Endeavour Silver Corp.

Second Quarter 2014 Financial Results

Conference Call Transcript

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Speakers:

Meghan Brown
Director, Investor Relations

Bradford Cooke
Chief Executive Officer

Dan Dickson
Chief Financial Officer

OPERATOR:

At this time, I would like to turn the conference over to Meghan Brown, Director of Investor Relations. Please go ahead.

MEGHAN BROWN:

Thank you, Operator. Good morning everyone and welcome to the Endeavour Silver Corp. Second Quarter Conference Call. On the call today we have the Company's CEO Brad Cooke, as well as our CFO 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 2014 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. The Company does not intend to and does not assume any obligation to update such forward-looking statements or information other than as required by applicable law.

With that, I'll turn the call over to Endeavour's CEO Brad Cooke.

BRADFORD COOKE:

Great. Thanks Meghan, and welcome everybody to this conference call on Endeavour's financial and operating results for the second quarter of 2014. As usual I will run through the highlights of our second quarter and make a couple of comments on our outlook for the third quarter and then open it up for questions and answers. Also on the line is our CFO, Dan Dickson, for anybody wanting to know more about numbers.

So right off the top, let's talk about operations. Silver production in the second quarter was up year-on-year to 1.67 million ounces of silver. Gold production was down 24% year-on-year to 15,000 ounces compared to the second quarter of last year. Our silver equivalent production dipped a little bit - 6% - to 2.6 million ounces in the second quarter compared to Q2 of last year.

Our bullion inventories at quarter end were about 120,000 ounces of silver and 270 ounces of gold in bullion; concentrate inventories were about 87,000 ounces of silver and 1,200 ounces of gold. Those numbers are down a bit from our Q1 inventories but up sharply from our year end inventories.

Those operating numbers drove our financial results for the second quarter with revenue down 23% to $55 million, primarily due to the metal prices. Mine operating cash flow dipped 25% to $20 million; cash flow from operations, however, only dipped 4% to $12 million. EBITDA was down 20% to $13 million. Our adjusted loss of $0.3 million is down—an improvement, significant improvement from the $2.7 million loss in Q2 last year but down from our gain in Q1. Similarly, the net loss of $0.3 million in Q2 this year was comparable to the $0.4 million loss in Q2 last year and down from our gain in Q1 of this year.

All in all, our consolidated quarterly and year-to-date silver production was up relative to 2013 thanks to higher silver grades and recoveries, offset by lower tonnage. I should point out that lower tonnage processed in Q2 this year compared to last year was primarily the result of returning the leased Las Torres plant near our El Cubo mine. Last year, if you recall, we were able to significantly boost the Bolañitos mine production and run those extra ore tonnes over to the Las Torres plant for processing. This year we're simply running the Bolañitos mine and plant at its 1,600 tonne per day capacity; hence the reduction in tonnage throughput year-on-year.

Our quarterly and year-to-date gold production is down compared to last year and again it's directly related to the overproduction from the Bolañitos mine last year; the result of lower grades and tonnage throughput offset partly by higher recoveries.

So the silver equivalent production is down a bit on a quarterly basis, up a bit on a yearly basis and we've commented on what's going on there; the reduction at Bolañitos this year largely because of giving back the Las Torres plant, offset by increases in production from both Guanaceví and El Cubo.

We did unfortunately have two fatalities in late March, early April at Guanaceví and El Cubo and they did unfortunately impact our operating numbers, and therefore our financial numbers. Because safety is number one at Endeavour we immediately put each of the three mines into temporary closures to completely review and retrain our safety procedures and policies throughout the workforce, and we've also, since that time, conducted two independent reviews of our safety programs and hired a full-time safety specialists who is currently working with our mine safety teams on a full one-year contract to really drive home the point that safety is number one. We've also been implementing other safety training procedures as recommended by Synergy, an independent safety consultant.

So, we do expect that our first half performance, both operating performance and financial performance, is probably a good guideline for our second half performance. We had outperformance in Q1 that was by intent. We wanted to put the pedal to the metal in Q1 and really get a head start on the year. Q2, obviously, was a little bit of a step back from our Q1 performance, both operationally and financially, but on average the first half is what we expect to do in the second half.

So we're still well within our guidance in terms of production and costs for the year.

Since completing the rebuild of the El Cubo mine plant and infrastructure in Q2 last year, we have focused on trimming our operating costs and expanding our profit margin, and I would like to point out that we've been very successful at growing our free cash flow and our balance sheet. Since June 30 of last year we've added $33 million of net cash to the balance sheet, and even in Q2 while our cash balance didn't change - it remained around $44 million - we did actually pay off more of the debt on our line of credit.

So our outlook to year end remains very positive on both the metal prices as well as our silver and gold production. We're very aggressively exploring brownfield targets around all three mines to boost our reserves and resources. At San Sebastián, which was our greenfields discovery of the last two years, we are focused on continuing to expand that resource by aggressively drilling there this year in advance of completing our mine permitting and an economic study later this year.

So, Operator, I think that is the sum total of my comments. Let's open the call up for questions and answers.

OPERATOR:

Thank you. The first question today comes from Benjamin Asuncion of Haywood Securities. Please go ahead.

BENJAMIN ASUNCION:

Good morning guys. Thanks for taking my questions here. I just have a few questions, just some housekeeping issues here. Looking at Bolañitos and Guanaceví on the quarter and when we look quarter-on-quarter on the operating costs on a per tonne basis we saw an increase. Could you give us some colour on what drove those increases and whether or not some of those drivers as sustainable or sort of more one-time impacts on the quarter?

DAN DICKSON:

Hey Ben, it's Dan, Dan Dickson the CFO. Thanks for your question. We did have a couple of not necessarily one-time issues but PTU bonuses get settled in the second quarter and from what we accrued for 2013 we actually settled for a little higher at both Guanaceví and Bolañitos, even higher at Bolañitos than Guanaceví which drove really our cost per tonne from $85 up to about the $88-89 range for Bolañitos. Then the remaining difference about $4 was just variance, regular variance with regard to day-to-day operations.

I think going forward for Bolañitos, still in $85 to $88 range is fair, and for Guanaceví I'd expect it to still stay around the $105-$103 range for the back half of the year is our expectation.

BRADFORD COOKE:

Thanks, Dan. This is Brad and just for the others on the call I'd like to clarify that PTU is the annual profit sharing tax with the Mexican workforce, and it occurs once a year, usually in the second quarter and therefore is a once-a-year charge.

BENJAMIN ASUNCION:

Perfect. Just one other question here, on the recovery side. So far in the first half this year we've seen sort of stronger recoveries, both at Guanaceví and Bolañitos. Can you give us some colour on what's driving those?

BRADFORD COOKE:

Well, at Guanaceví we have seen over the last year and a bit slowly improving recoveries as we tweaked the process plant. We're also gaining the benefit of our dry stack tailings, not only in that we're recycling all of that water back into the plant but by stacking the dry tailings on top of the old wet tailings we're actually compressing the wet tailings and squeezing a little bit of gold and silver-bearing recycled water out of them and that's helping the overall recoveries. At Bolañitos it's nothing more than improved recoveries in the plant. We've tweaked the process and obviously it's a continuous thing; we always look to see if we can continue to improve recoveries.

BENJAMIN ASUNCION:

Okay. Perfect. Then just the last thing at El Cubo. Could you just give us some colour on the progress of development and kind of how you are in relation to your budget to let's say attaining reserve grades? You know, looking back at guidance at the beginning of the year you were talking about the upper end of guidance for throughput was around the 1,550 tonnes per day. When do you think you'll be able to attain that kind of run rate?

BRADFORD COOKE:

Yes. Thanks, Ben. We had made great strides on both tonnes and grades at El Cubo in Q4 last year and Q1 this year. Q2 was a step backward unfortunately in both tonnes and grade, largely due to the shut down of the Santa Cecilia mine after the fatality at El Cubo. We're trying to make up for lost time. We haven't changed our guidance there at all. We are still hoping and expecting to get to 1,500 plus tonnes per day by year end, but we do have a little bit of catch-up to do there.

BENJAMIN ASUNCION:

Okay. Perfect. Well, thank you very much for answering my questions.

BRADFORD COOKE:

Thanks, Ben.

OPERATOR:

The next question is from Bhakti Pavani of Euro Pacific Capital. Please go ahead.

BHAKTI PAVANI:

Hi guys. Just a couple of questions. The metal prices still seem to be depressed and you have been implementing a lot of cost-cutting strategies, so what would be your strategy going forward? How do you intend to manage the cash costs and all-sustaining costs, or is there any further room of decreasing those costs?

BRADFORD COOKE:
There's always room to cut costs but it's always in the context of the metal prices, and so when the gold and silver prices went over a waterfall last April, a year ago April, and stayed low for much of last year, we responded quickly and accordingly to slash all of our discretionary costs across the board. Many of those cost-cutting measures are sustainable.

Where we're looking at increasing our spending this year is on long-term sustainable expenditures, both capital and exploration. For instance, we'd launched a very significant mine redevelopment program last year and the year before at El Cubo; put the brakes on some of that and now we're back aggressively developing new areas we've discovered at El Cubo to facilitate long-term ramp up of production there.

In terms of exploration, we spent close to our budget last year and we came up with a fairly careful $10.5 million budget this year. Thanks to our ability to dramatically increase our free cash flow over the last four quarters, we did decide at the Board level late in Q1 that we would slowly increase our exploration and capital spending in Q2/Q3 so long as we were getting the free cash flow that is needed to basically fund those programs. And as you can see from our Q2 numbers, we were able to significantly increase our capital and exploration spending without at all impairing the balance sheet; in fact we improved the balance sheet in Q2.

BHAKTI PAVANI:
So the plan to improve the balance sheet and paying down the debt is still on the cards, right?

BRADFORD COOKE:
Oh yes. We'd like to see $25 million or less on the line of credit by year-end and $50 or more in cash by year end. That's been very much our agenda, to have a stronger balance sheet this year and we've been very successful at improving it.

Now, let's talk about my views on metal prices and therefore costs going forward. We're bullish on gold and silver. We think this year is a turning point for the precious metals. We're not quite seeing it yet but even the move from kind of $19 per ounce silver to $20 per ounce is very significant for our company. If you look at our internal cash flow models, our EBITDA model for the Company is $11 million of additional EBITDA for every $1 move in the price of silver this year; that's on an annualized basis. So that's a pretty significant jump in EBITDA and it funds more capital and exploration.

I expect going forward that Q3 and Q4 we are going to see more progress in the silver and gold prices. Every dollar increase in the silver price, and every corresponding $60 increase in the gold price makes a very significant impact on our bottom line.

So we feel comfortable now with our accelerated capital and exploration spending in Q2 and Q3. Most likely it will be completed in Q4 and the spending will actually dip again in Q4 as we bring, hopefully, San Sebastián to the Board for a decision. Then next year, in the context of higher metal prices, we're again hoping that we can make a positive decision to develop a fourth mine at San Sebastián.

BHAKTI PAVANI:
That sounds good. Now that you have mentioned that as you have more free cash flow the plan is to pay down the debt and also to increase the capital spending program, so when it comes to capital spending, are you focusing only on San Sebastián or how is that capital allocated over the three mines and to the drilling?

BRADFORD COOKE:
Sure. This year the lion's share of capital is mine development and the lion's share of that is El Cubo. This year the exploration budget is largely Bolañitos, El Cubo and San Sebastián with a little bit for Guanaceví.

BHAKTI PAVANI:
Okay. Also, you are almost half way through the third quarter. Are there any kind of issues that you have been chasing? Because a couple of the other companies that I spoke to have been having some issues in the area. So have you to date faced those?

BRADFORD COOKE:

Well there's nothing new. Obviously we faced the safety issues at the end of Q1 and we feel that we've fully dealt with those, but safety is an ongoing thing. It's not a static issues; it's something that you try and deal with every day, month and year.

Other than that, there's really nothing new on the horizon for us. The operations are actually running very well.

BHAKTI PAVANI:

Okay. Perfect. That's it from my side. Thank you very much.

BRADFORD COOKE:

Thanks, Bhakti.

OPERATOR:

The next question is from Howard Flinker of Flinker & Company. Please go ahead.

HOWARD FLINKER:

Hi Brad.

BRADFORD COOKE:

Hello Howie. How are you?

HOWARD FLINKER:

Good, and you?

BRADFORD COOKE:

Good, thank you.

HOWARD FLINKER:

You're welcome. I have two arithmetic questions. Last year in the second quarter, mark-to-market derivative liabilities and mark-to-market loss on contingent liabilities; are those the

Mexican tax or is that something else?

DAN DICKSON:

Hey Howie, this is Dan, the CFO.

HOWARD FLINKER:

Hi Dan.

DAN DICKSON:

Those are something else. The mark-to-market on derivative liabilities were for warrants that were outstanding that were priced in Canadian dollars and we report in US dollars.

HOWARD FLINKER:

Okay.

DAN DICKSON:

So we recognize that derivative liability. The contingent liability is payments owed to AuRico if the gold price averaged $1,900, $2,000 or $2,100 per ounce by July 2015. At this point in time it doesn't like gold's going to average $1,900 so we're not probably going to have make the payments. So the contingent liability is held at about $100,000 which is valued by a third party for us.

HOWARD FLINKER:

What are the trigger prices again to AuRico?

DAN DICKSON:

Gold's got to average $1,900 for a $10 million payment; $2,000 for another $10 million payment; and then $2,100. Average it over a year to make those payments. So right now it would be great if we could pay that but it's not looking like we're going to.

HOWARD FLINKER:

The terminus of that bonus is the end of 2015?

DAN DICKSON:

July 12, 2016.

HOWARD FLINKER:

I'll bet you $0.05 you have to pay it.

BRADFORD COOKE:

Howie, we would be thrilled to make a $10 million payment to AuRico because if we do it means that gold will average $1,900 per ounce or better between now and next July.

HOWARD FLINKER:

Right. I knew what I said. I will add something else that you probably did not notice but—and most people did not pick up. Yesterday, some guy who's name I can't remember published inventory data at the Shanghai Exchange for the silver inventory and he had a few photos of the image from the monitor where he had receipts or totals or whatever from the Shanghai Exchange. I don't have all the details of administration in Shanghai - maybe you could help me - but between March of last year and June of this year, inventories of silver in the exchange dropped 90%. That's a rather astonishing number. I don't know—as I said, I don't know how they trade silver in Shanghai. I think you have to deliver physical product to the buyer or transfer the actual ownership of physical product you have in the warehouse to the buyer, so the physical product remains, but it was extracted. It's rather startling to me that there would be almost no inventory left in Shanghai. If it's true - and so far I tend to believe him - that bodes really well for silver in the very near future.

BRADFORD COOKE:

Yes. Thanks, Howie. Obviously I'm not an expert on silver and gold inventories worldwide but my only comment here is that last year was quite a watershed fall in the prices of both metals and I suspect that people depositing silver into inventory in Shanghai lost interest quickly and in fact started drawing silver away from the—basically the tide turned from sellers to buyers is what I'm saying, which explains the drop in inventory in Shanghai.

HOWARD FLINKER:

Yes, I know.

HOWARD FLINKER:

Even so, if in Shanghai—if those numbers are correct in Shanghai, I know they can't go below zero and it took only 15 or 16 months to get from 100% to 10%.

BRADFORD COOKE:

Yes.

HOWARD FLINKER:

If it's true, there's not much time left before demand emerges. We'll know pretty soon. It could be phony but…

BRADFORD COOKE:

One of the reasons I'm bullish.

BRADFORD COOKE:

It could be a phony but the number was so striking it really caught my eye and I thought I'd pass it on.

BRADFORD COOKE:

Great. Thanks, Howie.

BRADFORD COOKE:

You're welcome.

OPERATOR:

The next question is from Christos Doulis of PI Financial. Please go ahead.

CHRISTOS DOULIS:

Hey Brad, just a quick question on costs. It was brought up a little bit earlier but I didn't hear your comment on El Cubo. I noticed that El Cubo costs seemed quite a bit higher in the quarter. I've got it at $112 per tonne versus $92 per tonne in the previous quarter. Any comment here? Are we going to see it come back down again? Is this—the bonus that you're referring to, is that what's driving this, or should we expect higher costs above that $92 at Cubo going forward?

DAN DICKSON:

Hey Christos, it's Dan. Yes, with El Cubo it's more of a function of tonnes – the drop in tonnes and us shutting down the Santa Cecilia area. It took a long time for us to get that up and running to where we saw it in Q1, so we were kind of eating through a lot of costs with guys not producing the same tonnes. We do expect that cost per tonne to come back into the $95 range for the year. We expect that to come back down below $100 per tonne in Q3 and Q4; it's just a function if we can get those tonnes out or not. Like Brad said, everything so far in Q3 has been steady as she goes, so hopefully it continues.

CHRISTOS DOULIS:

Okay. Thanks guys.

OPERATOR:

Once again, anyone wishing to ask a question may press star and one at this time. The next question comes from Andrew Kaip of BMO Capital Markets. Please go ahead.

ANDREW KAIP:

Good morning guys.

BRADFORD COOKE:

Hi Andrew.

ANDREW KAIP:

Hi. Hey Brad, I've got just one question and it has to do with your corporate expenses. They've been trending upward over the last couple of quarters and I'm wondering if you can provide some insight into where you expect them through the remainder of the year.

DAN DICKSON:

Hey Andrew, it's probably a good question for me. I think if you look over the past four quarters the trend is up, and you'll see it in the G&A note, it's actually on the stock-based comp basis. So we actually give out on an annualized basis at the AGM, we provide options to staff and 20%

vests immediately. So you'll always see that Q2 is our highest quarter for stock-based comp and then 20% vests over time. But there's a breakdown between labour and direct charges, and stock-based comp. I think if you see it on a direct charge basis, we're relatively flat even if you look over the eight quarters. The same for labour: we're relatively flat. We had about two or three quarters ago some bumps in labour related to some severance costs but in general our G&A is relatively flat and we expect stock-based comp to be about $10- or $11 million for the year.

ANDREW KAIP:

Okay. Thanks very much.

DAN DICKSON:

No problem.

OPERATOR:

There are no further questions at this time. I will now hand the call back over to Bradford Cooke for closing comments.

BRADFORD COOKE:

Well thank you, Operator, and thank you everybody for listening in. We're looking forward to a more bullish Q3 and Q4, both in terms of gold and silver prices and in terms of our financial and operating performance. We'll talk to you in three months. Thank you.

OPERATOR:

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