Endeavour Silver Corp.

2019 Q1 Conference Call

Transcript

Date: **May 6, 2019**

Time: **10:00 AM PT / 1:00 PM ET**

Speakers:

Bradford Cooke
Chief Executive Officer

Godfrey Walton
President and Chief Operating Officer

Dan Dickson
Chief Financial Officer

Galina Meleger
Director, Investor Relations

OPERATOR:

Thank you for standing by. This is the conference operator. Welcome to the Endeavour Silver First Quarter Financial 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, Director of Investor Relations. Please go ahead.

GALINA MELEGER:

Thank you, Operator. Good morning everyone and welcome to the Endeavour Silver Corp. 2019 First Quarter Financial Results Conference Call. With me on the line today we have the Company's CEO Bradford Cooke, as well as our President and Chief Operating Officer Godfrey Walton, and our Chief Financial Officer Dan Dickson.

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 2019 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, and on behalf of Endeavour Silver, I would like to thank you again for joining our call today and I will now turn it over to our CEO Bradford Cooke.

BRADFORD COOKE:

Thanks, Galina. Welcome everyone to this first quarter financial results conference call on Endeavour Silver. As you have already seen, we had a pretty tough quarter in Q1 2019. We got a very slow start to the year in our operations, and that has really impacted our financial performance in Q1.

Bolañitos and El Cubo, two of our mines, continued to be profitable in the quarter, but Guanaceví, our first mine, continued to struggle and incurred almost half of the net loss incurred during the quarter. We have initiated additional detailed reviews of mine plan alternatives for Guanaceví, including ways to improve the viability of mining the main Santa Cruz ore body, and accelerating the development of the two new ore bodies of Milache and Santa Cruz Sur. Clearly, we need to do more than that, so management has actually implemented multiple measures to improve our operating and financial performance. We've basically initiated cost cuts across the entire range of the Company's activities, and so we are dealing with the hand we dealt ourselves in Q1 and I'm confident that we'll get through it.

The highlights from the first quarter financially were a significant drop in net earnings to a $13 million loss. Cash flow from operations dropped to around $2 million. Mine operating cash flow was around $4.5 million. Revenue decreased to $29 million. That was on the back of lower gold and silver equivalent production and, respectively, 1.07 million ounces of silver, 10,000 ounces of gold for 1.9 million ounces of silver equivalents.

With regard to what we're doing about the poor performance in the first quarter, we are focused clearly on accelerating the development at each mine site so we can gain access to more reserves and accelerate our production rates to get back on plan as soon as possible. In addition to that, we are evaluating how to mine higher grades and reduce dilution, and also we're doing various studies to improve metal recoveries.

Management changes have already been implemented at Guanaceví and Bolañitos to address some systemic issues, and we expect to improve supervision of the day-to-day operations going forward in order to achieve our plan development and production targets.

In order to boost mine development, we need better equipment utilization and better contractor performance. Some mining equipment has already been relocated from low priority areas to high priority areas. Some new mining equipment has already been delivered to one of the sites, and we've already made changes to some mining contractors and are considering other changes.

Really, the longer term solution on equipment, though, is to order a new fleet and we're going to our board meeting tomorrow with a proposal to lease a fleet of equipment for delivery in the second half, that should significantly reduce maintenance costs, dramatically improve availabilities, and therefore enhance productivity.

We have hired a new senior mine planning engineer to review and renew certain mine plans, and there is a new senior mining geological consultant who is with us now, reviewing and improving grade control, moving from mine to mine.

We've already done some reductions in terms of employees and contractors in Q1, and additional reductions are under way in Q2. We just felt we had too many people not doing enough work and that one of the ways to reduce costs and boost productivity was to keep the best performers and reduce our workforce accordingly.

Exploration has pretty much ceased its brownfields and greenfields exploration and is now working on assisting our mine exploration group with mine site infill drilling to, again, boost areas of reserves for better production this year.

Senior management has taken a leadership position in all of this, having already taken voluntary reductions in pay. Our Vancouver administrative staff have followed in the same way, and we've reduced and are continuing to reduce all discretionary spending short term.

Last but not least, the studies underway to evaluate Guanaceví, which is by far the most important factor in our loss in Q1. We should have those studies done by month end, so we expect to make additional changes in June.

Notwithstanding all that, we continue our top priority on safety performance and in general we had a good safety performance in Q1. Management is also clearly focused on our next mine at Terronera. Know that El Compas has declared commercial production in Q1. We are focused on arranging the financing and optimizing the prefeasibility study while we await receipt of the final government permit, which we believe to be day-to-day, and Board approval to commence construction.

Last but not least, our Parral project represents the potential to become mine number six and a Preliminary Economic Assessment is already underway based on last year's resources, and mine permitting is underway given that Parral was historically a mine up until 1990, and there's minimal disturbance needed to recommence production at the Veta Colorada Mine.

In summary, we recognize that we underperformed in Q1, and every big problem can be broken down into multiple small problems; we've identified all those small problems; we've been tackling the small problems, and we are already starting to tick off accomplishments as we move to resolve our operating and financial performance in Q1.

With that, I'd like to open the call up for questions.

OPERATOR:

Thank you. 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. Once again, to join the question queue, please press star, then one now.

Our first question comes from Joseph Reagor of ROTH Capital Partners.

JOSEPH REAGOR:

Thanks, Brad, for taking the questions. A couple of things, I guess quick off the top. On the G&A front, with the reductions in Vancouver and thinking about over the remainder of the year, what should we expect for G&A, and should there be any one-time items, like there was the $1.1 million in Q1? Should we expect anything like that in Q2?

DAN DICKSON:

Thanks, Joseph. Dan Dickson, CFO. Yes, the reductions that were seen out of Vancouver and Management, which effectively are G&A costs, the voluntary pay cuts across the executive level, that amounts to just under $500,000 in a year. Obviously not a huge impact but at the same time it sends a message that we're in this with the rest of our employees.

Secondly, discretionary spending, Investor Relations, travel for the group, etc., etc., that will all reduce. Exact numbers still, again, probably under $500,000 on an annualized basis. At the same time (inaudible 9:49) that we send.

With regards to severance, you were correct. We had $1.1 million of severance flow through. That related to El Cubo where we reduced our staff from about 160 employees. We actually have a reduction of staff going through at Guanaceví here in Q2 which is an expected cost of about $0.8 million in the second quarter that will flow through. At that point, we should be done for a little bit, unless we announce something later in the year, but at this point there would be no changes at this time.

Right now, from a G&A standpoint, for the end of the year total amount we expect to be about $6 million cash outflow, so anywhere between $5.5 million to $6 million. Q1 was almost upwards of $3 million. Inside that G&A was stock based compensation. We granted options in March. Typically in the past we had done that in May.

JOSEPH REAGOR:
Okay. Thanks for the colour there. Shifting gears a little bit to the exploration front. The press release seems to suggest that some of your brownfields exploration and greenfields exploration in Peru may be going away, or at least be being delayed, but then the guidance on exploration, the total number spend for the year didn't change. How should we look at that? Are you saying that it hasn't changed yet and it may go down? Or is it more of that it's going to be back-half weighted?

BRADFORD COOKE:
Thanks, Joe. It's Brad. Obviously we needed to cut exploration. We spent over 2 million bucks on exploration in Q1 and it's the easiest cut to make. It's also discretionary. We can bring it back on when we feel more comfortable with the cash flows. So, what did we cut?

Obviously mine site infill drilling was not cut. That's basically critical for defining and gaining access to reserves this—to boost this year's production. But brownfields and greenfields exploration around Guanaceví, around Bolañitos, El Compas and El Cubo, these are all candidates for reductions immediately, and those reductions have been made.

Chile is not scheduled for exploration until the last quarter. Sorry, the drilling in Chile was scheduled for the last quarter, and we'll obviously be making a decision about that later on in the summertime.

The main hit on exploration is just the greenfields and brownfields in Mexico at this time.

JOSEPH REAGOR:
Okay, and then one final one. Does the Q1 results impact any of your planned financing for Terronera, assuming it gets the permit and approved by the Board. Has it made any changes? Are you guys using the same plan that you were a quarter ago?

BRADFORD COOKE:
I think it's steady as she goes. As you know, our focus is mainly on the debt side, and we're reasonably confident we can finish off those financing arrangements here in the not-too-distant future.

JOSEPH REAGOR:
Okay, great. I'll turn it over. Thank you.

BRADFORD COOKE:
Thanks, Joe.

OPERATOR:
Our next question comes from Chris Thompson with PI Financial. Please go ahead.

CHRIS THOMPSON:
Hey, good morning, guys. A quick question I guess on Guanaceví. My understanding is that you're producing from Milache right now but you're ramping up there. You want to position, I guess, Santa Cruz Sur for production second half of this year, and then obviously you want to dial back the mine plan which is exploiting resources from existing other areas. I'm trying to understand exactly what is happening at Guanaceví. Are we having problems with executing that plan, or are these issues concerning exploitation of, was it Porvenir Norte ad Santa Cruz?

GODFREY WALTON:

Hi Chris. This is Godfrey. Thanks for the question. It really comes down to not having the development go at the speed that it was planned. The areas that we were meant to be mining today are not the areas that we ended up mining, and therefore the grades were lower than expected. We've over the last I'd say month here, we've been pushing on development and it is increasing. As Brad mentioned, we required a couple of pieces of equipment and they were actually two jumbos that arrived in April, and they are making a difference to our development.

The development is picking up. It will get us back on track as to where we should be mining, and that will increase the production from Milache. We're evaluating what's happening at the bottom of Santa Cruz to see how far we should continue with that. Then, we're pushing development at Santa Cruz Sur which should have been producing by now but it is, again, behind on development and so by the end of the year I think they'll be a lot better positioned to produce as planned.

CHRIS THOMPSON:

Great, Godfrey. I mean obviously you guys are reviewing your plans at the moment. At what point would you consider suspending production from Guanaceví, just to give you a little bit of breathing room, I guess, to fully sort of adjust the operating plan before executing on it? Is that something you would consider?

GODFREY WALTON:

All things are being considered at this point, and as Brad mentioned, we expect to have those studies completed by the end of this month, and then we'll be making further decisions on actions at Guanaceví.

CHRIS THOMPSON:

Okay. Then the final question, I'll just flip it in. Compas right now, is that free cash flow positive at the moment?

BRADFORD COOKE:

Dan?

DAN DICKSON:

We've seen grades come up there, Chris. We changed up the contractor at the end of the quarter, actually mid-March. We've seen grades come up above 4 grams, and in the plan it's about 6 grams of gold per tonne. We've seen that come up in the 4 or 4.5 range, and if we can stay at that 4 we should be at least cash flow neutral in Q2 and expect that go cash flow positive in the second half of the year.

BRADFORD COOKE:

Chris, this is Brad. Just to put that in context, Compas is the only mine where we plan to use contractors, only contractors for the (inaudible 17:04) on dilution, almost 100% dilution. With the new contractor, with new supervisors, with the consulting ore control geologist, we are already seeing improvement in grades and a reduction of dilution. There's more coming, but I think that what we're seeing week to week right now is sufficient to be breakeven, and we obviously want to do better.

CHRIS THOMPSON:

Okay. Thanks guys. Thank you.

OPERATOR:

Our next question comes from Heiko Ihle of H.C. Wainwright.

TYLER BISSET:

This is Tyler calling in for Heiko. Thank you guys for taking our question. Just wanted to first say that we appreciate the cohesive nature in which everyone in the organization from the top on down seems to cope with the voluntary pay cuts together.

You state in your release that you guys are working on debt financing for Terronera. What sort of terms are you seeing there and can you provide some colour if original plans to fund the mine remain intact, or has anything in regards to timing or funding sources changed?

DAN DICKSON:

Thanks, Tyler. Yes, we're still looking at—I won't get into the details of terms. It's not fair to the counterparties that we're working with, but the terms are fair. It's just how much we can get to fund for Terronera, and we've been out there publicly and said basically we're looking kind of if it's a $100 million bill, the 60/40 split or almost a 50/50 split. There's funds available for that; it just depends on how much we need to secure, and obviously the terms of that. We've seen everything from 6% up to the predatory pricing of 20%. Obviously we're not going to move with some of that predatory pricing in the debt world, and that's fine, but we think we can get it done at a reasonable rate. It's just taking a little bit more time, and the key thing for that is that permit. Obviously guys from the credit sampling aren't going to be able to lend until we have that permit in hand, and that makes sense, but we're fully confident we can get that done here in the next couple of months.

TYLER BISSET:
Perfect, thank you. I think you may have touched on this briefly, but just for clarification. You mentioned severance costs as one of the reasons for the higher all-in sustaining costs, though in the financials it appears to be just $1.1 million. Are we missing something there, or is that the full figure? Can you estimate incremental expenses during the remainder of the year?

DAN DICKSON:
Yes. The $1.1 million severance costs at Cubo actually is not in our all-in sustaining costs. We don't put it in our production costs because it was a reduction of our operations. Cubo went from 1500 tonnes down to just over 1000 tonnes per day in Q1, and our plan was to get down to 750 tonnes per day, so that's the reason why that $1.1 million hasn't gone into our cost profile. We see it more as an administration expense.

Secondly, going forward we do have layoffs happening here at Guanaceví, as Brad touched on. That's going to be another $0.8 million that we'll see flow through in Q2.

Other incremental costs going forward, with the reductions until we announce larger layoffs, which isn't expected but again we're look at Guanaceví as all the alternatives at Guanaceví, that could add things, but there's nothing more to add at this time.

TYLER BISSET:
Okay.

BRADFORD COOKE:

It's Brad here. Dan, can you also comment on the impact of inventories on our Q1 financials? Because we really didn't focus on that in the news release.

DAN DICKSON:

Yes. We had writedowns. We had NRVs of inventories that flew through our financial statements, so we built stockpiles at Compas during our pre-commercial production stage, and we had about a million of NRVs related to Compas. If everybody recalls, we were down for six weeks due to a trunnion failure at the plant, and we were effectively ready to go for pre-commercial production. Those costs, which amounts to about $0.4 million is also running through our operating expenditures as well.

Other than thank in all-in sustaining costs, to answer Tyler's question, Guanaceví, just an inability to get up through the tons is actually driving those high all-in sustaining costs. G&A was a little bit higher, again, because we had stock based comp in Q1 compared to the previous year. All in all, though, with the NRVs through the inventories, that would be a small impact, a million and a bit going through.

TYLER BISSET:

Perfect. Thanks, guys.

OPERATOR:

Once again, if you have a question, please press star, then one.

Our next question comes from Mark Reichman of Noble Capital Markets.

MARK REICHMAN:

Good morning. Just three areas that I wanted to just focus on. The first would be Bolañitos and the arsenic concentration, and addressing your confidence in moving to a mine plan that accesses the lower arsenic ore, because as I understood in the first quarter you were basically having to blend with lower arsenic ore to be able to market, so that's one area, and I guess that's probably Godfrey's question.

The second would be if Dan could just kind of step back and provide kind of a high level view of the Company's liquidity against anticipated cash flow generation and the funding of capital expenditures.

Then the third area would be for Brad, and that's just to address the government permitting process for Terronera. Thank you.

GODFREY WALTON:

Hi Mark. This is Godfrey to look at the arsenic. Yes, we did have a issue in Q1 and it's flowed a bit into Q2. We have been blending the arsenic concentrate from Bolañitos with Cubo, which has helped significantly to help bring the average arsenic content down below 1%, which is what our buyers are interested in having it below 1%.

We've also been working on using depressors. We've actually identified that the arsenic is coming from arsenopyrite and so we're about half way through a test to use depressors to depress the arsenopyrite and it's working quite effectively. We expect that to be a solution to the arsenic problem.

We're also doing a lot of drilling to identify where the levels of arsenic are high and low, and so that we can continue blending internally within Bolañitos and not requiring the concentrate from Cubo.

We expect to have that solved in Q2, and I think we're actually quite close. We are going to try a number of other depressors for the arsenopyrite, which may be more effective, and so that will be ongoing in Q2 here.

DAN DICKINSON:

Mark, on your second question, kind of the high level impact on liquidity of some of these plans going forward. Clearly, we wouldn't have taken pay reductions if we didn't see cash go from $33 million down to $22 million in three months. Part of that $11 million decrease was $4.5 million of working capital changes, so basically payables going out the door or receivables building, and part of the arsenic issue impacted the level of inventories that we held at the end of the quarter, and timing of payments on some of our receivables that boosts our receivables, again, impacting cash.

If you even separate that, just losing $7 million or $6 million of cash in a quarter clearly made Management jump and move, and cutting back exploration for the year we think we'll be in a decent enough position to stay liquid. Obviously we have $22 million cash, no debt on the balance sheet. We have room to maneuver but we didn't want to wait too long.

Some of the things that we're looking at comes down to Guanaceví and the alternative plans that we'll get at the end of the month and into June. Clearly, we can't sustain $5 million of negative free cash flow from Guanaceví, and we think we have a plan. Getting in Milache and getting into Santa Cruz Sur, Milache has got significant better grades and Santa Cruz Sur has got significantly wider veins. If we can do that and execute that plan here over the next three to six months, we'll be fine.

Exploration taking a step back obviously is a way to preserve cash. There are some projects that we would love to spend exploration dollars on that we think are exciting projects that could be the future of Endeavour, but it's just the timing of those cash flows, and we'll manage our balance sheet on that timing of those cash flows here over the next six to eight months and hopefully we get a little bit more positive news in the silver price, but clearly silver has been fairly stagnant, and if not a little bit depressed here, sitting under $15, and it's something that we get paid to manage.

It's our job to manage that when it comes to buying more equipment to improve productivity at Guanaceví and Bolañitos. We're doing that through a leasing structure, so it's not cash going out the door immediately; it's going to be cash over time. We think the maintenance costs that we can save at Guanaceví and Bolañitos for some of these new equipments will basically offset the lease payments is what we're showing. Hopefully that's a positive going forward and we don't have to make more changes.

MARK REICHMAN:
Okay.

BRADFORD COOKE:
Mark, to answer your question with regard to Terronera permits, if everybody recalls, we've been several years now in the permitting process. We did receive the

environment impact study approval well over a year ago. We waited much of last year to get the water authority's approval to use a certain creek for the storage of our tailings. We got that around Christmastime, and since that time we've been waiting for the main environmental authority to give us the green light for using that creek for the storage of our tailings.

How does that occur? What is the process there? We're waiting day to day for the receipt of a Notice of Request for Payment for that permit to use the creek for tailings. We believe that is very short term. After that, it's about a two or three week process for us to actually make a payment and have it notarized so that it's accepted by the environmental authority, and they will then grant the permit.

We still believe we're going to have this permit this quarter, and that will give us everything we need from the permitting point of view.

MARK REICHMAN:
Great. I really appreciate the colour. Thank you very much.

BRADFORD COOKE:
Thanks for your questions.

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

BRADFORD COOKE:
Thank you, Operator. Thanks all for listening in today. I talked about breaking a big problem down into a number of small problems and then slowly but surely resolving them. I'd just like to highlight that in the last month we're in the middle of ticking off grade improvement at El Compas. We're in the middle of ticking the arsenic issue at Bolañitos. We've ticked off contractor underperformance at Compas, and we're in the process of doing it at Guanaceví. Layoffs obviously across the board, where possible. So, there's a lot of actions that have already been taken.

I think we're also very fortunate in that we're one of the very few silver mining companies to have a portfolio of projects that we are proposing to build into new mines, and drive organic growth. This transition from optimizing old mines to building new mines is bad timing this year given the space of the silver price, and so that's really what Dan was talking about with regard to cash flows. We just have to make sure that we manage our balance sheet appropriately as we make this transition from optimizing old mines to building new mines.

We're cautiously encouraged by the changes that are underway, and I think if we just keep our heads down and do what we've done before, we'll get through this tough period.

Thanks a lot for listening.

OPERATOR:

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