Seeking Alpha α

McEwen Mining: A Look At The Valuation After The Drop

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by: Taylor Dart

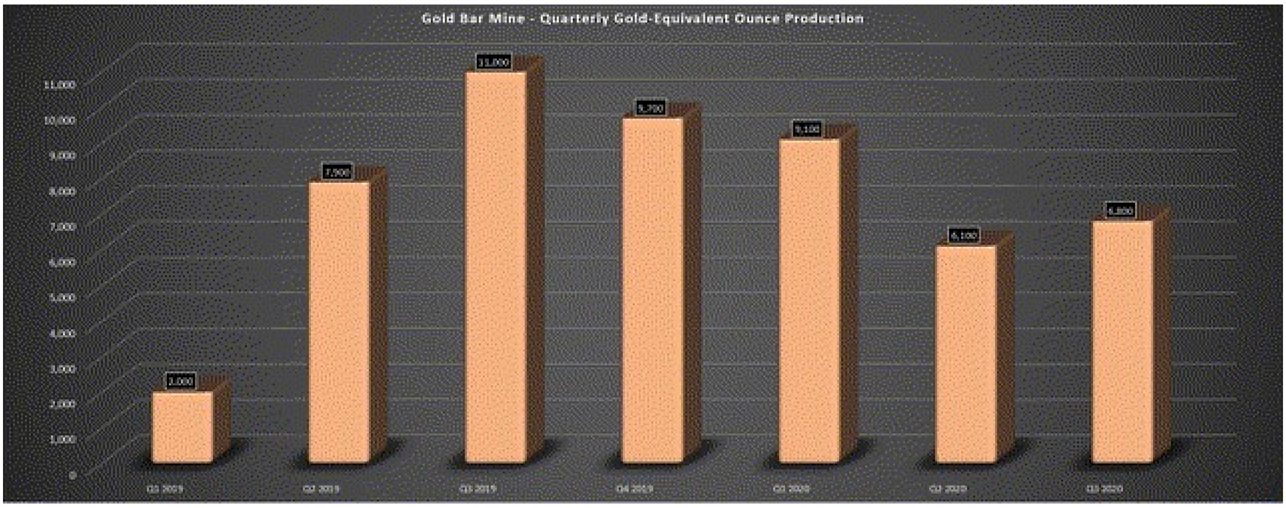
Summary

- McEwen Mining continues to be one of the worst-performing gold stocks this year, down over 15% year-to-date vs. a 20% return for the price of gold.
- The company recently announced that its 49%-owned San Jose Mine is offline temporarily due to COVID-19 infections in Argentina, a further headwind to the company's Q4 output.
- Some investors might argue that the stock is cheap here as it's down over 70% from its 2016 highs, but I would argue that it's actually expensive relative to peers.
- I continue to see McEwen Mining as an Avoid due to overvaluation relative to peers and industry-lagging margins, and I would view any rallies above $1.50 as selling opportunities.

It's been a rough couple of months thus far for the Gold Juniors Index (GDXJ), but the index is still up over 20% for the year, with leaders like Calibre Mining (OTCQX:CXBMF) and Jaguar Mining (OTCPK:JAGGF) enjoying triple-digit year-to-date returns. Unfortunately, even record highs in the gold price (GLD) haven't been able to help McEwen Mining (MUX) exit its slump, with the stock down 20% year to date, adding to what's been a miserable few years for shareholders. While some investors may think that the stock is cheap because it's more than 70% from its 2016 highs, I would argue that it's cheap for a reason and actually expensive relative to peers. Therefore, I continue to see the stock as an *Avoid*, and I would view any rallies to $1.50 as selling opportunities.

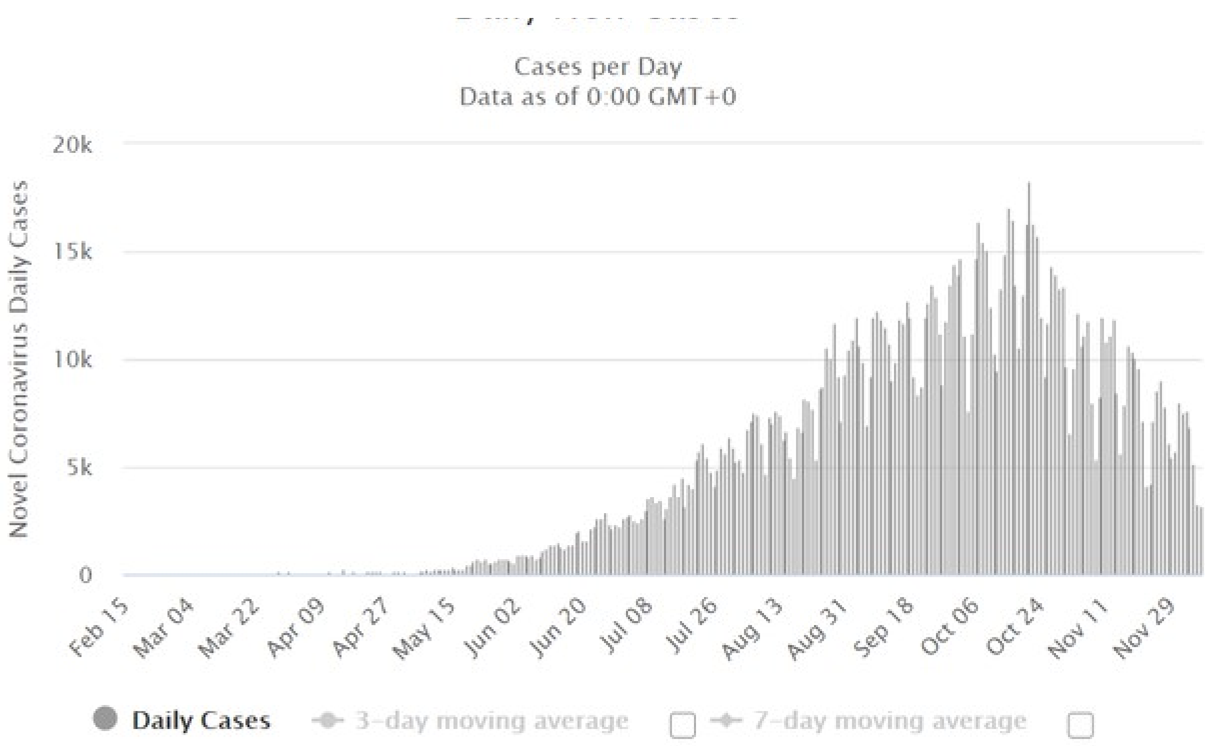
(Source: Company Presentation)

For investors still following McEwen Mining, it's been a rough year thus far, with just 84,000 gold-equivalent ounces [GEO] produced, a more than 30% decrease from the ~128,200 GEOs produced in the same period last year. One of the reasons for this operational weakness has been COVID-19, with the company's 49%-owned San Jose Mine unable to operate at full capacity since the pandemic hit. Still, the company's newest Gold Bar Mine has also continued to disappoint, weighing on results. In fact, while attributable production from the San Jose Mine is down 40% year over year (39,800 GEOs vs. 67,500 GEOs), Gold Bar should have been able to pick up most of this slack if it was operating as planned. However, the Gold Bar ramp-up has been an absolute disaster with just 22,000 GEOs produced year-to-date, tracking a country mile shy of the estimated ~62,000 GEOs of annual output expected in the 2018 Feasibility Study.



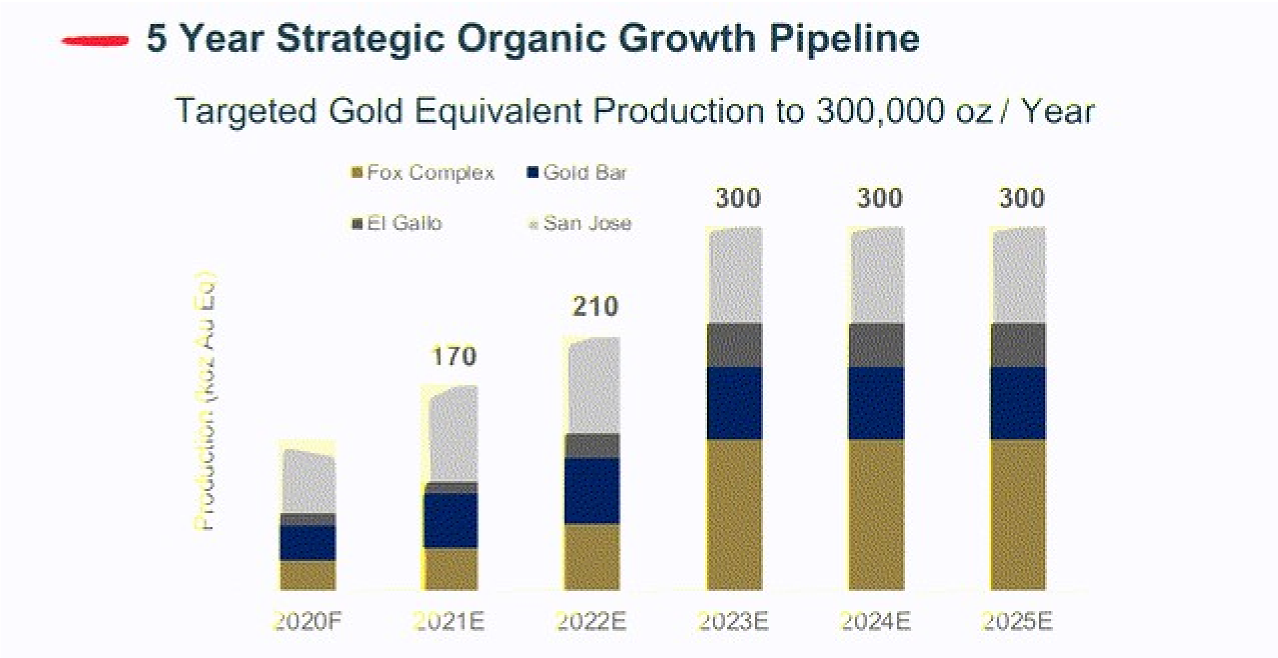
(Source: Author's Chart)

Unfortunately, the situation at McEwen's largest contributor to annual output (San Jose) has not improved, with the company recently announcing a temporary lockdown in the Santa Cruz province of Argentina that affects the San Jose Mine. This should lead to an even further hit to what's already been a disappointing year at the mine, as even if San Jose comes back online in December, it will be at reduced capacity. The other concern from this news is the Santa Cruz province seems to be an anomaly vs. the trend in COVID-19 cases in Argentina because Argentina's total cases peaked in late October and have dropped significantly, but Santa Cruz has still been affected by a recent shutdown. Based on this shutdown, which has McEwen Mining relying mostly on Black Fox and Gold Bar for Q4 production, I have lowered my FY2020 production estimate for McEwen Mining to 110,000 GEOs. This would translate to a 36% drop in output year-over-year and one of the worst drops across the sector. This is incredibly disappointing given that FY2020 GEO production should have been above 140,000 GEOs even with COVID-19, with the benefit of the Gold Bar Mine in Nevada coming online.



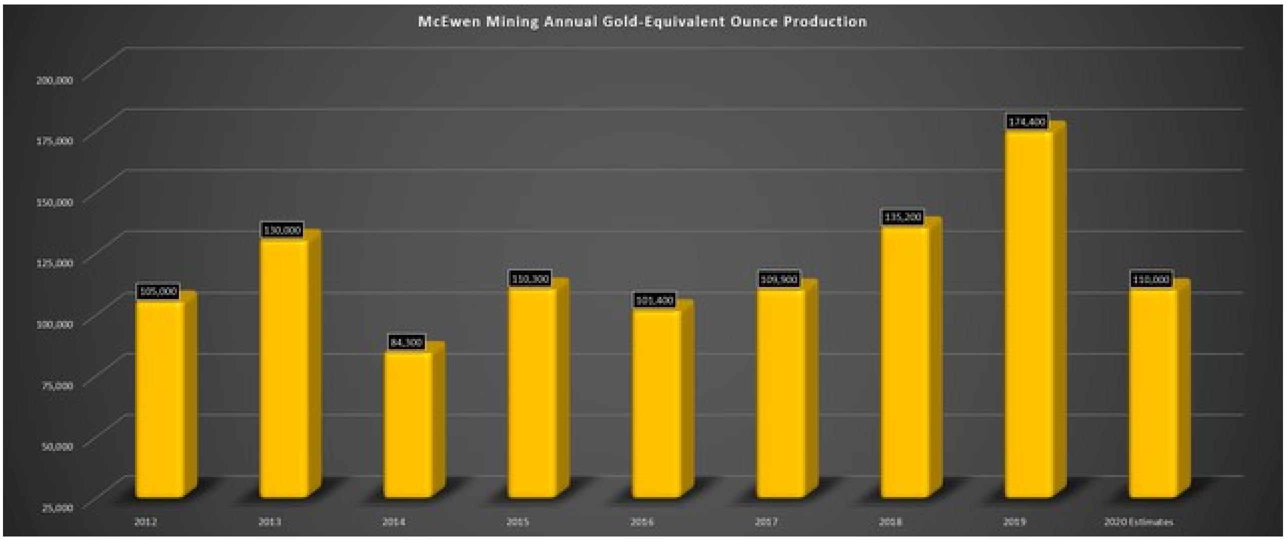
(Source: WorldoMeters.info)

The only silver lining from this sharp drop in annual gold production is that it's set the company up with the easiest year-over-year comps possible as production is likely to hit a 2-year low based on my FY2020 production estimates (110,000 GEOs). If we compare this to the company's estimates of 170,000 GEOs in FY2021, this offers the potential for 50% growth in annual output year over year, which the company may applaud if they hit FY2021 estimates. However, the below chart is very misleading as it doesn't show the previous trend, which helps put things in context.



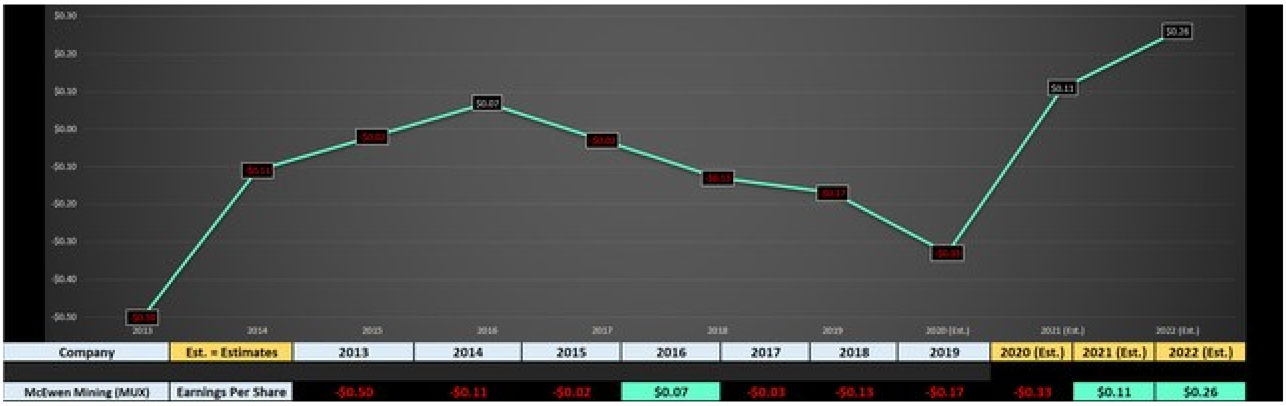
(Source: Company Presentation)

As shown below, even if annual output were to rise next year by 50% (110,000 GEOs to 165,000 GEOs), this would still translate to a compound annual production growth rate that's in negative territory relative to the FY2019 results. Therefore, while some investors might be getting bullish about this potential for sharp production growth, I would argue that it's the bare minimum we would expect, and there's no reason to get excited at all. In fact, even if we measure from FY2018's ~135,200 GEOs in production and come up with a moderate production growth rate of 26% over three years (FY2019: 135,200 GEOs vs. FY2021 estimates: 170,000 GEOs), the share count has increased from 333 million shares in Q4 2017 to ~404 million shares currently, offsetting the majority of the production growth. This explains why the company's earnings trend is so depressing relative to other names in the sector.



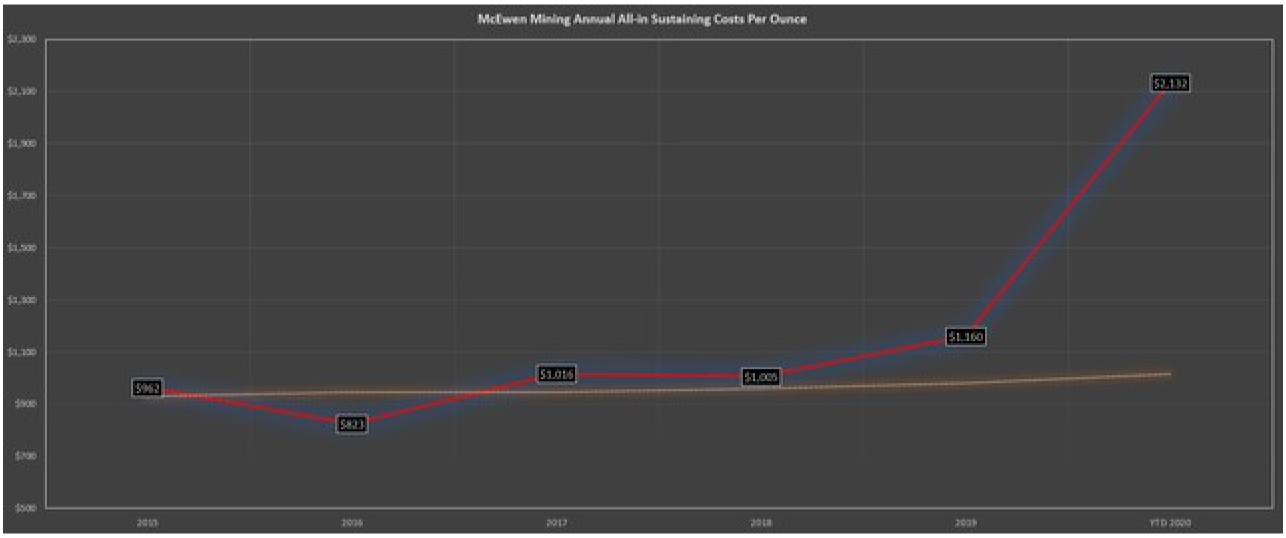
(Source: Author's Chart)

If we look at the earnings trend below, this is where the valuation issues arise, as there is no real earnings growth to speak of and minimal annual earnings per share in general. As shown below, McEwen Mining is on track to post net losses per share for its fourth year in a row, with FY2020 estimates coming in at a net loss of $0.33 per share. Fortunately, this trend is expected to improve materially, with McEwen Mining set to report $0.11 in annual EPS for FY2021, a new multi-year high for annual EPS. However, while this is undoubtedly an improvement, this leaves the stock trading at 9.5x FY2021 annual EPS based on a share price of $1.05. This is not cheap at all for a mid-tier gold producer with some of the highest costs in the sector and a cost profile that has climbed every year since 2016. In fact, my max forward P/E ratio, I use for the industry is 17, and the maximum P/E ratio to assign for a **laggard** like McEwen Mining would be 10. Therefore, assuming $0.11 in annual EPS, and a multiple of 10, the fair price for the stock sits at $1.10, which doesn't leave much room for upside from current levels.



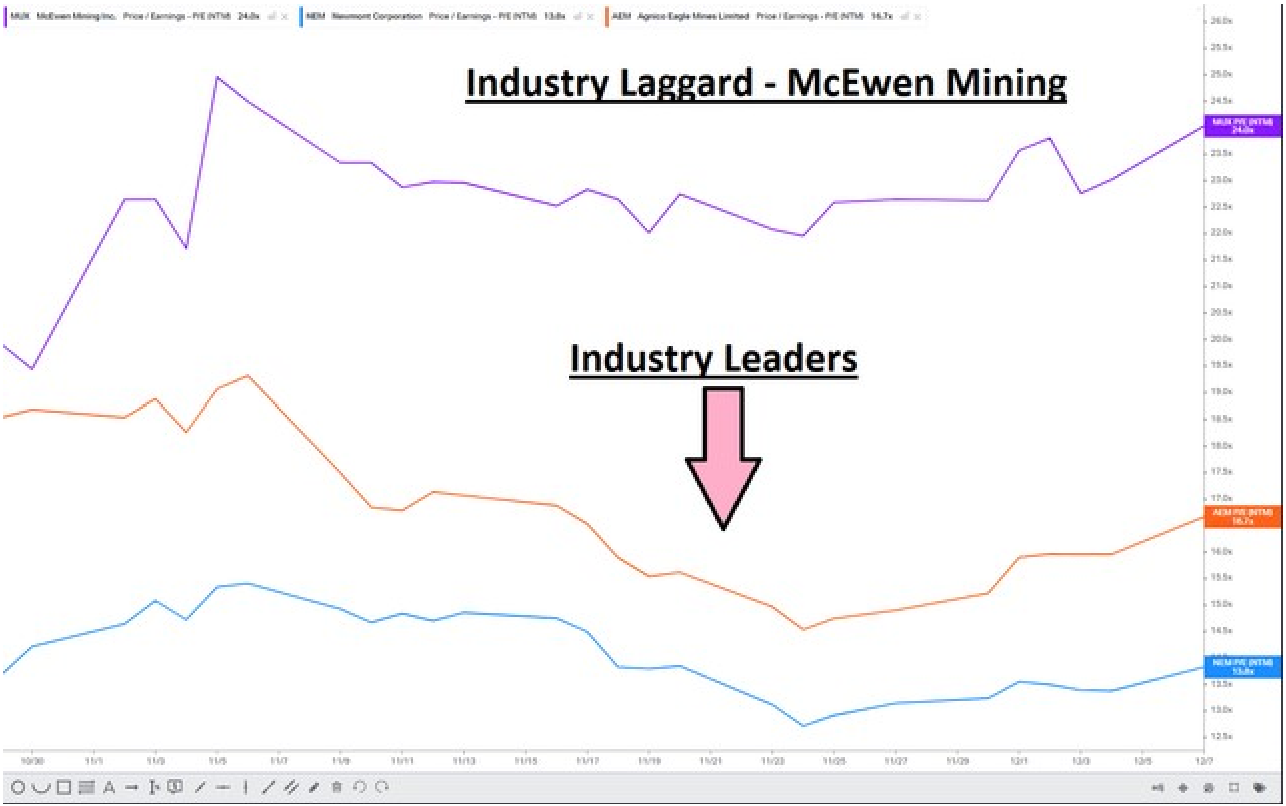
(Source: YCharts.com, Author's Chart)

Some investors might argue that a P/E of 10 is far too cheap for McEwen Mining when the S&P 500 (SPY) is trading at a forward P/E ratio of 20. However, cyclical companies typically trade at a deep discount to other industries, and so there is no reason to expect a premium valuation for a cyclical name. However, this is even more true for an industry laggard, where a multiple should sit in the low end of the fair value for the industry average. As noted earlier, the upper end of my range for gold miner P/E ratios is 17, and I believe it's generous to give McEwen Mining a multiple of 10. Let's take a look at why below:



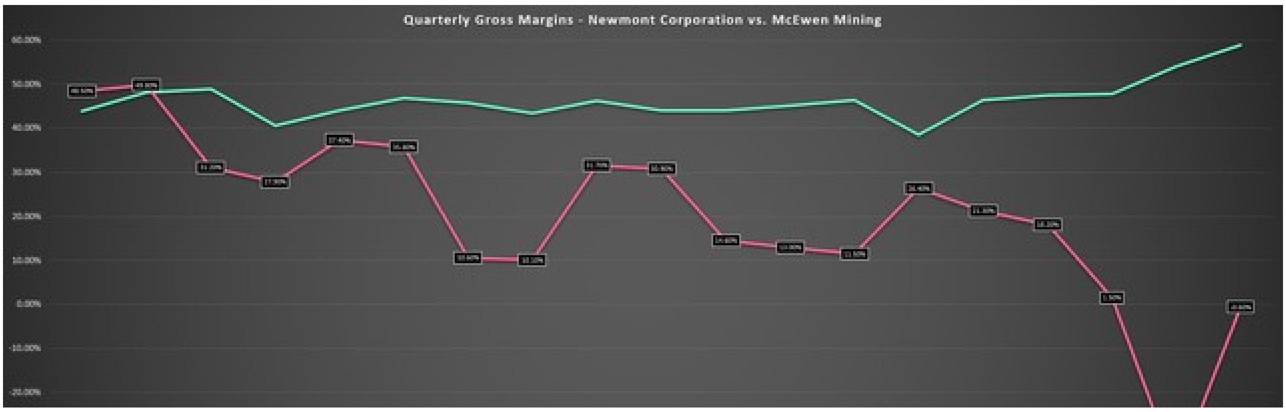
(Source: Author's Chart)

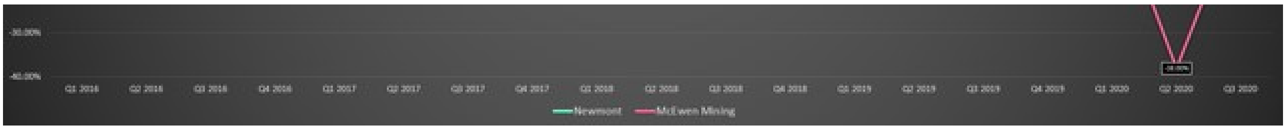
The chart above compares McEwen Mining's costs (red line) to the industry average (white dotted line), and we can see that its costs have consistently been above the industry average. However, this year has been even worse, with year-to-date costs coming in at above $2,100/oz. While these costs will drop as production increases and are likely to settle below $1,500/oz for FY2021, McEwen Mining continues to be one of the highest-cost producers in the sector Therefore, it makes zero sense that the stock would drop at a P/E ratio in the upper end of the range, which I use for the industry group. The other reason that the company should not trade in the upper end of the range is that the company has under-performing assets that have not operated as planned, with Black Fox and Gold Bar continuing to be disappointments.



(Source: Koyfin.com)

Some investors might disagree with my belief that the fair value for McEwen Mining is $1.10 and that the stock should not command a multiple above 10. However, even if they do challenge this belief, McEwen Mining has another problem: opportunity cost. As shown above, investors can buy industry leaders like Agnico Eagle (AEM) and Newmont Mining (NEM) at a lower forward P/E ratio than McEwen Mining with 2.00% plus dividend yields. Therefore, while one might see McEwen Mining as cheap at 24x forward earnings (Q4 2020 through Q3 2021) and ~9.5x FY2021 annual EPS estimates (Q1 2021 through Q4 2021), it's clear there's better value out there elsewhere. In fact, Newmont's margins dwarf that of McEwen Mining, as shown below, and the stock makes much more sense with a better operational track record, a more diversified asset base (10+ mines), and an industry-leading yield (2.70%).

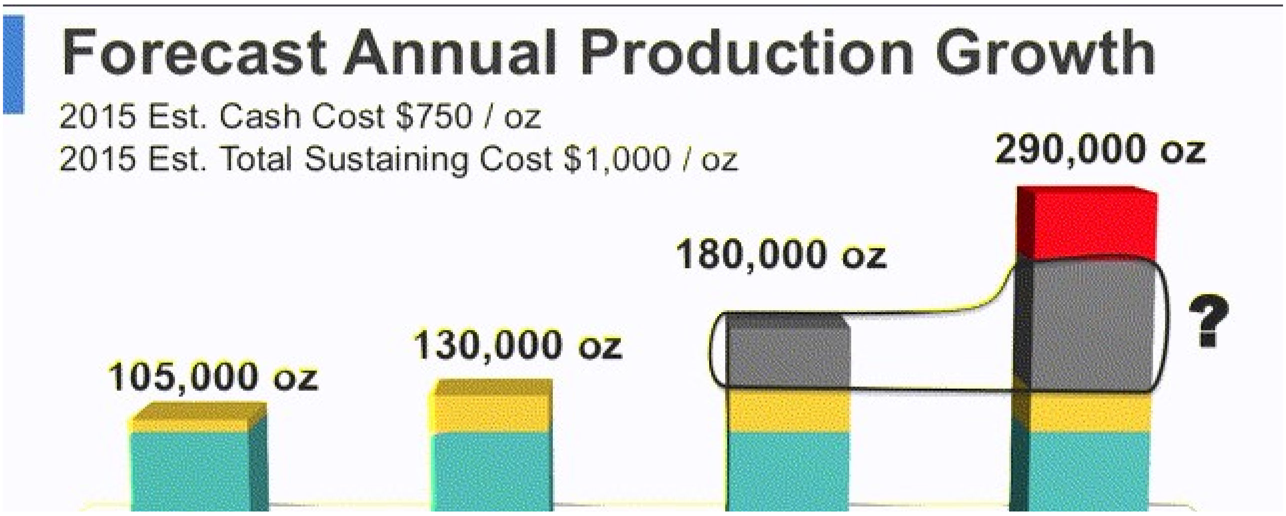


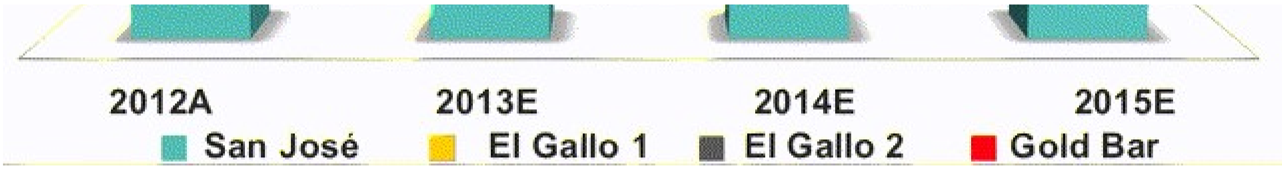


(Source: Author's Chart)

It's important to note that fair value does not preclude the stock trading above fair value, and we see stocks oscillate above or below fair value all the time. However, this does mean that the upside is limited if we see a rally in McEwen Mining, and I would expect the stock to have trouble with the $1.50 area if the stock does see a bounce in the new year. Given that I believe four industry leaders are trading for 30% below fair value, I don't see any reason to be rushing into McEwen Mining. This is especially true given McEwen Mining's dismal track record of creating value for shareholders. The best evidence of this track record is the share price, with the stock going nowhere since 2016 while gold is up over 50%.

(Source: TC2000.com)





(Source: Company Presentation)

McEwen Mining might look cheap to those looking at beaten-up names in the sector, but I would argue that the stock is actually expensive relative to its peers. *Worse, the stock has not shown that it can deliver against its expectations and guidance for years now, so there's not only limited upside to fair value but also higher execution risk. This is because the company's stock's annual production is still miles below its previous FY2015 goal of 290,000 GEOs (see 2013 company presentation). In summary, I continue to see the stock as an Avoid, and I believe there are dozens of better opportunities elsewhere in the sector. While a bounce is possible as the stock has had a horrible run the past few quarters, I would view any rallies to $1.50 as selling opportunities.*

Disclosure: I am/we are long GLD, NEM. I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.

Additional disclosure: Disclaimer: Taylor Dart is not a Registered Investment Advisor or Financial Planner. This writing is for informational purposes only. It does not constitute an offer to sell, a solicitation to buy, or a recommendation regarding any securities transaction. The information contained in this writing should not be construed as financial or investment advice on any subject matter. Taylor Dart expressly disclaims all liability in respect to actions taken based on any or all of the information on this writing.

Comments (17)

TGAgrippa

Taylor: Assuming no huge spike in precious metals prices that rescues all the leaky boats, given Rob McEwen's industry reputation (excellent), his lofty goals (inclusion in the S&P 500), the company's current plight (between a rock and a hard place), and considering Rob McEwen's age (70), do you have any feel for what the end game might be here? Care to speculate?

09 Dec 2020, 08:17 AM

Taylor Dart
Contributor Premium
Author's reply » Hi TGA,

I can speculate that I will buy a lottery ticket if McEwen Mining ever makes it into the S&P-500 as that will prove that miracles do happen. Outside of that, no real idea what occurs, 70 is still pretty young, and he looks like he's in great shape so I would imagine he would stay at helm for at least another 5 years. No idea on anything else though.

09 Dec 2020, 08:21 AM

Jack Snow

MUX has a very large copper deposit that is rarely mentioned. I consider it a hidden asset of great value with copper being so strong. Have you any comment or ideas about this deposit and what it might be worth? Thanks

09 Dec 2020, 05:59 AM

Taylor Dart
Contributor Premium
Author's reply » Hi Jack,

Don't really think it's worth anything as they've been discussing it for several years and have yet to monetize it. I would expect the market is giving them about zero value for it, and I would consider that about right. The project takes $2.4 billion to get into production, the company has about as good a chance as finally realizing its goal to be included in the S&P-500 as it does to build Los Andes.

09 Dec 2020, 06:06 AM

espuma a medida

Thanks for the report!

09 Dec 2020, 04:51 AM

GopherAg

MUX was one of my first gold companies purchased. I liked the fact the CEO had most of his personal money tied up in the company, so his financial interests were the same as other stockholders. Unfortunately, MUX seemed to make several bonehead moves and kept getting overextended. Fortunately I got out with only a small loss!

09 Dec 2020, 12:33 AM

Taylor Dart
Contributor Premium
Author's reply » Hi Jim,

Couldn't agree more. Good call getting out at a loss, sometimes its the best move before it splits wide open.

09 Dec 2020, 04:28 AM

Tom Turner

Looking at the management on their website, nobody has anything close to a geologic education or experience. This is a red flag.

08 Dec 2020, 10:54 PM

bver88

@Taylor Dart

serial DILUTERS and laggards INDEED - as there exist so many better choices in the pm space -

a rising tide may lift this BARGE, but EXCUSE laden management notwithstanding, I wouldn't touch this one with the pole used on the vessel = AVOID with capitals

blessings from nz Aotearoa, land of the long white cloud

08 Dec 2020, 10:13 PM

Brian Cellars

Thanks for the article. I took a small position already based on a comment in Sept. by Steve C.... that in February MUX was the best setup on his rubber band list of highly oversold stocks with a lot of pent up kinetic energy. Since it was nearly back to that price, I figured it was worth while taking a small position. Fortunately I waited till November and got it under 1.30 CAD. I'll heed your advice now and keep it as a small position.

08 Dec 2020, 07:52 PM

Amir Pourheidar

You were clearly biased only to the negative side and you didn't mention anything at all about the positive tailwinds. You didn't mention the reasons that the company performed terrible past years, because most of them were non-recurring events, and if mux returns to the same production figures of 2019 in 2021, with the gold price at all-time highs it will lift the stock. Most importantly you completely ignored the exploration successes, starting the Froome mine in Q3 2021 and huge copper play in Argentina.

08 Dec 2020, 07:31 PM

Taylor Dart

Contributor Premium

Author's reply » A) Exploration success meaningless until it translates into production results

B) Theyve been talking Los Andes Copper for years - minimal value and minimal progress monetizing it

C) Gold Bar is a disaster and not even doing 1/2 output it was supposed to

D) Black Fox bought as an underperforming asset - no surprise, still not performing but more $ sunk into it

E) when you have an unfortunate ‘non recurring’ event each year, the events themselves may be non recurring, but it’s clear that the underperformance and lack of execution is recurring

F) we’ve been hearing turn around for years. I liked the stock in 2016, bought at 1 sold at 3 and have said to avoid since, sometimes it’s best to be biased as a team that can’t deliver for years isn’t likely to suddenly turn it around. If you look at image from article, we were guided to have 290k GEOs in 2015, were in 2020 with 110k GEOs - were going backwards

G) management can absolutely improve and gold price helps but the company doesn’t have a single impressive asset, there’s simply no point in going down chain to mid tiers if you don’t have exceptional management with exceptional assets.

H) I never said stock can’t bounce, but it’s a sell at $1.50 if it gets there. Cheap stocks are cheap for a reason 95% of time (edited)

08 Dec 2020, 08:19 PM

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bver88

@Taylor Dart agree fully with points A thru H

thank you for an excellent unbiased NON cheerleading report-

blessings from nz Aotearoa, land of the long white cloud

08 Dec 2020, 10:24 PM

Taylor Dart
Contributor **Premium**
Author’s reply » Los Azules, not Los Andes.

How exactly do you think MUX is going to build a $2.4 billion capex mine when they had to dilute to built Gold Bar and it's a disaster of an asset thus far with industry-lagging costs and output 40% below expectations.

09 Dec 2020, 06:07 AM

SStrump

Made the most off of MUX the last couple of years than any miner Selling $1 Puts n Calls premium. They are locked into keeping it above $1 because of delisting which Rob does not want to happen ... So this cornered situation is about as good as it gets on a small capital base. His company is NOT going bankrupt with Gold's situation so only way is up. Back n forth on the options I go. jmo.

08 Dec 2020, 05:17 PM

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csaller
Marketplace
Thanks for the report

08 Dec 2020, 05:08 PM

Taylor Dart
Contributor **Premium**
Author’s reply » Hi Csaller,

Happy it was of value, thanks for reading!

08 Dec 2020, 05:11 PM