

Transcript of
Fortuna Silver Mines, Inc.
Q4 2022 Earnings Conference Call
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Participants

Carlos Baca - Director, Investor Relations
Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder
Paul Weedon - Senior Vice President, Exploration
Cesar Velasco - Chief Operating Officer, Latin America
David Whittle - Chief Operating Officer, West Africa
Luis Dario Ganoza - Chief Financial Officer

Analysts

Adrian Day - Adrian Day Asset Management

Presentation

Operator

Greetings and welcome to the Fortuna Silver Mines Fourth Quarter and Full Year 2022 Financial and Operational Results Call. At this time, all participants are in a listen-only mode, and a question-and-answer session will follow the formal presentation. [Operator Instructions]

I will now turn the conference over to your host, Mr. Carlos Baca, Director of Investor Relations. Please go ahead.

Carlos Baca - Director, Investor Relations

Thank you, Ali. Good morning, ladies and gentlemen. I would like to welcome you to the Fortuna Silver Mines fourth quarter and full year 2022 financial and operational results call. Hosting the call today on behalf of Fortuna will be; Jorge Alberto Ganoza, President and Chief Executive Officer; Luis Dario Ganoza, Chief Financial Officer; Cesar Velasco, Chief Operating Officer, Latin America; David Whittle, Chief Operating Officer, West Africa; and Paul Weedon, Senior Vice President, Exploration.

Today's earnings call presentation will be available on our website, fortunasilver.com. As a reminder, statements made during this call are subjected to the reader advisories included in yesterday's news release and in the earnings call presentation. Financial figures contained in the presentation and discussed in today's call are presented in US dollars, unless otherwise stated.

Before I turn over the call to Jorge, I would like to indicate that this earnings call contains forward-looking information that is based on the company's current expectations, estimates and beliefs. This forward-looking information is subject to a number of risks, uncertainties and other factors. Actual results could differ materially from a conclusion, forecast or projection in the forward-looking information.

Certain material factors or assumptions were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information. Additional information about the material factors that could cause actual results to differ materially from the conclusion, forecast or projection in the forward-looking information and the material factors or assumptions that were applied in drawing a conclusion or making a forecast or projection as reflected in the forward-looking information is contained in the company's Annual Information Form and MD&A which are publicly available on SEDAR. The company assumes no obligation to update such forward-looking information in the future, except as required by law.

I would now like to turn the call over to Jorge Alberto Ganoza, President and Chief Executive Officer and Co-Founder of Fortuna.

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Thank you, Carlos and greetings to all. And safety first, we closed the year with a strong trend of improvement on key safety performance indicators, which year-over-year continue coming down as a result of multiple initiatives implemented across the business.

Our KPI for total recordable injury rate closed the year at 2.3, down from 3.2 in 2021 and below the industry average of 2.9. Lost time injury rate also showed a strong improvement, ending the year at 0.39, down from 0.53 in 2021. We recorded five lost time injuries in the year, down from six in 2021. However, all these work was tainted by a fatal accident at our Lindero Mine in January 2022. Safety is a precondition for business, and we remain firmly committed to a zero harm work environment.

On December 21st, we made public our position statement on the adoption of the Global Industry Standard for Tailings Management. Our commitment to generate shared value over the long-term for our stakeholders involves adapting strategically our business practices and standards, enabling us to better cope with risks, opportunities and heightened expectations. We consider Tailings Management to be paramount for responsible mining, and the adoption of GISTM allows us to refine our approach to save Tailings Management in a way to ensure operational excellence.

On March 14th, we informed of positive news coming from Mexico, with the Court granting a permanent injunction to our San Jose Mine, effectively protecting the 12-year environmental impact authorization of the mine. Cesar, our Chief Operating Officer for LatAm will expand on this later on the presentation.

Our business generated adjusted net income of \$7.2 million or \$0.02 per share in the fourth quarter, in line with analyst consensus, and for the full year, \$42.4 million or \$0.15 per share slightly ahead of the analyst consensus of \$0.14. Net income, however was negatively impacted by non-cash impairment charges, net of taxes adding to \$164 million coming from Yaramoko, Lindero and San Jose Mines. Luis, our CFO will expand on the impairment analysis drivers later in the presentation.

We generated free cash flow from ongoing operations of \$4.4 million in Q4, and a healthy \$69.1 million for the year. These after servicing sustaining CapEx and corporate expenses. Production for the year was well within the range provided in our 2022 guidance. We delivered 259,000 ounces of gold and 6.9 million ounces of silver or 402,000 ounces of gold equivalent. Measured against 2021, Fortuna is on an exciting growth plan. We have grown our gold equivalent production from 305,000 ounces of gold to 402,000 ounces in 2022. And this year, we anticipate further growth to approximately 450,000 ounces in our guidance.

Despite persistent inflationary pressures throughout 2022, all of our mines performed within the AISC range provided in our annual guidance. The only exception was the Lindero Mine, which recorded as AISC of \$1,142 per ounce of gold, marginally above guidance. Main consumables such as diesel, cyanide, cement and explosives have experienced increased costs to varying degrees depending on the mine and location.

For example, at our Lindero Mine in Argentina year-over-year, cyanide costs increased by an average of 34% and at our Yaramoko Mine in Burkina Faso, 44%. At our Caylloma Mine in Peru year-over-year diesel costs increased by an average of 60% and at our Lindero Mine is 34%. While we have observed easing of inflationary pressures thus far, conditions remain challenging.

Annualized cost increments at our mines over the past two to three years range from 6% at Caylloma or to 8% at San Jose, 12% at Lindero, and 17% at Yaramoko. As per World Gold Council fears up to Q3 2022, margin compression for the industry can be observed showing 11% annualized increase in AISC inflation since 2020. In Q3 2022, 50% of global mine supply was produced at an all-in sustaining cost of approximately \$1,300 per ounce, only eight, seven quarters ago that figure was \$1,100.

Our flagship, Seguela Mine construction in Cote d'Ivoire, West Africa remains a primary focus for management. For the second half of 2023, we have provided production guidance for Seguela of 60,000 to 70,000 ounces of gold at an all-in sustaining cost in the range – ranging from \$880 to \$1,080 per ounce, that's all-in. David will further expand on Seguela later on the presentation.

And on the exploration front, I would highlight our success with the delivery of growth in resources at the Sunbird deposit, one of six deposits making the Seguela Mineral inventory. On December 5th, we reported a new Sunbird open pit resource estimate of 279,000 gold ounces at an average grade of 2.66 grams per tonne in indicated category, plus 0.5 million ounces of gold at an average grade of 3.7 grams per tonne in the inferred category.

On Monday 13th, we reported fresh results from the Sunbird Infill program, Paul Weedon, our SVP, Exploration is here with us and can provide an exploration update. So Paul, do you want to go ahead, please?

Paul Weedon - Senior Vice President, Exploration

Thank you, Jorge. At Sunbird, the latest is the Seguela deposits are shaping up as potentially the largest. The current focus at Sunbird is on the conversion drilling to upgrade and expand the 506,000 ounces of inferred by the end of Q2 2023. We've currently got two drill rigs turning on

that program. As seen in the news release this past Monday, results to-date are consistent with or better than what was previously modeled in the optimized shell. We've also extended the mineralization of approximately another 100 meters further north and beyond the optimization shell, with several high-grade intersections, such as the 5.6 meters of 12 grams gold from 28 meters down hole in AuSGRC 1566.

In addition, deep drilling to the further north to extend this high-grade, sorry south to extend these high-grade shoots will resume in Q3, potentially setting up the foundations for future underground development.

In our non-Seguella division, exploration will continue into Q3 with the recently discovered high-grade Kestral, Badior and Barana prospects which we highlighted in December the 5th news relates, and then further target generation will continue on Seguella with more than 30 known drills remaining to be tested.

Moving further to inferred into Burkina Faso, explosion work around Yaramoko continues to generate new anomalies. Our underground drill test in the Western strike extensions in the Zone 55 mineralization has extensive mineralization approximately 100 meters further beyond the current resource envelope and drilling is continuing in those areas.

Moving to Peru, currently Caylloma is due to test the depth extensions of the 4 kilometer long Animas Vein later in Q2, targeting down-dip projections of oreshoots 1 and 3, some 200 to 400 meters below the previous drilling in the previous mine and current mine workings.

Additionally, regional exploration work around Caylloma continues to highlight the prospectivity, including the emerging Antacollo area. And then finally in Mexico, work at San Jose continues to test the depth extensions in the northern strike extent, as well as planned exploration work announced toward Taviche work in Oeste.

Jorge, back to you.

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Thank you, Paul. We'll move on to an update from the Chief Operating Officers. We can start with LatAm. Cesar, please.

Cesar Velasco - Chief Operating Officer, Latin America

Thank you, Jorge. And as you have already mentioned, last Tuesday Fortuna announced that the Mexican Federal Administrative Court granted a favorable permanent injunction to Minera Cuzcatlan, which allows the San Jose Mine to continue operating under the terms of the original 12-year environmental impact assessment permit, which the Court reconfirmed in November of 2022.

These permanent injunction will remain in effect, allowing for continued operations at the San Jose Mine, up until the Court rules in response to the resolution issued in January 2023 by the SEMARNAT to revoke San Jose's EIA. Although uncertain, we expect that it could be in one and a half to two years.

Moving down to Peru, despite social unrest and numerous road locates throughout the country, operations at the Caylloma Mine have been unaffected and 2023 annual production guidance is to remain. I will now discuss the original results of our three operating mines in Latin America.

The fourth quarter of 2022 marked the fifth consecutive quarter of consolidated gold production of over 35,000 ounces. For the full year, Latin America achieved record gold production of 153,318 ounces, a 14% increase compared to 2021. Consolidated silver production was 6.9 million ounces, achieving the higher end of annual guidance. All three mines delivered production results in line with their mining plans and mineral reserves estimates.

In Argentina, the Lindero Mine delivered another consistent year with gold production totaling 118,000 ounces. This represents a 14% increase from 2021 and is directly related to an improvement in the performance of the three-stage crushing and stacking system.

Throughout 2022, management implemented numerous high impact optimization initiatives to better capture efficiencies, allowing the operation to offset some of the cost increases from inflationary pressures on key consumables. These initiatives included improving the efficiency of the Salta plant, subsequently decreasing consumption of fresh makeup cyanide and sulfuric acid and the optimization of the mine fleet's tracking distance, reducing diesel consumption and improving productivity.

In the last quarter of 2022, a project to improve the recirculation circuit of the HPGR was initiated with the aim of reducing granulometry and improving gold recovery of ore placed at the leach pad. In Mexico, the San Jose Mine's silver and gold production for 2022 totaled 5.8 million ounces of silver and 34,124 ounces of gold, achieving the upper end and midpoint range or final guidance, respectively.

Average head grades for silver and gold for the year were 191 grams per tonne of silver, and 1.14 grams per tonne of gold, a 9% and 12% decrease, respectively, when compared to 2021. But remaining in line with the mines' mining sequence and mineral reserve estimates.

Last year, mine production using sublevel stopping methods, represented 35% of ore sent to the processing plant, and for 2023, it is expected to reach 60%. In Peru, Caylloma Mine continued to deliver steady production in 2022, producing 1.1 million ounces of silver, exceeding the upper range of annual guidance by 4%.

Zinc and lead production totaled 46.2 million pounds and 34.6 million pounds, respectively, both exceeding the upper range of annual guidance. Base metal production benefited from higher mill throughput during the year and material mined at the level 16 of the Animas vein, allowing for a significant improvement in ore grade and oxide-sulfide ratios, therefore boosting plant recovery.

Back to you, Jorge.

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Thank you, Cesar. We can move on to David on West Africa.

David Whittle - Chief Operating Officer, West Africa

Thanks, Jorge. Operations in West Africa continued solid performance here at 2022 with Yaramoko delivering gold production of over 100,000 ounces as the midpoint of annual guidance. Seguela's construction is tracking well with respect to our schedules and budgets with first gold pour projected for mid-2023.

Ongoing worldwide inflationary and supply chain pressures did not impact budgetary expectations at Yaramoko now the construction progress at Seguela. Recent political disturbances in Burkina Faso have had no impact on Yaramoko's operations.

Safety performance at the Yaramoko Mine was strong. Unfortunately, Seguela LTI incidents took place in the fourth quarter. The Yaramoko underground grade control and brownfields exploration program continued with an encouraging outcome, extending our plans of mining boundaries on the western side of the ore body.

Construction progressed and Seguela continues to track sorry, continues on-track and on-budget. As of the end of February, the project was 93% complete with approximately \$160 million incurred initial \$173 million capital budget.

The water storage dam is complete and it's currently storing sufficient water for commissioning and operating activities. In the processing plant, structural mechanical and piping and electrical and instrumentation installations are nearing completion with energization and commissioning activities about to initiate.

First ore to the crusher for commissioning is expected in early April, followed by first ore to the mill later in the month. In parallel with the excellent progress on the ground, operational readiness scopes are advancing well. The mining, technical, processing and maintenance teams are being recruited with all senior management positions currently favorable.

Mota-Engil and mining contractor continued with on-site mobilization on the establishment activities together with the recruitment of key positions and equipment operators. The first phase of grade control drilling has been completed with more than 12,000 meters drilled initial results appearing to align closely with the current geological models.

As at the end of February, cleaning of the Antenna pit as occurred, an excavation of waste is taking place with over 60,000 cubic meters of waste strips and being utilized for the construction of the bunker. Preparations are currently underway for the start of the blasting operations in order for the first ore to be available for the commissioning of the [technical difficulty]. Back to you, Jorge.

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Thank you, David. The team does a good job keeping our website updated on the construction gallery for Seguela. So I invite you to visit the website and the construction gallery. So Luis, you want to give us a briefing on the financials?

Luis Dario Ganoza - Chief Financial Officer

Yes, thank you. I will start addressing the impairments we have recorded in Q4. We recorded total impairment charges as Jorge mentioned, of the \$188.8 million before tax and \$164.5 million net of tax. At Yaramoko, we have recorded an impairment charge of \$103.5 million before tax, that impairment is related to the ranks of exploration and evaluation assets of \$60 million. And lower expected cash flows as a result of higher costs and lower reserves from the elimination of crown pillar recoveries from our reserve base.

At Lindero, we have recorded an impairment charge of \$70.2 million before tax, the impairment is related to lower expected cash flows as a result of higher costs to a large extent related to inflationary pressures seen throughout 2022 and the effect of higher discount rates.

At San Jose, we have recorded an impairment charge of \$9.1 million before tax, the impairment is related to higher costs as well as capitalized exploration expenses over the past few years, which can't fully replace depletion. Also contributing to impairment is the fact that the partial replacement of the position we have seen has been at a lower head grade compared to the previous average head grade of the reserve.

As a result of the impairment, for Q4 2022, we recorded a net loss of \$160.4 million, after adjusting for the environment and a write-down of our stockpiles at the Lindero Mine on \$3.8 million, adjusted net income was \$7.2 million, compared to \$29.1 million in Q4 2021. The reduction in adjusted net income was mainly due to lower sales volume, lower silver prices, and higher cost year-over-year across our operations. The lower volumes were largely in line with our mine plan.

EBITDA for the quarter was \$55.8 million, a \$33 million reduction over Q4 2021 as explained before, you may lead to lower sales of \$34 million. Free cash flow from ongoing operations that is after CapEx, our operating mines and corporate expenses was \$4.4 million, compared to \$46.8 million in Q4 2021. The drop in free cash flow is consistent with a reduction of EBITDA and higher CapEx execution quarter-over-quarter of \$5 million.

For the full year, we have recorded a net loss of \$135.9 million compared to a net gain of \$59.4 million in 2021. The loss is explained by the impairment charges as previously discussed. After testing for the impairment charges and other non-recurring items, adjusted net income for the year was \$42.6 million, compared to \$100.6 million in 2021. The decrease of \$60 million in adjusted net income was a result of lower EBITDA of \$31 million higher depreciation and depletion of \$50 million and lower taxes of \$25 million.

Outside of the impairment charges, the main items of adjustment to our adjusted net income in the year were \$8 million of ore stockpile inventory write-downs and \$5.3 million write-offs of mineral property. Our free cash flow from operations for the full year 2022 was \$69.2 million, down \$17 million from the \$86 million recorded in 2021. The reduction in free cash flow was consistent with lower EBITDA of \$35 million, higher CapEx of \$25 million, partially offset by lower taxes paid and changes in working capital.

In 2022, we converted 28% of EBITDA into free cash flow compared to 31% in 2021. On our balance sheet and liquidity position in Q4, we increased our corporate facility by \$50 million to \$250 million, which at the end of the year for Fortuna total liquidity position of \$150 million, comprised of \$80 million in cash and cash equivalents and \$70 million undrawn under the credit facility.

Our total financial debt outstanding as of the end of the year was \$226 million and \$146 million net of cash. This is an increase of \$60 million and \$87 million over a year-end 2021, respectively.

During the year, we spent \$251 million on additions to mineral properties, plant and equipment as per our cash flow statement, which was mostly comprised of \$108 million in the Seguela project construction, \$9.3 million of Seguela Brownfields exploration, \$8.1 million of Greenfield exploration and \$112 million of capital expenditures including brownfields at our operating mines, there is a \$30 million balance related to capitalized interest, capitalized management fees and advances to contractors.

So year-end, we have incurred \$147 million out of the \$173 million construction budget at Seguela. The amount remaining to be spent, including projects accounts payables as of December 31st, was \$38 million. And finally, between Q2 and Q3, we repurchased a total of 2.2 million shares under our share repurchase program at an average share price \$2.68 US dollars per share.

Back to you, Jorge.

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Thank you, Luis. Carlos, to you.

Carlos Baca - Director, Investor Relations

Thank you, Jorge. We would now like to open the call to any questions that you may have.

Operator

Thank you. At this time, we'll be conducting a question-and-answer session. [Operator Instructions] Thank you. We have a question from Adrian Day with Adrian Day Asset Management. Please go ahead.

Q: Yeah, hi. Good afternoon. I just wanted to ask, you had mentioned when you were discussing impairments, you mentioned that San Jose below head grades. Can you kind of quantify that?

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Luis, do you want to expand on that?

Luis Dario Ganoza - Chief Financial Officer

Yes. I mean, the extension of life of mine at San Jose, has mostly to do with Victoria Vein, which does carry a lower head grade with respect to average grade of the reserve. That is in our

reserve statement. I'm not able to give you exact head grades out of the Victoria Vein out on my head right now, there isn't, but I'm not sure if either Paul or Cesar want to jump in there.

Q: I mean could you characterize it as meaningful or marginal or?

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

Well they – go ahead

Luis Dario Ganoza - Chief Financial Officer

I was just going to say that we're not going to get an exact number on the head grade. But what I can say on my end is that, the projected life of mine, the remaining life of mine at San Jose is still based on those lower head grades with respect to our historical production, is still contributing significant margins and free cash flow, not at the same rate certainly as before.

But I mean, for instance, in our current mine plan, you could – based on our production guidance for the year, you can appreciate lower head grade, lower production with respect to 2022. And in 2022, lower with respect to 2021, but nonetheless, this – in the current price environment, we're still projecting healthy free cash flow out of San Jose in the range of \$25 million to \$30 million, right. That I think, additional color I could provide on what those lower head grades imply for San Jose moving forward at this stage.

Q: Okay. Okay. I appreciate that. And one other question, if I may, also on the impairments. At Lindero, you mentioned the impairment was mostly due to higher costs. I mean, none of us knows what's going to happen to costs going forward. But assuming the costs stay where they are, does this affect – will this affect either your production, your annual production or maybe even your ultimate production from the mine in terms of volume?

Luis Dario Ganoza - Chief Financial Officer

No. I mean, the guidance we have provided already for the year, for 2023 already incorporates our view as to inflation trends in the New Year, right. So there is no new information here with respect to what's already been shared as part of our guidance for 2023, either on production or on costs.

Q: Okay. Sorry, I didn't express myself clearly. Do the – will the higher costs make any of the ore uneconomic that you were expecting to be economic?

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

I think our reserves – I think we're going to update our reserve inventory as we publish every year in the coming weeks. But we do not expect any significant deviation to what you have been seeing in the reserve.

If you look at our production for 2022, San Jose delivered 5.7 million, 5.8 million ounces of silver and for the full year of 34,000 ounces of gold. If you look at our guidance for 2023, San Jose is delivering again between 34,000, 37,000 ounces of gold and 5.3 million to 5.8 million ounces of silver.

If you look at the reserve average grade, the Victoria Vein comes later in the life of the mine – in the remaining life of mine. So, the grade in the reserve, it's where we provided an average and in the later years is we have the lower portion of grade that make that average, right. So you see a bit of a decrease in grade and a decrease in production. For 2023, we're still seeing similar figures in line with what we have in reserves.

But certainly from the impairment perspective, we've been investing heavily in exploration for a number of years at the tune of \$9 million to \$10 million a year. And that exploration investment has not been able to offset the depletion of the mine. We've been only marginally successful with the exploration to-date and that has weighted on the impairment and also the cost inflation that we see at the asset level has also weighed it on that, right. So, it's a mixture of things there, Adrian.

Q: Okay. Okay. Thank you, thank you.

Operator

Thank you. We have had a question come in from Dave Kranzler. What do you expect generally to be the annual sustaining CapEx at Seguela once it is fully ramped up?

Jorge Alberto Ganoza - President, Chief Executive Officer and Co-Founder

David, do you want to tackle that one?

David Whittle - Chief Operating Officer, West Africa

Yeah. Certainly for the budget that we've – guidance we put forward for this year, we have an all-in sustaining costs there in Seguela between \$880 and \$1,080 per ounce. Obviously, as the first year of commissioning with 71,000 ounces, we're obviously expecting the profile to grow beyond there.

And with the exploration work that Paul is doing, we would expect the mine plans to be quite dynamic over the next year as well and certainly provide us some growth expectations. So in terms of life of the mine at the moment, we would still be expecting to be below that \$1,000 an ounce all-in sustaining area.

Luis Dario Ganoza - Chief Financial Officer

Maybe just to complement on David's answer. In terms of an absolute dollar figure, CapEx at Seguela for the life of mine, right, consistent with the numbers implied in AISC just provided by David should be in the \$16 million to \$20 million range.

Operator

Thank you. [Operator Instructions] Okay. We have no further questions in queue. So I will hand it back to Mr. Carlos Baca.

Carlos Baca - Director, Investor Relations

Thank you, Ali. If there are no further questions, I would like to thank everyone for listening to today's earnings call. Have a good day.

Operator

Thank you, ladies and gentlemen. This does conclude today's call. You may disconnect your lines at this time, and have a wonderful day. We thank you for your participation.