Transcript of
Fortuna Silver Mines
First Quarter 2020 Financial and Operational Results
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Participants
Carlos Baca - Investor Relations Manager
Jorge Alberto Ganoza - President, Chief Executive Officer and Director
Luis Ganoza - Chief Financial Officer

Analysts

Presentation

Operator
Ladies and gentlemen, good day, and thank you all for joining us for the Fortuna Silver Mines First Quarter 2020 Financial Call and Operational Results. As a reminder, all phone participants will remain in a listen-only mode and today’s session is being recorded.

To get us started with opening remarks and introductions, I’m pleased to yield the floor to Mr. Carlos Baca with Investor Relations Manager. Please go ahead, sir.

Carlos Baca - Investor Relations Manager
Thank you very much. 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 2020.

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 2020, click on the earnings call webcast link. Jorge Alberto Ganoza, President, CEO and Director; and Luis Dario, CFO, will be hosting the call from their home offices in Lima, Peru.

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.
In addition, as Fortuna is in the midst of a public offering of its securities, management will not be taking any questions during or after the call today.

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

**Jorge Alberto Ganoza - President, Chief Executive Officer and Director**

Thank you, Carlos, and good morning to all. I’ll be presenting an introduction to our first quarter results and discuss actions taken during this more months of unprecedented uncertainty we’re living in and then turn the call over to Luis, who will take you through the financial statement.

On Slide 6 of the presentation. We’ll give it a second, so we can move there. On Slide 6 of the presentation. In the quarter, we reported strong free cash flow of $14 million and EBITDA margin of 34%, below our targeted 40% margin. Overall, our results were negatively impacted by lower gold and silver production and sales against the comparable period and year budget. This is a result of mining from lower-grade zones at the San Jose Mine and lower silver and byproduct metal prices.

We will provide more detail on these during the presentation. The company has taken actions to maintain an adequate level of liquidity considering these uncertain times and the capital demands of our project pipeline. As of the end of March, we reported $88.5 million in cash, announced a $60 million equity financing, planned for $23 million in 2020 capex and opex reductions and propose amendments to financial covenants in our credit facility.

As of March 19, the date of demobilization due to mandatory isolation period in Argentina, our Lindero Project is 94% complete. Remaining funding to commercial operations is $75 million to $80 million. Our construction and operations crews are mobilizing back to site during the second-half of May.

We expect to be up and running at full speed under a new construction and commissioning plan by the end of the month. Considering all the COVID-related delays and limitations, we’re now planning to begin commercial operations in Q1 2020.

Over the past month, the COVID pandemic have put our generation to an unprecedented test. During these times of extreme uncertainty, our actions at Fortuna are being guided by three principles: support of local government actions, safety of our personnel and neighboring communities, and business continuing.

We have withdrawn our 2020 production guidance. Our Caylloma Mine has managed to operate all this time, but our Lindero Project and San Jose Mine were halted on March 19 and April 2, respectively. During this second-half of May, we’re mobilizing and preparing to resume activities at both units.

In early May, we published our 2019 sustainability report. This report is a more comprehensive and significant improvement over the previous year publication. We’re listening to our stakeholders and working to address the demands placed in our industry by a rapidly changing world. I invite you to read the document and provide comments to the company.

Moving onto Slide 7. In Slide 7, we shared with you our key safety performance indicators. We present the KPIs as a 12-month rolling average to better represent trends. And as you can appreciate, we are delivering solid and consistent improvement year-over-year. We still have a lot to improve on and are continuously learning from our mistakes, but a cultural change has been set in motion in our organization and it shows with the results.
Slide 8. In Slide 8, our Q1 production for both gold and silver was negatively impacted by lower grade and slight lower tonnage throughput at our San Jose Mine in Mexico. San Jose production in the quarter deviated from the annual plan to accommodate two initiatives, pillar recoveries and a pilot test for long-haul stoping.

These changes to the plant temporarily forced mining into higher risk areas from the perspective of great predictability and mining dilution, leading to lower grades in the quarter. This issue has been addressed and corrected in late Q1. And now that we have withdrawn 2020 guidance, we plan for grades to be in line with the base assumptions over 2020 guidance for the remainder of the year.

For the second quarter of the year, we expect a significant drop in silver and gold production as a result of the Mexican COVID response plan, which mandated an industry-wide stoppage, which at the San Jose Mine came into effect on April 2.

Based on the recently published government guidelines, mining has been included in the list of potential industry and is expected to resume operations either on May 18 or June 1. The date for each operation will depend on a government regional assessment of the virus contagion. At this moment, the government has not provided any further guidance.

Slide 9. Under Slide 9, silver accounted for 52% of sales and gold for 29%, for a combined 81% precious metals contribution. Silver price was a lower cost during the quarter. We realized an average price of $16.30 per ounce for silver, but price at the end of Q1 closed at slightly below $14 or $13.90. Silver spot price today covers back around $16.5. Gold continues to show a steadfast performance with prices today trying to build a solid base above 1,700, compared to 1,570 for the quarter.

Slide 10. We’ll give it a minute for the presentation to update to the new slide. On the Slide 10. Compared to a year ago, sales dropped by $11.5 million, negatively impacted by the previously described lower metal production, lower by-product base metal prices and commercial terms for our concentrates.

Our EBITDA was hit primarily by the lower sales. The adjusted net loss was deepened by negative $2.6 million in our income tax provision as a result of the devaluation of the Mexican peso and $1.2 million dividend withholding tax.

Slide 11. San Jose all-in sustaining cost was driven higher by lower metal production. But on a cost per tonne basis, we were in line with our budget at $71 per tonne. Caylloma all-in sustaining cost was driven higher by lower zinc and lead prices, which were down 20% and 8%, respectively.

Cost on a per tonne basis were in line with our budgets of approximately $80. Here we’re still waiting for the slide to upload. I don’t know if everybody is seeing the same slide in the presentation.

I move onto Slide 12. Moving onto Slide 12. In the quarter, we reported consolidated capital expenditures of $26.6 million. The bulk of this, of course, related to Lindero Project construction and commissioning activities accounting for $21.4 million.

On Slide 13 of the presentation. We share our project pipeline. Here I can highlight once again the relevance of our Lindero Project to our low-cost coal production growth.
On Slide 14 of the presentation. On May 8, we disseminated a comprehensive news release updating the market on our plans to resume construction activities at Lindero. We also provided guidance on our revised construction and commissioning timelines, which take into consideration COVID-related restrictions and limitations.

The construction workforce is mobilizing back to site in the second-half of May. We plan to initiate ore stacking in the leach pad in July, with the aim of producing first gold as part of the commissioning and ramp-up phase starting in September and going until December. During this period, gold-related production is estimated in the range of 25,000 to 28,000 ounces.

On Slide 15, with project completion stands at 94% as of March 19, the date project demobilization took place. We’re working to have our full construction workforce operational on site by early June. For the start of commissioning and initial ramp-up, we plan to bypass the tertiary HPGR crushing circuit with an agglomeration. This means, we will be placing secondary crushed ore on the leach pads until November when the tertiary crushing circuit is scheduled to come online.

The objective of this bypass plan is to remove the risk to initial production of commission in the HPGR under a tight timeline without onsite vendor support. This plan will also allow to reduce parallel activities, allowing a better concentration of resources on completion and commissioning of solution handling, ADR and SART plant. Our remaining project funding requirements for capex, preproduction, working capital and VAT stand at $75 million to $80 million.

Following, we have a series of recent pictures from our construction. In my computer here, the presentation has frozen on one of the early slides. So I don’t know if that’s the case for everybody, but I would apologize if that is the case.

But I will now turn the presentation to Luis, who can provide you with further details on our financial results.

**Luis Ganoza - Chief Financial Officer**

Thank you, Jorge. I’ll make reference to Slide 20 of the webcast. As Jorge has described, sales were impacted mainly by lower production at San Jose, a sharp drop in base metal prices, treatment and refining charges and quarter-end silver price adjustments. Compared to the first quarter of 2019, sales fell $11.5 million. The net loss of $4.5 million and the adjusted net loss of $2.2 million are the result of a decrease in sales combined with an unusually high income tax provision for the period.

Free cash flow from ongoing operations for the quarter was $14.2 million, a strong increase over the same quarter in 2019. The increase was due primarily to positive changes in working capital of $9.5 million compared to negative changes in the quarter—in the first quarter of 2019, as well as lower capital expenditures in 2020.

On the next slide, Slide 21. As mentioned before, the main component of the drop in sales was lower precious metal production, in particular, the effect of gold at San Jose. The negative sales adjustment of $2.8 million correspond to the drop in silver, zinc and lead prices at the end of March, which when combined with a positive price effect of $1 million, results in a negative impact from metal prices of $1.8 million. The negative impact of treatment and refining charges reflects a deterioration of commercial terms for zinc and lead concentrate in 2020.

On to next slide, Slide 22. Our adjusted operating income was $5.5 million. The effect from lower sales was mitigated by lower G&A of $2.9 million and a foreign exchange gain on an adjusted basis of $1.9 million. This is
after adjusting for a $3.2 million loss related to the devaluation of the Argentine peso. The detail of these adjustments are shown on the appendix section on Slide 29 of the webcast.

As a separate note, we also recorded in the quarter $1.1 million of Argentine peso-denominated investment gains, which partially offset the negative impact that the devaluation of the peso continues to have on our VAT receivables at the Lindero Project.

Cash costs at both San Jose and Caylloma were mostly within similar levels as in 2019 and the fall in EBITDA at both operations was mainly a result of lower sales. This effect was more pronounced at Caylloma, which recorded a sharper drop in EBITDA associated with a larger fall in sales when compared to 2019.

On to Slide 23. Total G&A was $3.6 million, which was $2.9 million below 2019. G&A for corporate and subsidiaries taken together was $0.3 million lower than Q1 2019, while the main reduction came from a credit in share-based payment of $1.4 million, as shown in the table, compared to a charge of $1.3 million in 2019.

Our effective tax rate in the quarter reflects the impact, as Jorge mentioned, of devaluation of the Mexican peso, to a large extent, this impact is on the deferred components of the income tax provision. As we know under IFRS, the calculation of the income tax is subject to the volatility of foreign exchange. We estimate this effect of around $2.6 million. Additionally, there was a one-time charge in the quarter related to $1.25 million of withholding taxes.

On to next slide, Slide 24. Here also, as mentioned by Jorge, we have taken measures to strengthen our balance sheet, preserve liquidity and address the impact of the suspension of operations at San Jose on our financial covenant.

We expect that these budget reductions of $12 million in cap and Brownfields exploration and $11 million in operating and corporate expenses will be constantly reassessed over the coming months as the overall situation related to the pandemic and commodity prices evolve. Our cash liquidity position at the end of the quarter was $88.5 million.

Thank you, and back to you, Carlos.

Carlos Baca - Investor Relations Manager

Thank you, Luis. As noted at the beginning of the call, Fortuna is in the midst of a public offering of its securities. Accordingly, management will not be taking any questions today. I would like to thank everyone for listening to today's earnings call, and we look forward to you joining us next quarter.