I would like to encourage you to access the videos and follow our progress.

On May 9, we were pleased to announce the publication of our 2018 sustainability report. This is our first sustainability report and was produced under the Core Option of the GRI Standard. The document presents a comprehensive view of the commitments and actions we're taking to conduct our business in an ethical manner measuring our economic, social and environmental impacts. This document is one more step we take towards improving transparency and communication with stakeholders.

Slide 6, our mine teams delivered another consistent quarter with silver and gold production tracking in line with our 2019 guidance of 8.2 million to 9 million ounces of silver and 49,000 to 54,000 ounces of gold. Measured against the previous quarter, silver and gold production were down 7% and 11% respectively. This is explained largely by San Jose silver and gold rates being down 6% and 12% respectively against the comparative quarter. It is worth noting that the first quarter of 2018 we had positive reconciliation in high grade stocks and mining concentrating in some of these high-grade areas within the quarter for operational reasons.

Slide 7, precious metals accounted for 75% of the 59 million in sales for the quarter. Average realized silver price for the period was $15.60 per ounce and $1,316 per ounce for gold. This is 7% lower for silver and only about 1% lower for gold against the comparable period. Byproduct lead and zinc prices were down 19% and 21% respectively.

Slide 8, our sales were down 16%, adjusted EBITDA down 25% and adjusted net income down 36%. In spite of the significant drops, we managed to sustain an EBITDA margin of 40% down from 45% in the comparable quarter and adjusted net income of $8.5 million. The lower sales figure against the comparable quarter is largely explained by lower metal prices, less metal produced and concentrate inventory buildup at San Jose.

Slide 9, all-in sustaining cost at $10.70 is within our range of guidance for the year but 11% above the comparable quarter. San Jose linked costs had no variation with last year and Caylloma all-in cost is impacted by the drop in base metal prices and better sustaining capital execution. Cash cost per ton at both operations is marginally higher when compared against Q1 2018 and below budget.

Slide 10, we recorded capital expenditures of $37.6 million for the quarter of which approximately 31 million are attributed to Lindero. This is worth mentioning that during the quarter we have spent 42 million comprised of recorded capital expenditures plus advances at Lindero or spending on the project is planned to continue at this space which is what the project requires for completion at year end.

Next slide please, in Slide 11 we show our portfolio pyramid. I would like to highlight here that with Lindero in production will be in a position to take our annual gold production from the current 50,000 ounces of gold to north of 200,000 ounces of gold while maintaining silver production at 8 million to 9 million ounces of silver.

Next slide please, Slide 12 shows a simplified schedule with some selected milestones.

I would like to move on to the next slide please. Just to recap, we continue to plan for commercial operations in Q1 2020. The project shows a 47% advance as of April, 97% of the project's total direct capital costs have been committed, $115 million construction capital remaining to completion, and we continue to forecast $295 million for a total capital CapEx. We continue to report approximately $70 million in contingencies within the $295 million fee.

Next slide please. Here we'd like to present you some of the latest photos showing the advance at Lindero. This is a view of our start-up leach pad on Slide 14. As you can see, the complete 35 hector site of the start-up leach pad is ready and receiving liner and over liner. We expect to conclude the leach pad by the month of August so it will be ready to start receiving first ore in October early in Q4.

Next slide please. In Slide 15 we present pictures of the crushing circuit. This is the critical path of construction and we started electromechanical installation of the tertiary crusher which is an HPGR high-pressure grinder roll. The equipment is mounted on the final stages of installation as we speak. We are starting this week with the mounting of secondary crushers. The primary crusher is the last piece of equipment that is going to be installed and here all of the ground preparation and foundation work for the crushers is concluded and retention walls are virtually concluded by now as well. Next slide?

Here we show in the upper pictures this is the tunnel under the stockpile but we'll feed the HPGR coming from the secondary crusher. This is a tunnel that takes a lot of concrete but it's well advanced by now and we started pouring, placing concrete in the tunnel this week as well. Next slide?

ADR and SART plants are not on the critical path of the project, foundations are concluded, and this project needs to be commissioned in December, late November or early December and we are on schedule with that timeline.

Next slide. Mine development, we have on-site all the mine fleet, the mine fleet is operational and complete; six,100-ton trucks, two wheel loaders, a shovel, two drill rigs for production, graders, dozers and the mine work has advanced and the mine is prepared for production. We expect to initiate the production blasting in the month of July.

I would like to remind everybody that at Lindero, Lindero benefits from very low strip ratio of high-grade mineralization out crops over extensive areas of surface. So we benefit from accessing ore from the start at the mine. There's no over stripping or extensive mine preparation that needs to take place. So the mine is ready for production as we speak.

Slide 19, we're advancing with ancillary facilities. Here you see, on the left, the [indiscernible] is being installed and mounted and on the right pictures of our power plant, the plant is ready for commissioning by mid-year. So we will be fully operational with power from this 8-megawatt plant where we're going to be self-generating power for our operations. Next slide?

So with this I will pass on the call to Luis.

Luis Dario Ganoza - CFO
Thank you, Jorge. Slide 21, so again sales for the first quarter were $59 million, down 16% from 2018 due to lower metal prices and lower metal production when compared to the prior year. We reported net income of $2.2 million compared to $13.8 million in Q1 2018 and adjusted net income of $8.4 million compared to $13.2 million in Q1 of 2018, the reduction was driven mainly by lower sales.

Our adjusted EBITDA was $23.8 million compared to $31.8 million recorded in 2018 and free cash flow from ongoing operations was $2.2 million compared to $16.8 million in 2018. Free cash flow in the quarter was affected by short-term movements in inventory and accounts receivable around of $7.1 million. At current metal prices, we expect free cash flow to be, on average, in the range of $8 million to $10 million per quarter.

Next slide, please. So on slide 22, I am breaking down our sales performance for the quarter. We can see the highest impact came from lower silver and base metal prices and lower silver and gold sold. Less favorable treatment and refining charges in 2019 also had an impact on sales when compared to 2018.

Slide 23, our comparative segmented results show a similar pattern at both operations mainly lower margins driven by lower prices and slightly higher costs in the case of San Jose. Cash cost of San Jose was $68.7 per ton, which was above the midpoint of our guidance for the year but aligned with our budget for the first quarter. Cash flows at Caylloma was slightly below the range of our cost guidance for the year and is expected to increase closer to the midpoint of our guidance.

Slide 24, G&A is slightly below Q1 2018 and in line with guidance provided in our year-end call. Our effective tax rate for the quarter was affected by the devaluation of the argentine peso as 24 percentage points out of the 76% effective tax rate are explained by this factor alone.

Next slide, Slide 25. So finally, on slide 25, the evolution of our cash balance reflects the increase space of spending at Lindero. We closed the quarter with $113 million in the treasury and maintained total liquidity of $193 million. Construction spending on Lindero in the quarter was $42.2 million while total spending on the construction as of the end of March was $165 million.

This leaves the total amount remaining to spend on the construction budget of $130 million as at the end of March and, as Jorge disclosed, at the end of April, this amount was $115 million. This amount excludes NAV '18 [ph].

So thank you and back to you, Carlos.

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

Operator
[Operator instructions]. We'll take our first question from [indiscernible].

Q: My question is about the Lindero depreciation and depletion for the first three years. So given the 20% increase in CapEx required for the project and accelerated depreciation schedule, how much are you expecting of depreciation and depletion for the first three years of the operation?

Jorge Alberto Ganoza - President, CEO and Director
I mean, the depletion will take place, I take it we're talking about financial depreciation, depletion. The depletion will take place over the life of mine that is 12, 13 years. So doing the quick math here as we speak that's $295 million CapEx over 13 years that's around $22 million of depreciation and depletion combined I would say on average per year.

You mentioned accelerated depreciation that would be a feature of tax depreciation. There is some of that that we expect to benefit from, but I am not sure if that was what you were referring to.

Q: Yes so the relative tax depreciation?

Luis Dario Ganoza - CFO
Yes on the tax side of things there are incentives that will allow us to benefit from accelerated depreciation on fixed assets over, if I am not mistaken, over a three-year period for a significant portion of the construction spend. I'm not able to give you precise figures at this very moment. Happy to share them outside of the call.

Q: Okay thanks.

Operator
And we'll take our next question from Chris Thompson with PI Financial.

Q: Just a couple of quick questions. We'll start off with San Jose and then I just wanted to start the question on Lindero. So San Jose first of all, I did notice obviously an uptick in unit costs on the quarter, currently looks like on the high side of guidance. Do you expect these to remain there or can we see them retreating more to 2018 levels?

Jorge Alberto Ganoza - President, CEO and Director
Chris, thanks for the question. We expect to be within the range of guidance. We see nothing that suggests a trend away from our guidance, Chris.

Q: Just on the grades, I know you did mention that they were a little lower than anticipated. Well, they beat our expectations and it looks like they're tracking above guidance as well. So again similar sort of question, how should we be modeling the grades both gold and silver for the remainder of the year?

Jorge Alberto Ganoza - President, CEO and Director
Grades were basically in line with our budget for the quarter. We show lower grades at San Jose compared to the comparable quarter Q1 2018 that leads to the drop in metal, in production in the comparable quarter as well. But 2018, in the start of 2019, it benefited from positive reconciliation and concentration of mining on high grade areas due to operational reasons which led us to mine above budget and plan in the start of the year.

So that's why you see a drop quarter-to-quarter, quarter versus quarter in metal and that's led by grade, but our grades at this mine are tracking along plan. And I think something I can say about this mine is that our ability to project grade and tonnage has always been very good due to the nature of the deposit and we expect no deviation with respect to guidance and grade. We're seeing what we planned.

Q: Just on exploration maybe a little bit of an update on what's happening at San Jose?

Jorge Alberto Ganoza - President, CEO and Director
At San Jose, we do a cut for resources around midyear, so we're tightening up our drilling. Our focus, we have three, four rigs working on peripheral areas, on the deep extension and to the south, and in some areas in the

north around the shell of existing resources. We have provided some results previously. We need to provide a market update on additional results. But we expect, based on what we're seeing that we will be able to have new resources come in that will help us deal with depletion. That's our expectation based on the drilling to-date.

I cannot report any game changer this quarter or anything like this. I think San Jose is at a stage where our exploration is yielding resources that help us deal with depletion. So we're preparing to close our drilling for the first half of the year to consolidate the data that will go into out resource estimations in the second half of the year which support our budgeting and reserve exercises [indiscernible].

Q: And then the final question, just Lindero here. You were talking about obviously the crusher being a critical path item. Maybe just can you outline the remaining critical path items for the project and then sort of put it in context by way of timing?

Jorge Alberto Ganoza - President, CEO and Director
Yes all the eyes and efforts of the construction team are on the crushing and leach pad. We are pushing and working on our schedule to keep on track. We plan to start placing ore in October in the leach pad. So that will require the entire crushing system to be operational, that will require power, that will require a leach pad to receive the ore that will require the stacking system and when I talk about crushing, it's crushing and agglomeration system. So crushing and agglomeration, power, water, stackers, leach pad.

Out of all of those, the one that is on the critical path is the commissioning of the crushing and agglomeration. We have the stackers arriving on site as we speak. We already received about half of the stackers. Those are starting to be assembled, so no issues there. And the leach pad, as you have seen on the picture, all the earth works related to the leach pad and site preparations are concluded. We need to rollout geo membrane and then place over liner on top of that. So that work is ongoing and our plan calls for the completion of the leach pad and have it ready to receive ore in August. So that is running with time in our schedule.

Power, we'll have power available from the 8-megawatt plant in June/July. So no issues there. You've seen in the pictures that all the power stations are there, are installed. The secondary tension [ph] line, the secondary transmission power line is advancing well according to plan so no issues there.

Water, our well field is 13 kilometers away from site. The wells, of course, were concluded early in the project and we're laying down the water pipeline. This is also a work that we plan to have concluded by midyear and it's advancing well. So the last thing to be delivered within all of this is the actual crushing and agglomeration. We need to mount the equipment, install it, put up the belt conveyors and commission the crushing, and it's a big works.

Now, the bulk of that excavations and the risker part of that in terms of uncertainties are related usually to excavations and although that is done, although the excavations are done, as you see we have built retention walls. We are basically concluded with all the major placement of concrete for large foundations with the exception of the tunnel for the stockpile between the secondary and HPGR but as you've seen in the pictures as well that work is advancing and advancing according to plan.

So I just tried to give you a bit more color of where we are with all of this. So we need to start placing ore in early Q4 in the leach pad and then the delivery of SART and ADR, comes in late November, early December, we have no elements on critical path on the side of procurement and expediting all of that is, we have nothing, no red flags there.

Everything we need is arriving on time. We have the contractor's on-site and I have to say that getting the project to this stage has been a monumental effort. As we have shared with you the challenges that we face with the start of this project with delays on camp availability, challenges with excavations in the leach pad and foundations. All of those issues are resolved.

We currently have are roughly a 1,200 people on-site, close to 1,000 people today, climbing up to 1,200 on-site. All the major contractors are running on all cylinders on the project and the project is really advancing at the pace that we need and that's also reflected in the rate of spending of the project.

In Q1 we spent $42 million and that is the rate of spend that we need in the project for conclusion at year-end and based on the activities that we're seeing, which are the planned activities, we can sustain the rate of spend and bring this project to successful conclusion by year end.

Operator
[Operator instructions]. We'll go next to Adrian Day, Adrian Day Asset Management.

Q: My question is specifically on Caylloma and you gave us a breakdown of metals by production. Can you tell us how that compares with the comparable period of the comparable quarter and then also perhaps just discuss a little bit about the variability of metal production, specifically going forward how you see it?

Jorge Alberto Ganoza - President, CEO and Director
All your question refers just to Caylloma and also correct. For Caylloma today, zinc and lead are major components of value. So with respect to zinc and lead against the comparable quarter, as we showed in the presentation, there is no significant or variance in terms of metal output for zinc and lead.

Zinc production is up 2% compared against the Q1 2018 and our lead production is up 2% against Q1 2018, and silver production is basically online as well with the Q1 2018. What has hit Caylloma comparing against the previous comparable quarter is the large drop in the zinc and lead prices we've seen compared to a year ago. Lead prices are down 19% and zinc prices are down 21%.

But in terms of metal output, the mine is running well according to plan even though we are seeing also higher all-in [ph] sustaining cost that's also explained by higher sustaining capital but it is basically a good execution of our budget in the quarter compared against last year.

Last year we had a larger sustaining capital budget at Caylloma, it was about $16 million. This year our sustaining capital or CapEx budget for Caylloma is about $13 million. So it's a lower sustaining capital or investment budget for that mine but we had a much better execution of that budget in the start of this year compared to last year. So that's also impacting our all in sustaining costs. The way to view the cost performance of the mine to better view the cost performance is on a cost per ton basis and on a cost per ton we are online with budget. And I also mentioned again the—

Q: So the amount, the relative production of zinc, lead and then silver doesn't really change much?

Jorge Alberto Ganoza - President, CEO and Director
No. The mining is operating at steady state and we have provided guidance.

Operator
[Operator instructions]. Mr. Baca, there appears to be no further questions at this time. I'll turn the call back over to you for any additional or closing remarks.

Carlos Baca - IR Manager

Thank you, Tom. 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.