

First Majestic Silver: More Upside Potential Than You Think

Dec. 14, 2020 11:08 PM ET9 comments | 10 Likes

by: Don Durrett

Summary

- One of the few remaining large silver-focused miners.
- They recently lowered their costs and are in a much stronger competitive position.
- They have strong free cash flow and a strong balance sheet.
- I like their high-quality properties, large resources, and strong management team.

Stock Name	Symbol (US)	Type	Category	Share Price (US)	FD Shares	FD Mkt Cap (12/12/2020)
First Majestic Silver	AG	Silver	Mid-Tier Producer	\$10.77	228M	\$2.4B

I recently had a phone call with First Majestic Silver to get an understanding of their near-term and medium-term strategy. I had no plans to write-up an article, but I came away so impressed that I decided to share the information with you.

Company Overview

First Majestic Silver (NYSEARCA:FM) is a large silver producer in Mexico. They will produce about 22 million oz. of silver equivalent in 2020 (100% of their revenue comes from silver and gold). They have 3 producing mines in Mexico.

They have relatively low costs, with their break-even cost (free cash flow) around \$16 per oz. They expect this cost level to remain through 2023, which is an impressive expectation. They are currently valued at about 15x free cash flow and I would expect that to continue if they maintain a strong balance sheet and their current cost structure.

They have \$138 million in debt and \$232 million in cash. They accumulated that debt from the acquisition of Primero and plan to pay it off soon. Their strategy is to remain cash-focused with a clean balance sheet free of debt. This is very shareholder-friendly.

They recently announced a dividend at 1% of net revenue (this is total revenue minus smelter costs, which are minimal). This currently is a tiny dividend, with a yield well below 1% the share price, but it is a start. At some point, they will be loaded with cash and plan to give part of it back to shareholders.

They plan to expand production from 22 million oz. AGEQ in 2020 to 30 million oz. AGEQ by 2023. That's a big jump and the market seems to be ignoring it. It clearly is not priced in. This growth came from steady exploration. FM usually has 20+ drill rigs turning in Mexico.

Currently, FM is drilling a significant discovery on leases they own that surround Silvercrest Metal's Las Chispas property. This has become one of the most prolific properties in Mexico. This discovery could lead to more production growth.

Tax Issue

FM has a large potential tax liability from its Primero acquisition and the way the silver stream was taxed. On their most recent MDA on Sedar.com, they list a potential \$192 million tax liability, plus potential interest and penalties. Ouch. I doubt they will have to pay the entire amount. Currently, they are appealing the tax liability in the Mexican appeals court, and they expect it to eventually go to the Mexican supreme court.

This tax issue could take a few more years to be resolved. The ugly part is that some institutions will not purchase FM shares until this tax liability issue is resolved. That puts downward pressure on the stock. One positive factor regarding this dispute is that the Canadian government is trying to help out with this tax issue and it could potentially get resolved diplomatically instead of through the courts.

Management

FM has an excellent management team, including their CEO Keith Neumeyer, who I consider one of the best in the business. He built this company from its inception and has done an excellent job with strategy and execution.

He has focused on being primarily a silver producer and has limited the dependence on offsets. Currently, they have zero offsets and only produce gold and silver. He has also focused on maintaining a strong balance sheet, which I think is critical for returning shareholder value.

Another thing I like about Keith is his vision for higher silver prices. He has been vocal in his belief that silver prices are going much higher. I agree with him and it gives me confidence that he will be positioned well for this outcome.

Strategy

They have a somewhat unique strategy of being conservative, yet growth-oriented. They want to grow, but they want to be smart about it. They did acquire Primero, but their style is not to be aggressive with acquisitions. They prefer to focus on finding new mines on their large landholdings in Mexico.

They do want to diversify out of Mexico, but this is not a top priority or their focus. They are looking for potential deals outside of Mexico, but will probably wait until their balance sheet is overflowing with cash before making a big acquisition. They want to be selective and not overly aggressive. The good news is they have significant production growth for the next 3 years, so they can be patient looking for deals.

Balance Sheet

(refer to Sedar.com)

They have about \$232 million in cash and \$138 million in debt. They have strong free cash flow and will be free of debt very soon. This gives them one of the better balance sheets for large silver miners.

Risk/Red Flags

Their only red flag is their focus in Mexico, which is steadily losing its reputation as a mining-friendly country. The tax issue that FM faces is a good example of the direction Mexico is trending. There have also been strikes and road blockages in recent years. Also, an increase in crime has become an issue for some mining locations.

The reason to own FM is for its upside potential. It should be noted that this upside is dependent on silver prices rising. Conversely, if silver prices fall, then their share price will also fall. No silver miner is immune to falling silver prices. That said, with their relatively low costs, they should be able to survive any downturn until we finally do get a break out in silver.

Future Valuation

I'm going to use two silver prices and two timeframes. I'm also going to use an all-in (break-even) cost of \$20 per oz. FM is expecting to keep their all-in cost around \$16 per oz. for the next 3 years, so \$20 is conservative.

I'm going to use 25 million oz. of AGEQ production. They plan to increase production from 22 million oz. AGEQ in 2020 to 30 million oz. AGEQ by 2023. I consider 25 million oz. AGEQ to be a conservative number for a future valuation.

Scenario #1 (\$50 Silver Price)

- Timeframe: 2 years.
- Estimated All-In (break-even) Cost Per Oz.: \$20
- Estimated future annual free cash flow: 25M oz. x \$30 = \$750 million
- Estimated future market cap: \$750 million x 15 = \$11 billion
- Comparing the current market cap (\$2.4 billion) to the future market cap (\$11 billion), you get a potential 350% increase.

Scenario #2 (\$100 Silver Price)

- Timeframe: 3 years.
- Estimated All-In (break-even) Cost Per Oz.: \$20
- Estimated future annual free cash flow: 25M oz. x \$80 = \$2 billion
- Estimated future market cap: \$2 billion x 15 = \$30 billion
- Comparing the current market cap (\$2.4 million) to the future market cap (\$30 billion), you get a potential 1,100% increase.

For either valuation to occur, the price of silver needs to reach at least \$50, their all-in costs have to remain below \$20, and their production needs to reach 25 million oz. AGEQ.

I think their upside will land somewhere between 350% and 1000% in 2 years. If silver doesn't reach at least \$50 within 2 years, I will be surprised. One thing to be excited about if you are a shareholder is if silver prices exceed \$50. The leverage that FM has for higher silver prices is quite stunning. For example, if silver goes above \$50, for every \$10 move, FM's free cash flow could increase by \$250 million (assuming 25 million oz. AGEQ production).

Conclusion

First Majestic has much more upside potential than most investors realize. It is quite conceivable that they could be a 10 bagger at \$100 silver in three years when they reach 30 million oz of AGEQ production. For a quality producer to have that kind of upside potential is quite stunning. Perhaps, we won't reach \$100 silver in 3 years, but if we get anywhere close, FM should perform incredibly well.

Note: You can check the data included in this analysis on the company website.

Disclosure: I am/we are long AG. 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.

Comments (9)

alexander.friedrich

With a silver price of 50 Dollar/oz every miner has upside potential... I doubt that any investor will pay with these silver prices these valuations. This analysis is not serious. Sorry for my poor English, I'm from Germany

15 Dec 2020, 02:01 AM

Don Durrett

Contributor Premium

Author's reply » @alexander.friedrich If you're not expecting \$50 silver, then I don't see the point in investing in silver miners. There is too much risk and not enough reward. (edited)

15 Dec 2020, 03:26 AM

mattgrim81

Premium

Where do you get that all of there revenue comes from gold and silver? Pretty sure like all silver miners they receive zinc and lead bi credit's

15 Dec 2020, 01:16 AM

Don Durrett

Contributor Premium

Author's reply » @mattgrim81 You can check, but I'm sure I'm correct. I know, it's pretty shocking that currently they have no offsets. (edited)

15 Dec 2020, 03:25 AM

urbanabkk

AG Market Cap 2.3B USD / Revenue 2019 245.5M USD = 9.37

FSM (Fortuna Silver) Market Cap 1.14B USD / Revenue 2019 257M USD = 4.44

HOC (Hochschild) Market Cap 1.34B USD / Revenue 2019 755.7M USD = 1.77

PAAS (Pan American Silver) Market Cap 6B USD / Revenue 2019 1.3B USD = 4.61

FRES (Fresnillo) Market Cap 11B USD / Revenue 2019 2.18B USD = 5.04

If you want leverage to the price of silver I would look elsewhere. AG is over valued compared to their peers.

15 Dec 2020, 12:39 AM

Don Durrett

Contributor Premium

Author's reply » @urbanabkk Nice list. Thanks for sharing. I own all of them except Fresnillo. And I agree that Hochschild has the biggest upside potential of all of them.

I wrote the article because of the lack of perception of FM's upside potential. Your list highlights (which

is to be expected) that most of the quality silver producers have high upside potential. (edited)

15 Dec 2020, 03:30 AM

lifewithtombg

Conviction is needed. Slow and steady wins this game.

14 Dec 2020, 11:44 PM

pappazan

It's been a loooooonnnngggg wait for this stock to do something...anything!

14 Dec 2020, 11:18 PM

Don Durrett

Contributor Premium

Author's reply » @pappazan Indeed, good point. This article shows that the wait is going to be worth it. The next 2-3 years should be a good ride.

15 Dec 2020, 03:32 AM