Endeavour Silver Corp.

Second Quarter 2023 Financial Results

Conference Call Transcript

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Speakers:

Dan Dickson
Chief Executive Officer

Donald Gray
Chief Operating Officer

Christine West
Chief Financial Officer

Galina Meleger
Vice President Investor Relations

Operator:

Thank you for standing by. This is the conference operator. Welcome to the Endeavour Silver Corp. Second Quarter 2023 Financial Results 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 Galina Meleger, Vice President of Investor Relations. Please go ahead.

Galina Meleger:

Thank you, Operator, and good morning, everyone.

Before we get started, I ask that you view our MD&A for cautionary language regarding forward-looking statements and the risk factors pertaining to these statements. Our MD&A and financial statements are available on our website at edrsilver.com.

With us on today's call is Dan Dickson, Endeavour's CEO; Christine West, our Chief Financial Officer, and Don Gray, Endeavour's COO. Following Dan's formal remarks, we will open the call for questions.

And now, over to Dan.

Dan Dickson:

Thank you, Galina, and welcome, everyone. I would like to start by acknowledging the tremendous achievements we made at Terronera in Q2, which advances our strategy in pursuing high-margin production growth.

During the quarter, we obtained formal Board approval committed to project loan financing, established a seasoned team, and now construction is well underway. Terronera is a unique opportunity that will reposition the Company to generate significant free cash flow, bringing us one step closer to achieving our mission of becoming a premier senior silver producer.

Nevertheless, despite continued positive production performance, the headline for this quarter continues to be pressure on costs. As a company with operations in Mexico, we are facing the challenge of rising costs for which we remain vigilant to mitigate the impacts. Like all our peers, macroeconomic factors, such as industry-wide inflation and a strengthening Mexican peso, have continued to put pressure on consumables and labour costs across our operations. Unfortunately, we expect these trends to continue for the near-term.

In terms of production, consolidated Q2 silver equivalent production was up 8% year-over-year to 2.3 million silver equivalent ounces, bringing us to 4.7 million silver equivalent ounces for the first half of the year. This performance puts us well and in line to achieve this year's production guidance of 8.6 million to 9.5 million silver equivalent ounces. Compared to the same period prior year, both silver and gold production are up 10% and 6%, respectively.

While our Guanacevi operation was generally in line, higher tonnes milled were offset by lower grades. Adjustments to the mine sequencing during the quarter resulted in lower grades compared to our planned and recent quarters. However, we expect to return to higher grades for both the third and fourth quarters. As compared to Q1, both silver and gold grades decreased by 20% in Q2.

Performance of our other operating mine, Bolañitos, remains steady. Increased gold production was offset by lower silver production in Q2. The Bolañitos operations team continued a strong effort to meet or beat their targets including mined and processed tonnes.

Moving to our financials. We reported topline revenue of $50 million with a cost of sales of $37.5 million for operating earnings of $12.5 million. After exploration, G&A, and other expenses, we reported a net loss of $1.1 million or negative $0.01 per share. Excluding non-cash mark-to-market adjustments on marketable securities, our adjusted earnings totaled $2.1 million or $0.01 per share this quarter.

At the site level, Guanacevi delivered mine free cash flow of $5 million and Bolañitos was pretty much breakeven. Regarding operating costs we've seen pressures across several inputs. Our direct cost per tonne were up 15% this quarter.

At the time of guidance, our inflation assumptions were 5%. However, year-to-date, we've seen those costs, the costs of key inputs like steel used for ground support and consumables, such as zinc and cyanide, continue to increase well above our assumption. Additionally, labour costs are having a significant effect with the strengthening of the Mexican peso.

The peso has strengthened to a seven-year high. Originally, our 2023 guidance had assumed a 21 to 1 Mexican peso to U.S. dollar exchange rate. However, we're currently looking at 17 to 1. This is up 14% year-to-date which has increased in our local cost in U.S. dollar terms. All these factors manifest themselves into overall higher costs. Both quarterly cash costs and the all-in sustaining costs are above our upper bounds of our guidance at $13.52 per ounce for cash costs and $22.15 per ounce for silver or all-in sustaining cost per ounce.

As a result, Management expects costs to be higher than cost metrics previously provided in our 2023 guidance. Inflation is an industry-wide issue that's expected to persist throughout the year. We're closely reviewing our purchasing practices to see where and how we can mitigate the impact. Containing costs will continue to be a key focus as we work to improve the efficiencies of our operations. Management anticipates cost metrics for the remainder of the year to align with H1 2023 actual costs.

At June 30, we had cash on hand of $43 million and a working capital of $78 million. To maintain flexibility on project execution, we initiated a $60 million ATM filing in Q2. Completion of the definitive loan documentation for the $120 million senior secured debt facility is expected soon with closing and drawdown expected in Q3. After the quarter, we further enhanced our liquidity by selling a 1% stake in Capstone's Cozamin Royalty to Gold Royalty Corp. This sale will bring in a cash injection of $7.5 million in Q3. We originally obtained that royalty through a concession division agreement back in 2017 for less than $500,000.

Let me give you a quick update on construction at Terronera. At the end of Q2, we reached 30% completion. We have spent $70 million to the end of Q2 on direct development. Project commitments totaled $144 million and we are tracking in line with the optimized plan both on timing and on budget. During the quarter, we had steady momentum on engineering, surface construction at the plant site, mine development and establishing internal processes to best execute the project. If you're interested in seeing photos of the construction progress, I encourage you to visit our website under the Terronera page.

A quick recap. On-site personnel has increased to over 450 employees and contractors. Detailed mill and surface facilities engineering is over 70% complete. Engineering was finalized to request proposals for the mill construction contract, including structural steel, mechanical, piping, electrical and instrumentation. Access road construction is substantially complete. The focus on early road improvements have greatly facilitated construction ramp-up especially prior to the rainy season. The camp to accommodate 550 personnel is substantially complete. Nearly all dormitory units have been installed. Several final living units remain pending.

Mine development is advancing on two fronts with over 600 metres completed as at June 30. In the meantime, a new portal is being prepped to access the lower part of the ore body. Bulk earthworks for the planter is nearing completion with nearly 300,000 cubic metres of material moved. Excavations were completed for the course or reclaim tunnel, grinding areas and now rebar installation has begun.

On the procurement side, deliveries are advancing on schedule with shipments arriving at the Company's laydown warehouse. Major equipment deliveries in Q2 include jaw and pebble crushers, vibrating screens, flotation cells and the concentrate bag system.

And lastly, on the community side, we continue to partner with local schools to support education campaigns and cultural celebrations.

Looking ahead, our main focus is now progressing mine development, advancing concrete work for the mill platform and awarding the mill construction contract which will kick off the next major phase of construction.

I think that wraps up today's formal comments. Myself, Dan and Christine are happy to answer any questions that you may have. Operator, could you please open it 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 speakerphone, please pick up your handset before pressing any keys. To withdraw your question, please press star, then two.

The first question comes from Heiko Ihle with H.C. Wainwright. Please go ahead.

Heiko Ihle:
Thank you, Galina, Dan and team. I assume you can hear me okay?

Dan Dickson:
We can you hear you well, Heiko.

Heiko Ihle:
Excellent. Hey, on Terronera, I went through your July press release again earlier today and I compared it with your note today. I mean, Dan, also, you obviously provided some more colour earlier on this call as well, but I still got to ask. Are there any factors that are giving you a bit of a headache both from an availability and pricing point of view? It seems like the camp is mostly done and mine development continues at a good pace. But is there anything that we should maybe know about? I assume the answer is no, but I just want to double check.

Dan Dickson:
No, it's a fair question. I mean, like you say, we're seeing a lot of inflation across our operations. I think Don and his team have done a really good job from a procurement standpoint and being ahead of the game and locking a lot of our key components in. And I've mentioned this in the prior calls and prior press releases that our entire mobile fleet has already been on site.

A lot of the key components of the plant have been procured quite early on and expect delivery here in—well we got some in Q2 and in back half of the year and the remaining will come. And a lot of those components or key purchases have come in line with what our expectations were, have come in line with what our optimized plan is and the feasibility study. So we did a really good job with that.

Now there's always things that we get are concerned with and that's our job as Management and making sure that we hit our mine development headings and the rates and executing on that over the next year, year and a half will help us be on time and on budget for Terronera. Of course, there are some things that we win on and hopefully there are some things—or things that we'll lose on and hopefully there'll be things that we win on from a cost standpoint. But at this point in time, and it's early. Like I say, we're only 30% complete at Terronera. We feel like we're tracking very well to what budgets have been.

Heiko Ihle:
That was a very nice lead over to my next question. Obviously, the Mexican peso has increased quite a bit. You mentioned earlier in this call and also in your release we were at 17.12 right now. What are you using in your model for the remainder of the year? And I don't know if you have a longer-term modeling number for the peso as well, please?

Dan Dickson:
Yes. For the remainder of our year, we're generally putting our cost guidance right around what we did with H1. So we averaged just above $17 for H1, maybe it's closer to $18, so $18 to one is probably where we'd be comfortable saying that. For long-term, we'll look at that at the end of the year. We're kind of going through our budgets for 2024 at this point and just getting that kicked off.

Through different discussions with various banks, we do expect the peso to continue that depreciation that we've seen for the last 20 years. But again, we don't have a crystal ball when does that turn around and we no longer see appreciation in the peso. It's hopefully in the next six months, but again, don't have a crystal ball on that. And when we come out with guidance for 2024 we typically state what we're using for an FX rate at that time.

Heiko Ihle:
Got it. Okay. Fair enough. I'll get back in queue. Appreciate your time.

Dan Dickson:
Thanks Heiko. Thanks for the questions. Good to hear your voice.

Operator:
The next question comes from Craig Hutchison with TD Securities. Please go ahead.

Craig Hutchison:
Hi, guys. Thanks for taking my questions.

Dan Dickson:

Hey, Craig. How are you?

Craig Hutchison:

Good, well, thanks. Just on Terronera with regards to the Mexican peso, can you give us a sense of how much is exposed to I guess domestic currency, the peso, versus how much is exposed to the U.S. dollar?

Dan Dickson:

Yes. I mean obviously labour costs are significantly exposed to the peso compared to the dollar. A lot of the items that we've procured have been in U.S. dollars and we've committed $144 million of the $230 million. So for the $90 million left to be exposed. We're expecting somewhere between $30 million and $50 million to be tied to the Mexican peso. So, not significant at this point in time in time.

Craig Hutchison:

Okay. Great. And then in terms of your operations, is it—what's the kind of rough breakdown at Guanacevi and Bolañitos in terms of the exposure?

Dan Dickson:

Yes. Yes. 30% to 35% of our—depending, I think, Bolañitos hovers around 32% and Guanacevi a little bit higher around 34% or 35% of our costs are incurred in labour. Obviously, labour is completely exposed. So for the remaining 65% about half is tied to the Mexican peso. So, in total, you're looking at 55% to 65% of our costs are tied to the Mexican peso.

Craig Hutchison:

And just on the financing, I mean, just I know you talked about the inflation and some pressures you've seen on FX. Is there a potential to upsize that from the $120 million that's sort of been agreed to at this point, or has it sort of been finalized and that's the number we can expect?

Dan Dickson:

Yes. No it's been finalized. And I think for us as the management team we think that's kind of the upper end that we want to take on from a debt standpoint. We did put in the $60 million ATM facility that we haven't drawn on to give ourselves protection. Ultimately, if we do end up above the $230 million, we prefer that to come from equity just because we don't want to get too levered to debt.

Craig Hutchison:
Okay. That makes sense. All right. Thanks, guys.

Dan Dickson:
Thanks for the questions, Craig.

Operator:
The next question comes from Lucas Pipes with B. Riley Securities. Please go ahead.

Lucas Pipes:
Thank you very much, Operator. Good afternoon, everyone. I also wanted to start out on the cost side and maybe more broadly kind of what sort of measures you're taking today to ring-fence cost inflation? Are there things you're looking at at the operational level? I would appreciate any additional colour you might be able to share. Thank you.

Dan Dickson:
Yes. Thanks, Lucas. It's a difficult thing to ring-fence inflation and ultimately the strengthening of the Mexican peso when it comes to labour. But from an efficiency standpoint and making sure we're operating as best we can, I think we've done that well at Bolañitos. At Guanaceví we can be better at that. We're looking at improving our ventilation and our pumping, reducing our electricity usage with pumping and being more efficient in that standpoint. We're also looking to be more efficient on our advances underground, making sure that we have—we're using the right amount of explosives, right amount of steel rather than potentially using more than what we should have been.

And so I think it's really an efficiency standpoint from our operations team that we can find little wins here and there and whether it's about the inputs going into the number of units that we're using as opposed to those costs of those units. Because there's only so much you can do from a—like for example, the strengthening of the peso, our labour cost we need those labourers.

The question is do we need as much labour as what we have. That's where we can make those adjustments. Of course we've been kind of in a good fortune. Like Guanacevi, with the discoveries they've made in 2019 in the high grade. I think some of that grade is going to pick up in the back half of the year that will improve our cost on a per ounce basis. It's little things and being vigilant on those little things and making sure we're operating as best as we can.

Lucas Pipes:
Thank you for that. And a follow-up on Guanaceví. The higher grades with the El Curso ore body. How sustainable is that over the—you mentioned the back half of the year but as we look into 2024, should we continue to see those benefits improve or kind of stabilize at the second half level? Thank you.

Dan Dickson:
Yes I think it would stabilize. We do have a good life with El Curso remaining. I mean obviously we have Milache, we have Santa Cruz Sur, other areas that we're able to mine but Santa Cruz or El Curso is kind of the heart of where our production is coming from and that will continue for the foreseeable future, especially into 2024 and 2025.

Lucas Pipes:
I appreciate that. Thank you. And then one quick last one from me. Just with Pitarrilla, what was the outlook there and major milestones for the market to look forward to? Thank you.

Dan Dickson:
Yes. No that's a very fair question. I'm glad you brought that up. Well, for us, Pitarrilla, as most of our listeners probably know, we purchased that in 2023 for $70 million and we've really been pushing there. And to the end of 2023 and early 2024, we did a lot of relogging of the historical data. And for this year, we have $3.3 million budget and most of that's to push the ramp to what we think is or what our predecessors thought were as a manto zone and it was about 300 metres away to get there. We've had some delays. We've had some workarounds on the old historical ramp. It looks like we're going to have to push a parallel ramp, which means rather than being 300 metres, we'll have to be 500 to 600 metres ourselves, which will delay our drilling program and end up being either late Q4, more likely into 2024.

So, we're not going to have as much news on Pitarrilla this year, which was expected kind of the end of the year from a drilling standpoint and an economic analysis next year. So I'll push into next year just because of this ramp. But we do have big expectations still with Pitarrilla.

Obviously, we've defined a resource of over 600 million ounces, but we are looking at an expectation of seeing if we can make this an underground operation similar to what Silver Standard had looked at back in 2009. Obviously, I always wish things went faster than what sometimes they do. And hopefully, we can still get through that economic analysis in 2024.

Lucas Pipes:
I really appreciate all the colour and detail. To you and to team, best of luck.

Dan Dickson:
Thanks, Lucas. Thanks for the questions. Hope all is well.

Operator:
The next question comes from Justin Stevens with PI Financial. Please go ahead.

Justin Stevens:
Hey, everyone. Most of my questions have been crossed off mostly, but I got one last one. Obviously, the Guanacevi grades took a hit in Q2, but you're expecting an uptick in Q3 and beyond. Was the sequencing impact there mostly development related? And if so, do you think you'll be able to sort of stay ahead and keep enough stopes and high grade sections to keep that grade pretty flat going forward?

Dan Dickson:
Yes. A couple of factors went into that sequencing. We actually lost one of our high grade stopes. And we had spent a lot of Q2 cleaning that up and refixing up, so we can go back in here in Q3.

Development has been a little bit behind but not terribly behind, but we have a recovery plan to make sure our development stays ahead, so we don't have these changes in our plans—our mine plan sequencing and it's kind of the bugaboo of all underground operations in making sure that we have sufficient mine development and not getting ahead of ourselves and pulling out more ore, because eventually that always catches up to you. But we do expect Q3 and Q4 to stabilize and again grades to be slightly below Q1. I thought Q1 was pretty high grade than we really significantly did (phonetic 22:34) plan, but it will somewhere be between Q2 and Q1.

Justin Stevens:

Just on that, the high-grade stope, was that just like an isolated ground condition issue or…?

Dan Dickson:

Yes, we believe it was isolated. I'm always looking at that but we've had very good ground in El Curso and continue to expect to have good ground.

Justin Stevens:

Great. And I guess one other, just maybe an idea of time (phonetic 23:02) essentially. I know you've been looking to twin some holes at Bruner and sort of re-up that resource. Is that just sort of—should we expect that just by the end of the year?

Dan Dickson:

No, I think, that's going to fall into 2024. We haven't really pushed on Bruner this year. We did get all our drilling permits. But again, there's no plans and we want to make sure that we keep that cash (multiple speakers 23:25)

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Justin Stevens:

Priority is obviously on Terronera and everything?

Dan Dickson:

Yes, exactly, exactly.

Justin Stevens:

Yes. Great. All right. Thanks and look forward to seeing the uptick back in Q3

Dan Dickson:

Thank you. Thanks for the questions Justin.

Operator:

The next question comes from Cosmos Chiu with CIBC. Please go ahead.

Cosmos Chiu:

Hi. Thanks, Dan and team. Maybe my first question is on Bolañitos. I think in the MD&A you mentioned that Q2 experienced higher gold grades, increased throughput offset by lower silver production and lower silver grades. I guess, my question is that higher gold grade and lower silver grade, is that going to continue? And is that going to revert some time into the future?

Dan Dickson:

Yes. Thanks for the question, Cosmos. I mean, we actually get quite (phonetic 24:22) variations between Bolañitos between gold and silver. In general, I think our silver equivalent grades were in line with expectations with budget and Bolañitos is performing as expected. Q3, Q4, it would probably line up pretty good with H1's gold grades and silver ratio. And then, going forward, similar at that point.

Cosmos Chiu:

Great. And then looking at your guidance, Dan, as you mentioned production guidance has been maintained. Cost guidance has been maintained. But as we talked about on this call, there's a lot of questions about inflation, foreign exchange, FX rates. And you, I guess, in the MD&A you even made the comment that some of these inflationary pressures are expected to continue in the near-term, expect actual cost metrics to be higher than cost metrics previously provided by the Company's 2023 guidance. So what does that mean? Are we potentially looking at for the full year cost to potentially come in higher, or is that just looking out into Q3? I wasn't too sure what the wording around that (multiple speakers 25:37)

Dan Dickson:

No. Yes, I can be more clear on that, Cosmos. Ultimately, as you said from a production standpoint, we're at 4.7 million silver equivalent ounces produced. Our upper bound range is 9.5 million silver equivalent. So we're tracking really well from a production standpoint to the upper bound. Unfortunately, from a cost standpoint, all-in sustaining costs have been $22.15, cash costs have been near $12 or $12.21 for the first half of the year. We're expecting our costs to be above the upper bound range of our guidance.

So we're not restating the number, but we do expect for the second half of the year our cost metrics to be similar to H1, which again puts us above the upper bound range of our original guidance.

Cosmos Chiu:
Understood. And I guess Dan—sorry you were saying…

Dan Dickson:
No, no it's good. I'm glad you understood. I just wanted to make that clear.

Cosmos Chiu:
Okay. I guess, as we talked about one of the key components is the Mexican peso, I just looked at it again. I don't think right now you are hedged in any way in terms of Mexican peso. And then as you mentioned you don't have a crystal ball, I don't have a crystal ball either. So is there any thinking behind potentially hedging away that risk longer term especially with some of the costs associated with Terronera?

Dan Dickson:
Yes, it's a very good question. And there's two parts to that almost. From an operating standpoint, we aren't going to enter into any FX hedges for Guanaceví or Bolañitos. I think a lot of the literature that we still get is we expect peso to stay relatively strong through 2023, but to reverse course and get back on historical trend of depreciation against the U.S. dollar. So that's part of the thought patterns on why nothing from an operating standpoint.

From a Terronera standpoint, it's different, right? Because we have a big incurrence, because of the debt that we're putting in place with Soc Gen and ING, it's $120 million, there is an FX component hedging with regards to Terronera. It's not significant. Craig had earlier asked the question about what remains from an FX standpoint. We've provided that detail to those banks and we'll have to incur some FX hedging in place for the—as a covenant for the loan facility.

Again for everybody else on the call, with that loan facility, there's also a gold hedge requirement for the first two to three years, amounts to between 50,000 and 60,000 ounces of gold on that three-year basis, so averaging 20,000 ounces of gold per year. And we'll get into that detail when that gets all finalized hopefully this quarter, Cosmos.

Cosmos Chiu:

Great. And then one last question. As you mentioned rainy season is coming out in Mexico. You've gone through many rainy seasons. And so—but I just want you to talk about how have you prepared for it at the operations and also at Terronera? I'm reading there's upcoming major milestones at Terronera, but it's a lot of delivery, some concrete work. I don't see a lot of major earthworks. But again how have you thought about the risk around rainy season coming upon in Mexico?

Dan Dickson:

Yes. Obviously, as you stated with our operations, we've dealt with rainy seasons for 17 years, 16 years at the operations. I think we are pretty well averse to handling it and you don't see big changes in our production profile because of the rainy season. We've had issues in the past various years, whether it's clay in the crushers that impacted but only on a, I'd say, minute level.

From a Terronera standpoint, I think we've done a very good job preparing for it. That's the reason we've put so much work into the roads and the drainage around the roads and requirements for drainage. But I'm probably going to pass this question off to Don who's sitting in Mexico and is on the call. He knows this very well and probably can give you a better answer than I can.

Don, do you want to give Cosmos a little bit of colour around the work we've done around rainy season for Terronera?

Donald Gray:

Sure. There's quite a few things that we've done and similar to what we've done on other projects previously, and simple things like we pour lean concrete down in the bottom of the excavation, so that the contractor has something to work off of when it is raining ready with pumps and things like that for excavations where they may accumulate rainfall, that kind of thing.

The other thing is that we've done in some other places is put up some tents and overhead structures, real simple things. But if the contractor is prepared, which our contractor is, that we have the concrete contractor on site now, then we can get through it. So we've been prepared for it and are preparing for it and anticipate we can meet the challenge.

Cosmos Chiu:
Great. Thanks, Don. As you look out the window right now, is it raining?

Donald Gray:
Out the window right now it's—I've got mostly blue sky and a little bit cloudy afternoon. The clouds come in and we get the afternoon rains, but it's kind of typical for right now in this part of the rainy season so.

Cosmos Chiu:
Thank you, Dan. Sorry for putting you on the spot here. And again, thanks, Dan, for answering all my questions.

Dan Dickson:
No, those are great questions, Cosmos, and always happy to answer them.

Operator:
This concludes the question-and-answer session. I would like to turn the conference back over to Dan Dickson for any closing remarks.

Dan Dickson:
Well, thank you, Operator, and thank you everybody listening to our Q2 financial results call. I can tell by the questions. I think everybody understands the importance of Terronera and executing on Terronera over the next year and a half for Endeavour. Of course, Management is always eager and happy to answer calls from analysts. And hopefully, we expect good results here in Q3 from a production standpoint and we maintain our eye on costs and try to drive that down as best we can. Thanks everyone and have a good day.

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