



Endeavour Silver Corp.

Second Quarter 2017 Earnings Conference Call Transcript

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Speakers: **Meghan Brown**
Director, Investor Relations

Bradford Cooke
Chief Executive Officer

Godfrey Walton
President and Chief Operating Officer

Dan Dickson
Chief Financial Officer



Thank you for standing by. This is the conference operator. Welcome to the Endeavour Silver Second Quarter 2017 Earnings Conference Call. As a reminder, all participants are in listen-only mode and the conference is being recorded. After the presentation there will be an opportunity to ask questions. To join the question queue, you may press star, then one on your telephone keypad. Should you need assistance during the conference call, you may signal an operator by pressing star, and zero.

I would now like to turn the conference over to Meg Brown, Director, Investor Relations. Please go ahead.

MEGHAN BROWN:

Thank you operator. Good morning everyone and welcome to Endeavour Silver Corp. Second Quarter Earnings Conference Call. On the line today we have the Company's CEO, Brad Cooke, as well as our President and COO, Godfrey Walton, our CFO, Dan Dickson, and our VP Corporate Development, Dale Mah.

Before we get started, I'm required to remind you that certain statements on this call will contain forward-looking information within the meaning of applicable securities laws. These may include statements regarding Endeavour's anticipated performance in 2017 and future years, including revenue and cost forecasts, silver and gold production, grades and recoveries, and the timing and expenditures required to develop new silver mines in mineralized zones. We do not intend to and do not assume any obligation to update such forward-looking information other than as required by applicable law.

With that, I will turn the call over to our CEO, Brad Cooke.

BRADFORD COOKE:

Thanks Meg, and welcome everybody to this Q2 financial results call. As you saw from our news today, our second quarter financial performance was impacted by lower metal prices, lower production and increased exploration and development spending. The good news is that the production increased incrementally from Q1 to Q2 and we expect that to continue from the first half to the second half as we increase access to reserves at all three mines.



The result of slightly higher production in Q2 compared to Q1 was thanks to improving performance at the Bolañitos and El Cubo mines, but Guanaceví continues to lag behind plan and has been struggling with a number of issues. Not the same old issues but new ones that keep popping up.

Let's look at the financial performance first of all. On a net earnings basis, we basically broke even on the quarter. EBITDA was down to \$3.7 million and cash flow down to \$4.4 million, revenue down to \$32.7 million, all thanks to the combination of slightly lower production and lower metal prices. Cash costs were up to \$8.36 per ounce of silver net of the gold credit. That's due to the operating issues at Guanaceví. All-in sustaining costs were up to \$20.46 per ounce of silver, again, a combination of operating issues at Guanaceví plus our increased spending to extend mine lives at all three mines.

Interestingly enough, compared to the end of the year, and even with paying down debt, our working capital has only decreased by about 8%. We're currently sitting on \$75 million in working capital.

Let's talk about Guanaceví. Last year we had a number of issues related to breaking into effectively a hot water spring underground which caused power outages, pump failures and some flooding. We had just recovered from that when we encountered similar problems this year. In fact, even in July, for a third time we had a repeat of our electrical issues and pump failures and flooding in some of the deeper workings, so it's one thing after another at Guanaceví. We have recently repeated yet another repair of the electrical and ventilation systems. There's completion now, construction of a new underground pump station, and all of those things should help smooth our production coming into the second half of the year at Guanaceví. It's pretty clear, though, given the setbacks we've had since the start of the year, that we're not going to meet our planned guidance at Guanaceví, and so we've accordingly reduced our consolidated production guidance and raised our consolidated cost guidance.

Let's talk briefly about the development projects. At El Compas, work has begun on installing the project infrastructure, collaring the mine access ramp and refurbishing the plant. There are ongoing refinements to the project engineering; optimization studies are underway on various mining methods, and crushing and grinding alternatives. We have, however, had to delay the

anticipated commissioning of our mine and plant to the first quarter, specifically due to delays in our explosives permit. That's a government-wide permitting slowdown that we've seen at all of our permitting applications in Mexico, so that applies to Terronera as well.

Speaking of which, work is currently focused on refining our project engineering and optimization studies at Terronera: looking at different mining methods, crushing and grinding alternatives and power options, and like El Compas, mine and plant commissioning has been delayed into 2019.

So, our revised guidance is now somewhere around 5 million ounces of silver production, 50,000 ounces of gold production, for 8.7 million ounces of silver equivalent production for the year, plus or minus.

Operator, those are my comments for now. Why don't we open this up for Q&A?

OPERATOR:

Thank you. We will now begin the question and answer session. To join the question queue, you may press star, then one on your telephone keypad. You will hear a tone acknowledging your request. If you are using a speaker phone, please pick up your handset before pressing any keys. To withdraw your question, please press star then two. We will pause for a moment as callers join the queue.

The first question today Heiko Ihle of Rodman and Renshaw. Please go ahead.

HEIKO IHLE:

Hey guys, thanks for taking my question.

BRADFORD COOKE:

Thanks, Heiko.

HEIKO IHLE:

Listen, you had in there that it was slower in planned mine development due to narrow veins at Guanaceví. Is this continuing? Is this a quirk from the ore body? Please walk a non-geologist

through how this happened.

BRADFORD COOKE:

Well, clearly at every year end we do resource modelling and that's how we re-estimate reserves and resources. What we're finding in the deep, deep, deepest levels of the Santa Cruz mine at Guanaceví—and this is something that's come up just in the last quarter—is that we couldn't reconcile the model with what we were seeing underground. We've since done both an internal reconciliation and we asked the independent consultants, Hard Rock, to come back and re-assess their model. The conclusion was that there was an overestimation of width, and to a lesser extent grade, in the deeper levels of Santa Cruz. Strictly speaking, this impacts what we were expecting to see in reserves for 2017. I guess the only ray of light is that we have been drilling and expanding that area in terms of reserve replacement and resource expansion, so the net-net effect may be neutral based on exploration successes. But it's one of the factors that really held back our production this year, narrower widths.

HEIKO IHLE:

With the flooding at Guanaceví, can you walk us through how many metres got flooded, the pumping capacity at the site, just so it's quantified a little bit.

BRADFORD COOKE:

Well, it's not that the capacity has changed; it's the system—we had umpteen dozen small pumps and pump stations to lift the water, effectively 600 metres vertical to surface, and with the completion of a new and much larger pump station, we're now looking at only two lifts from the deepest levels to surface. So that's a significant increase in productivity and decrease in costs, decrease in power consumption, et cetera. That pump station is just coming on this week.

HEIKO IHLE:

But quantify the pumping capacity?

BRADFORD COOKE:

Godfrey, do you have the amount of water we're pumping?

GODFREY WALTON:

I don't actually have the actual amount of water, but we're about 400 metres below the water table and have been like that for several years. Over time we've added it pump by pump as each level goes down and that's where we've had all the electrical issues. Typically when we have a power issue, we'll end up with two or three levels that get flooded and then it takes us about a week to dry up those two or three levels each time.

In June, we had a lightning strike on one of our power lines and that knocked out the electrical system in the mine. Although we do have back-up generators, it will only cover part of the total electrical needed for the mine. So with the refinements in the electrical capacity and the pumping, it should be far more efficient.

HEIKO IHLE:

Got it. Okay, moving on to Bolañitos, it seems like gold grades came in quite a bit higher than expected. Do you expect this to continue for the rest of the year? Is this something where we should maybe amend our models a bit, or was this a Q2 phenomenon and it's probably going to come to an end?

GODFREY WALTON:

Gold grades are definitely higher at Bolañitos. We've actually intersected some sections in the Plateros vein that are coming in averaging 5 grams to 6 grams gold, and so those have been very welcome, but we'll find that the silver grades will start coming back to the 100 grams as we start mining higher up in Plateros.

HEIKO IHLE:

Excellent. Thank you, guys, so much for the heads up here. I appreciate it.

GODFREY WALTON:

Okay.

BRADFORD COOKE:

Thanks, Heiko. Just finishing off on Guanaceví, we've obviously been wrestling with this mine for a year now, but it's different issues that keep coming up and we keep fixing them, and I think we're through this latest round of electrical pump and flooding issues. There are no guarantees

that we won't get hit by lightning again but we are optimistic that the operations are going to start regularizing themselves. We've overcome a number of setbacks and I think even though it's not going to meet guidance this year, there's still a very healthy future for the mine. I mentioned in the news release that the longer-term outlook actually depends on the development of two new ore bodies that were found in recent years but have yet to be developed. Development is now underway on the Milache ore body and we're timing the future development of Santa Cruz Sur to match that so both come into production mid-year next year, and then Guanaceví will actually look like a very different mine than it does today, both from the production profile and from the cost profile.

HEIKO IHLE:

I wish you luck, and I mean lightning can only strike so many times, so it can only get better from here.

BRADFORD COOKE:

Thanks, Heiko. Let's move on to the next question.

OPERATOR:

The next question is from Malcolm Gissen of First Republic. Please go ahead.

MALCOLM GISSEN:

Hi, Brad. The news has not been terrific. You alluded to it a little bit in the comments you made at the end of the last question. What can you do to restore confidence in the market, in the management team and your operations after these recurring setbacks?

BRADFORD COOKE:

We are segueing at Guanaceví from the deep high-cost bottoms of the Santa Cruz and Porvenir Norte mines to these shallower higher-grade tops of the Milache and Santa Cruz Sur mines, and that's a transition that will take us another year, but that alone completely remakes the mine and it could well become one of our more profitable operations within a year. We are obviously still thinking we can help turn the corner on the existing deep mines, but there's still a lot of life in Guanaceví and, like I said, it'll look like a very different mine within the next year.

We always look to other mines to try and outperform when one mine is struggling. If you recall, we struggled with Cubo for three-and-a-half years and had some outperformance from Bolañitos and Guanaceví during that time. We can't comment on that now, but both Bolañitos and El Cubo are certainly on plan and we're constantly looking for ways to beat plan and help our production and our costs.

MALCOLM GISSEN:

Okay, thank you.

OPERATOR:

As a reminder, it is star, one to ask a question. The next question is from Bruce Zipper of Dakota Securities International. Please go ahead.

BRUCE ZIPPER:

Yes, thank you for taking my call. Can you guys discuss, with the guidance that you gave today for the rest of 2017, how that correlates into profitability, or lack thereof? Give us a little colour in that area, based on the numbers you think you can do.

BRADFORD COOKE:

Well, you've seen our all-in cost guidance jump from around 15-ish to 16.5. That's the impact on profitability is that we're expecting slightly less cash flow because of the slightly higher all-in sustaining costs. We're only halfway through the year though, so as I mentioned earlier, we're going to continue to look for opportunities to outperform at the other mines and that will help.

DAN DICKSON:

If I can add to that, Bruce—it's Dan, the CFO. We front-end loaded a lot of our sustaining capital to the first half of the year, so a lot of that has come through. A lot of the improvements that we've done to Guanaceví are going through our capital investments and that impacts all-in sustaining costs. I know the markets are quite fixated on all-in sustaining costs, but some of those capital items are going to benefit us for the next three or four years. It's just in that certain metric that the market looks to, it impacts today, and I think it's important to realize that it's not just today's capital, but that capital is going to be benefit us, hopefully, for the next three or four years, that we're putting into the ground. We need to look at both cash costs and all-in

sustaining costs, and recognize that we're putting investments back into these mines today. Basically, over 2015 and 2016, we reduced our investments to make sure we can get through some of the trough periods in the prices, and hopefully now we're coming back into a period where the silver price is going to gain and we're going to try to keep these costs where they are.

BRADFORD COOKE:

I think what Dan's saying is that the all-in sustaining costs peaked in the second quarter and we do expect them to decline because the bulk of our all-in sustaining capital has been invested in the first half.

We're not looking for massive changes in our cost forecast, but if you just do the math on our revised all-in sustaining cost forecast versus the second quarter, obviously costs have to come down to meet our forecast.

BRUCE ZIPPER:

Right, okay, but as far as the clients that I have in your company's stock, can you discuss your balance sheet, your cash in the bank, so on and so forth? How is that continuing to look?

DAN DICKSON:

Yes, we touched on it early on. We have \$53 million of cash in the bank and that's come down from December 31, 2016, as we invested into the long-term future of the company, but our working capital has only come down by \$8 million. Today, we sit on \$75 million of working capital. At the end of the quarter, we had \$4 million in debt, and \$2.5 million of that is going to be paid by September 30. So really, on a net cash basis, at \$48 million. We're healthy, but we want to take some of that working capital and put it into the long-term benefit of the company.

BRUCE ZIPPER:

Yes. Well, that's one of the pluses that we think you've got is that balance sheet. One last question. With a healthy balance sheet—I know things have been rough in the first half, but if there's an opportunity, do you have your eyes on any other buys or potential mines or other companies that might fit into your situation, or is that off the table until things get better?

BRADFORD COOKE:

Well, Bruce, let's look at three different timeframes. Short term, I think the most important things we can do on M&A is actually related to the three operating mines, and I am working with Dale on additional strategic acquisitions in and around Guanaceví, Bolañitos and El Cubo, and what those acquisitions do is help to extend the mine lives. So, that's very much in the forefront of our thinking for short-term growth and sustainability.

In terms of medium-term growth, you're well aware of our growth profile. We acquired some projects last year, plus our discovery at Terronera; they're all slated for future development. Two of them, El Compas and Terronera, are already in development. We do have I think one of the more aggressive growth profiles medium term in the silver sector.

Long term, we're looking for even bigger and better projects to put into the development pipeline. We have to ask ourselves what happens when Terronera is up and running? It has the potential to become our largest and certainly one of our lowest cost mines by 2019, but what about after that? Dale and I have been looking at a number of opportunities. It's a process, obviously. We've turned over a lot of stones and kissed a lot of frogs, but none of them have turned into princesses yet. The process continues.

BRUCE ZIPPER:

Okay. Well, that's interesting and I appreciate that comment, and all the best to you guys.

BRADFORD COOKE:

Thank you.

OPERATOR:

The next question is from Steven Epstein, a private investor. Please go ahead.

STEVEN EPSTEIN:

Yes, hello. Thank you. I just wanted to ask what your thoughts might be on whatever the changes might be in the metals markets going forward, up or down, whether it's significant or trending up or down, how much does that impact your decision to sell your reserves or process and restore concentrates or sell? Are you able to, or do you want to even deal with that kind of issue, or is that something that you're not affected by as much, you have to process it to go

forward with the cash flow?

BRADFORD COOKE:

First, on the metal prices, clearly, we are looking at the bear market of the last five-and-a-half, six years in the rear view mirror. I think it's also clear, based on last year's bounce, that we're looking at a bull market out the front window, but it hasn't arrived full bore yet, so we're kind of in an in-between period, a consolidation period in the precious metal prices. We certainly are bulls. We think that precious metals only have one way to go over the long term and that's upwards.

In terms of how that affects our strategy and our cash flows, well, obviously with low metal prices, our revenue and cash flow and profits are lower than when metal prices were higher, and we, as a strategy every year, develop our spending models based on our cash flow models. We try to cover all of our spending by our cash flow—that is the sustainability spending—so that only growth spending comes out of cash.

If you recall, we did raise some cash last year. That was specifically to fund our growth going forward. El Compas is fully funded. Terronera is partly funded, but we're not yet breaking ground there, and we fully expect to put a small debt facility in place, effectively a bank line of credit, to top up the Terronera financing for full production.

We typically manage our spending based on our anticipated cash flows and we expect those cash flows to rise. Certainly next year, we're looking at a bump in production and we certainly hope there'll be a bump in metal prices.

STEVEN EPSTEIN:

Very good, thank you. I do appreciate that, thanks.

OPERATOR:

This concludes the question and answer session. I would like to turn conference back over to Bradford Cooke for any closing remarks.

BRADFORD COOKE:

Well, thank you very much operator, and I'll ask Dan Dickson, our CFO, to comment.

DAN DICKSON:

Thanks, Brad. Yes, the general sense on the call has been, obviously, Guanaceví and some of the operational issues that we've had at Guanaceví, and we hope that we're coming out of that here in the second half of the year, and in 2018, we'll get back to guidance.

One of the key things that Brad touched on in one of the caller's questions was on restoring confidence in the market. One of the important things that we've got to realize is over the last five years we have typically met our guidance, and in this case, with Guanaceví having these operational issues, it's probably the first time in the last five years that we've actually had to come out and revise our guidance downwards. In 2016, we revised upwards. We recognize that it's not a great thing for the Company to have to come out and revise guidance downwards, but I think it's good for us to come out to the market and be honest with where we are with our production and, hopefully, we can beat that in the second half of the year.

So, thanks a lot for everyone attending the call and look forward to putting out news in the second half of the year that will stimulate the stock to move higher.

OPERATOR:

This concludes today's conference call. You may disconnect your lines. Thank you for participating and have a pleasant day.