Transcript of
Fortuna Silver Mines, Inc.
Fourth Quarter 2020 Financial Results
March 12, 2021

Participants

Carlos Baca - Investor Relations Manager
Jorge Alberto Ganoza - President and Chief Executive Officer
Luis Dario Ganoza - Chief Financial Officer

Analysts

Don DeMarco - National Bank Financial
James Huntington - Scotiabank
Adrian Day - ADAM
Justin Stevens - PI Financial

Presentation

Operator
Good morning ladies and gentlemen, and welcome to the Fortuna Silver Mines Fourth Quarter and Full Year 2020 Financial and Operational Results. At this time all participants have been placed on a listen-only mode, and we will open the floor for your questions and comments after the presentation.

It is now my pleasure to turn the floor over to your host, Carlos Baca. Sir, the floor is yours.

Carlos Baca - Investor Relations Manager
Thank you, Matthew. Good morning ladies and gentlemen, I would like to welcome you to Fortuna Silver Mines and to our financial and operations results call for the fourth quarter and full year 2020. Today, we'll be using a webcast presentation which will be controlled by us.

To download the presentation, please go to our website at fortunasilver.com. Click on the investors tab, then on the financial sub tab and under Q4 2020, click on the earnings call presentation link. Jorge Alberto Ganoza, Prescient, CEO and Director and Luis Dario Ganoza, CFO will be hosting the call.

Before I turn over their 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 believes 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 overlooking information in the future except as required by law.

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

Jorge Alberto Ganoza - President and Chief Executive Officer

Thank you, Carlos and good morning to all. We will take you through our results for the quarter and year end with the aid of the slide presentation Carlos mentioned before. So we can go on Carlos to Slide 5 of the presentation.

Through our work over the last three years, we have come to place ourselves in a most exciting position today as we're delivering significant growth in gold production in a rising precious metals market. This year our production guidance from our three mines is in the range of 260,000 to 300,000 gold equivalent ounces, an increase of 80% to 100% over 2020.

Next slide please. Under highlights for the quarter, we have reported record breaking free cash flow of 34.5 million and our business operates with a robust adjusted EBITDA margin of 43%. We have strong liquidity of 132 million with net debt of 34 million and a debt to EBITDA ratio of 0.4. We expect to be net cash positive again this year.

Lindero production first – Lindero produced first gold in October 2020 and delivered 13,435 ounces in the fourth quarter as part of commissioning and ramp activity. During this ramp up quarter, Lindero was cash positive generating approximately $5 million in free cash with an all-in sustaining cost under $1100. Ramp up to the same capacity continues during Q1 of this year.

During this unprecedented year, our operation suffered temporary suspensions of production for San Jose mine in Mexico was down for 54 days. The Caylloma mine in Peru was down for 21 days and Lindero construction activities were suspended for almost three months considering remobilization.

The company was quick to implement containment measures for COVID across all sites mitigating risks to our people, neighbors while complying with rapidly changing government regulations and guideline and ensuring business continuity. Our direct costs attributable to managing the COVID risks across all sides amounted to $4 million in the year.

Moving on to Slide 7, we're listening to our shareholders and stakeholders in general, we're not only improving our reporting on ESG, but undergoing a cultural change of the way we incorporate sustainability in our strategy and business planning. Through rigorous materiality assessment, we're prioritizing our efforts.

This is a journey of continuous improvement. We have strength in governance, as evidenced by the rating agencies, and areas of improvement in taking longer term views on environment and social. We're committed to show Fortuna as a strong ESG performer.

Next slide please. On Slide 8 of the presentation, we share our key safety performance indicators. We present KPIs as a 12-month rolling average, to better represent trends. Our trend of improvement over the last year was truncated by the challenges imposed by COVID, particularly on the second half of 2020.

In the last month of the year, we experienced a spike in total recordable incidents and lost time injuries. COVID restrictions particularly at the San Jose mine and startup of operations at Lindero explain the poor performance.

High rotation of personal due to COVID contact tracing and incidence of suspect cases and inability to mobilize experienced operators and supervisors for Argentina, due to the closing of the borders to foreigners weighted heavily on these results. I can assure that for the start of 2021, we're seeing material improvements in performance at the Lindero mine while some challenges remain in San Jose.

With respect to production for the quarter, silver production was down against the comparable quarter as a result of lower grades at the San Jose mine, 17% lower grades and gold was up 100% due to the contribution of first gold production from Lindero.

Next slide please. For the year, silver production was down 19% mainly driven by the 54 days of suspension of production at San Jose and the impact of lower grades. Gold was 10% of the backup Lindero contribution to production as I mentioned in the fourth quarter.

Next slide please. Sales in the fourth quarter, silver and gold had an almost equal contribution to sales of 40% to 45%. And we capture in our sales and margins, the benefit of increased prices for both silver and gold. We sold silver in the quarter at a price of $24.40 per ounce and gold at a price of $1,864. Sales in the quarter jumped 50% to 103 million, while EBITDA jumped 48% to $45 million and our adjusted net income jumped 111% to $23 million or $0.12 cents share.

Next slide please. For the year, we reported sales of 280 million and a very healthy EBITDA of 112 million with a margin of 40%. Our costs were impacted from the all-in sustaining perspective from the lower production of silver at the San Jose mine again, as a result of a shutdown and lower grades and at Caylloma our costs were impacted also by the equivalency ratios with base metal.

Next slide please. We have concluded in 2020 capital intensive phase that we had embarked on for the last three years. The construction of Lindero is over and we are in the commissioning and ramp up phase and our CapEx budgets are expect – are trending now in – or within the bounds of ore sustainability investments at all three sites.

We are reenergizing also exploration looking forward and we provided this – we shared this in our guidance. We are reenergizing or budgets on exploration. We have traditionally been investing up until 2017 approximately 4% of sales on exploration and having drilling meterage always in excess of 30,000 meters.

In 2020 our exploration budget was a low $8 million. We drilled 8,000 – sorry, our drilling meters was a low 8,000 meters. And as a percentage of sales our investment on exploration was under 2% of sales. For 2021, we are taking our exploration budgets back again to a level of around for 4%, 4.5% of sales and drilling meterage is being expanded to an excess of 40,000 meters a year.

That is the kind of meterage and exploration investment we need to not only replenish reserves resources, but also expand them. So in 2021, exploration is a topical issue for us and you're going to see expanded investment on exploration now that the capital intensive phase of Lindero construction is behind.

Next slide please. With respect to our activities in Lindero by way of update as at the end of February, our mining unit operations at Lindero are operating and delivering according to the signed capacity. Our ADR plant has been now for several months operating at design capacity taking the full 400 cubic meters per hour pregnant solution and achieving gold extractions in the range of 90%.

Primary and secondary crushing circuits as of the end of February are operating at 67% of design capacity. And this month of March we're already seeing a solid day at within 85% of the same capacity. At the HPGR agglomeration and stacking, we are at 23% of design capacity. Here the limiting factor has been the stacking system. We have been dealing with operating and feeding issues at this stacking system. But I can advance that already in this early days of March, we're seeing performance improving and closer – solid days closer to 30%, 40% of the same capacity.

So all in all we're seeing strong trend in the right direction. And we are expect – continue to expect the material advances on the ramp up this month of March, as we implement several measures, and corrective measurements – measures on a lot of the components of process, right. But most importantly, all of these things are issues we can address and correct. But our models, or reserve models are conciliating extremely well against production.

And our leaching kinetics gold leaching kinetics are performing according to our design parameters and expectations. So those are two things we want to highlight and also the fact that as I mentioned before, we're trending in the right direction. With respect to our expectations on ramp up, we're still slightly behind – somewhat behind on the stacking, but we're seeing solid improvement in March.

Next slide, please. I think this is the end of my update on the presentation. Now I'll pass it on to Luis who will give you the highlights of the financial results. Luis?

Luis Dario Ganoza - Chief Financial Officer
Yes, thank you, Jorge. So on Slide 18, as has been discussed already by Jorge, we had a strong fourth quarter driven by higher sales of 50% over Q4 2019. Our margins were significantly up reflected in adjusted EBITDA and adjusted net income increases of 78% and 100% respectively.

Net income however, was slightly below Q4 2019 due to certain items below the operating income line contributing to a higher net income in the comparative period of 2019. Specifically, in 2019, we recorded $11 million of investment gains in the large deferred tax credit related to foreign currency fluctuations.

Slide 19 please. So in the quarter the highest impact in our sales came from both higher metal prices, silver in particular, which was up 41% and as Jorge mentioned the contribution of Lindero with $20.3 million for a total increase in sales of 34.5 million. Company elected to early adopt certain amendments to IAS 16, which deal with proceeds before intended use of assets. Under this amended standard company is required to recognize sales proceeds and related costs of items produced in the income statement while the company is preparing the asset for its intended use.

Next slide please, Slide 20. So reinforcing a bit of what Jorge discussed when looking at our comparative segmental results, EBITDA is up significantly quarter-over-quarter at both San Jose and Caylloma mines, reflecting the positive impacts of higher metal prices as previously discussed. Our production cash cost at both operations in Q4 remains at similar levels as a comparative forum. And it's overall within the ranges we expect for 2021 based on our guidance.

All-in sustaining cost at San Jose was $14.50 per equivalent ounces of silver for the quarter and $12 for the year. Again, based on guidance provided for 2021, we expect all-in sustaining cost to remain within a similar range of $12 and $14.50 per equivalent ounce of silver in 2021.

Slide 21 please. Yes, on Slide 21 we provide some additional detail on the reported Lindero results as is – as disclosed $20.3 million of sales contribution. Cash cost of sales shown in the table correspond to the full operating costs in the quarter. The only item of in-country costs and expenses that is not yet reflected in the income statement in Q4 is the offsite G&A of $1.1 million. Total Lindero contribution to our consolidated EBITDA was $11.3 million in the quarter. Also relevant to note, we have incurred export duties of 8% nominal rate over sales, which we expect to continue into 2021.

Next slide please, Slide 22. Yes, here we show the breakdown of our general and administration line item out of our financial statements for the quarter and the year. For the full year our corporate and in-country G&A expenses are below 2019. Increase in total G&A both for the quarter and the year is related to higher share-based payments related mainly to the performance of our share price.

As shown on the slide as well, we recorded on a foreign exchange loss for the quarter of $4.7 million and $12.2 million for the year. Driver of these losses as has been discussed in the past is a construction VAT receivable in Argentina. In 2019, we incurred a loss of similar magnitude, which cumulatively in the two-year period adds up to approximately $24 million.

This, however, has been partially mitigated by investment gains of $3.3 million in 2020, and about $10 million in 2019. So cumulatively, the net loss is more in the range of $10 million. It is worth noting that we have already started recovering VAT with a first lump sum amount of $10 million collected in January 2021.

The next slide please, Slide 23. Yes, here we provide a summary of our balance sheet and liquidity position. On the bar graph on the left, at the end of Q4 2020, our total liquidity came down slightly with respect to Q3 as our $150 million bank facility was scaled down to $120 million as was contractually scheduled. Worth noting, our net debt position shown at the bottom improved from 56 million in Q3 to 34 million in Q4.

With that, I will hand it back to you, Carlos. Thank you.

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

Operator
Certainly, ladies and gentlemen, the floor is now open for questions. [Operator Instructions] Your first question is coming from Don DeMarco. Your line is live.

Q: Thanks so much for taking my call. Jorge, so you mentioned the stacking system. I read that as at 23% in February performance increasing to 30% to 40% in March. Well, what kind of level would you be comfortable with in order to meet the guidance in 2021?

Jorge Alberto Ganoza - President and Chief Executive Officer
Thank you for the question Don. It is important to stress something that we try to describe well in the MD&A, which is we are bypassing whatever damage or extract ounces we're not placing with the stacking system, we are making up with placing on the leach pad with trucks. Also what we are tracking is the amount of extractable ounces that we place on the leach pad every month, right. So we are meeting the extractor ounces on the leach pad as per guidance. The issue is that the ounces that we place on the – with the stacking system, we expect gold extraction to be in the range of 75%, 78% over 90 days.

With the ounces that we place with trucks as they are a bypass that comes from the – where we draw ore from the secondary crusher stockpile, it needs a 34 millimeter crush. And for that kind of crushed material that PAD it's 34 millimeters, gold extraction is more in the range of 50% over 90 days. Overtime, we will achieve a higher extraction rate not the 75, but certainly higher than 50 overtime. So we're having to place more ounces to meet the guidance, more ounces in the leach pad to meet the guidance. So that's how we're managing. This is a temporary solution while the – we get the stacking system up to design, right.

What I said during the call is that in this early days of March we're already seeing the stacking system performing at between 30% and 40%. We had yesterday a good day with 9,000 tons per day which is more like 50% of capacity. We are dealing with some minor issues with the stacking mainly. The overland conveyor braking system malfunctions. Now that generate massive spillages is basically the automation system of the stacking system is not communicating properly at all times. And maybe we're testing what's happening and we get it working. And then we have a miscommunication and the braking system didn't work in sync.

Sometimes we get massive spillages from one of these large conveyor belts, right, that takes up to five hours to clean up and get it up running, right. So nothing that we – and just to complement here, I will leave the – for example, this is a good example of how COVID is impacting us. I believe this issue could be resolved in a matter of days or weeks, or even hours. The issue is that we do not have the benefit of having the vendor technicians on site, working with our operators, or maintenance team, right.

We're making good use of technology. But it's not the same. So a lot of these issues we – and we're improving getting the mechanical availability up and up and up. But I mean things that everybody could take hours or days to resolve end up taking days or weeks because we just don't have the – something that you'll see on a normal day, which is the – or ramp up vendor technicians on site with you right, in this case superior. The Argentinean borders remain largely closed to foreigners, so we cannot get the technicians' in-country, right.

Q: Okay. Well, thanks for that. Also on stacking, but maybe shifting over to grade. I recall around mid-October, the initial grades that you had stacked were a little bit below like maybe 0.83 grams per ton or something. You had previously maybe been targeting one – above one, but now I see that this grade, stack grade for the end – for the full year are one gram per ton, which implies there's been an increase in the stack grade. Are you comfortable with the grades that you're stacking right now and is it in line with your expectations and plan?

Jorge Alberto Ganoza - President and Chief Executive Officer
Yeah, great is in line with our plan, absolutely.

Q: Okay. And then finally, on capital allocation priorities we have you generating a lot of free cash flow in 2021. You mentioned you have expanded investment on exploration. Is a dividend something that you're thinking about at this point, or repaying the debt? What are your capital allocation priorities beyond investment on exploration?

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes, and thanks for the question because it allows me to point something here. We have three priorities now. One is – first, we believe at times like these companies – mining companies need to strengthen the balance sheet, right. These are the opportunities we have in the – in cycles, like these, legs of the cycles like we're now to strengthen the balance sheet. So we view having putting together a fortress balance sheet as a priority for us, right. So that's number – even though our debt to EBITDA is low and whatnot, we – you will be seeing us ensuring that we come out of this leg of the cycle with a very strong balance sheet.

Second is exploration investment. As I noted, in my intervention before, leaving shortchanging or investments on exploration for three years, as we were prioritizing capital allocation to Lindero construction. We have been drilling 2020, only 8,000 meters, not enough to replenish – deal with depletion at our mines and expand reserves. So we got those drilling meterages up north of 40,000, 50,000 meters. We're drilling at all sites. We have new initiatives outside of brownfields. We're going to be drill testing this year as well in Mexico and one in Argentina.

And last is returning to shareholders. Yes, that's something that we will consider the best way to return to shareholders, and we will evaluate those options against other opportunities for growth that we might identify. But certainly, returning capital to shareholders is in the way of dividends or special dividend or other means is something that the board is considering already.

Q: Okay, that answers my question. Thank you for that.

Operator
Thank you. Your next question is coming from James Huntington. Your line is live.

Q: Hi, guys. Thanks for taking my questions. Just for a follow up from the previous questions on the stacking, what sort of timeline – like it's just that your current rates, you think you could be ramped up on the stacking system? It's unfortunate, yeah, COVID is obviously, restricting you a fair bit there, but do you think this would be like a two-month process or sort of you'd be like might to send it away by the end of March. Just a bit more color there. Thanks.

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes. And that's a tricky question to answer. We have – or problems are – with the stalking are isolated right now to the braking system to the communications on the braking system, it's an automation issue. We've been trying a lot of things on solving problems and improving and now we're left with this one. And if you know how these works, you all of a sudden get it right and you get a bump on performance. And we're already starting to see better days and all of a sudden, we can see significant jumping in performance. We're almost at mid-March. So it's still our expectation to get within 85% of performance in March.

But if not, we'll see a spillage into April, right. But it's difficult for me to gauge. I believe the issues are issues that are solved in matters of days or weeks, what we have in front of us with the stacking is something that we should be solved in a matter of days or weeks, not months, right. Because of the nature of the problem, and where we are with the solution. So my best assessment would be days or weeks to get this program. It's just this one problem right now we're battling with and we have been battling with for a few weeks now, right. So I believe we're on the last leg of a solution for it.

Q: Okay, thank you very much for that. And then just if you could give us some color on the ramp up – the status of the SART plant and sort of what – how the ramp ups going there as well?

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes, the SART plant is not critical path for us. It's important. We need the SART plant, but we don't need it to produce gold and we don't need it in day one, right. So the copper content in the pregnant solution to now is manageable. We have – the SART plant in February was at 37% of design capacity. But we have reallocated resources from the maintenance team and operations team to the areas that are key or are on critical path for ore production, right, basically, stalking

and the crushing system. So we have de-prioritized efforts around the SART. We will come back to it once we got that stacking system running where we needed to be.

The SART plant, we've been running it at around 37% up to 40% of the same capacity. It's been operating efficiently at those rates. We've been able to precipitate 80%, 90% of the copper in solution. So the chemistry of this SART plant is performing. I will say in exceeding our expectations it's just a matter of increasing flow. Right now we have an issue with the copper filter. We're waiting for some – for a small repair on the copper filter, a minor issue and – but again, we have prioritized resources to critical path, which is basically the starting and primary and secondary crush.

Q: Okay, thank you very much for that. And then just one last modeling question for – from me. For depreciation at Lindero, could you guide us what you're sort of expecting this year on like $1 per ounce for Lindero and if possible, a more longer-term value?

Jorge Alberto Ganoza - President and Chief Executive Officer
Luis, do you want to give a punt to this one.

Luis Dario Ganoza - Chief Financial Officer
Yes, I heard you're asking for depreciation dollars per ounce. We're using the units of production method based on ounces produced. I don't have unfortunately a number in my head that I can share with you. But what we should expect as we're depreciating based on analysis on a pounds basis is of course is the depreciation tracking, of course, the production output throughout the life of mine, right So that will be in sync with the evolution of income throughout the life of mine. Yeah, I'm sorry I can't give you a number right now. So I don't have it in front of me.

Q: Okay, thanks very much. Yeah, that's all from me, then. Thank you.

Operator
Thank you. Your next question is coming from Adrian Day. Your line is live.

Q: Yeah. Hi. Thank you. My question is partly been answered already in one of your previous answers. But I wanted to ask you about the exploration a little bit more. In the foreseeable future, is it all exploration at or close to mine sites or are there any new areas you're looking at?

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes. It's a bit of everything, Adrian. So at the San Jose Mine in Mexico, we have an aggressive program – drilling program in the immediate vicinity of the mine, both on the north boundary of existing resources on the deep extensions and to the south. We have identified also four kilometers – sorry, 400 meters due east from the main ore shoot, two parallel structures, one that today hosts resources is the Victoria vein, where we have done no mining up to now. And then, a bit further east from Victoria, we have also a couple of interesting drill intercepts of another blind structure with grades in the range of 135 grams over a couple of meters. So we have a lot of drilling allocated to that.

In addition, at the San Jose Mine, we are exploring other areas and other veins within the system. But I would consider all of this in the – within the reach of brownfields, so opportunity that – where we are successful, we could have the opportunity to truck ore to our San Jose Mill. We signed this year, 2020, an agreement with Minaurum. We have optioned the Higo Blanco property. It's some 15, 20 kilometers due east from San Jose. It's an exciting exploration project with some exciting drill results that need follow-up. And that information is public, and you can look at it, so all of this is within our plans for 2021.

In the case of the Caylloma Mine, we have also a similar scenario, drilling within the extensions of non-mineralization and also stepping out into new areas, testing new ideas in a vein system that has been so productive for over 500 years literally. So in the case of Lindero, we are not doing near mine – near resource drilling. We are stepping out to the Arizaro gold porphyry. We're going to be drilling that this first half of the year. Arizaro is a gold porphyry – is a second gold porphyry center in our property. Lindero is the one that we're bringing – we have brought into production. And Arizaro is located 3.5 kilometers from Lindero, so well within trucking distance. There is a well identified gold porphyry system there that has received drilling throughout the years.

We believe there is potential, as evidenced by past drilling for near-surface, high-grade satellite, perhaps not too big. But, as we have infrastructure so close, we don't need a standalone. So these satellites could contribute, what, 5 million, 10 million, 20 million tons at grades in excess of 0.4, 0.5 grams gold we believe, as high as 5.7 some drilling would suggest. So we are going to be testing in those potential satellites at Arizaro. So apart from that we have drilling in new projects in Mexico and Argentina. Exploration, we have option properties, and we're advancing work and work advances. And we firm our commitments on those projects. We'll be discussing them publicly, right.

Q: Okay. Super. Thank you, guys.

Operator
Your next question is coming from Justin Stevens. Your line is live.

Q: Thanks, guys. Yeah. Most of what I wanted to get has really been covered off. But I was just mostly wondering how much copper are you guys seeing so far at Lindero? And the flip side of that would be how is the cyanide consumption relative to what you're looking for?

Jorge Alberto Ganoza - President and Chief Executive Officer
Sorry. I didn't hear you all that well. You're asking about the copper content in Lindero?

Q: Yeah, in the ore placed so far at Lindero and the cyanide consumption as well.

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes. Copper is – copper grades are trending along with what we see in our resource reserve model, around 0.1% copper is what we're seeing. And in the case of Lindero, what makes Lindero viable – technically viable is the fact that 95% of that copper – that 0.1% copper that we see in the Lindero porphyry is in the form of chalcopyrite. So only 5% of copper in chalcopyrite

leaches under a cyanide solution, so it doesn't eat cyanide like other copper mineral forms, like chalcocine where 70% of copper will leach in the mineral form of chalcocine, chalcocite, chalcosine, copertite or bornite. Those are the cyanide eaters.

In the case of Lindero we have chalcopyrite and the grade of copper is within our expectations at 0.1. Our cyanide consumption right now is slightly below half 0.5 kilos per ton. So it's tracking well within what we expect. And the copper that we're seeing in the pregnant solution, it's also within what we would expect with this leaching kinetics. So we're seeing copper in the range of 400 to 500 ppm in the pregnant solution. So, we're managing that with cyanide. And the SART plant that – although it's running at 30%, 40% of design capacity, it's doing the work, alright.

Q: Yeah. No, that's great. And then the only other question I had was do you guys have timing for your planned annual reserve and resource update?

Jorge Alberto Ganoza - President and Chief Executive Officer
Yes. We'll be releasing reserves resources in the coming weeks.

Q: Great, alright, that's it for me. Thanks.

Operator
Thank you. There are no further questions in the queue at this time.

Carlos Baca - Investor Relations Manager
Thank you, Matthew. 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.

Operator
Thank you, ladies and gentlemen. This does conclude today's conference call. You may disconnect your phone lines at this time, and have a wonderful day. Thank you for your participation.