SECRETS OF THE SILVER MARKET

BY BOAZ SHOSHAN &
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PROFIT FROM SILVER'S NEW BULL RUN

Secrets of the silver market

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Churchill's forgotten broadcast

Winston Churchill cleared his throat. After a pause, he leaned in to the microphone, and began.

Boaz Shoshan

It was 8 May 1932. Sunday.

It would be many years yet before Britain would hang upon his every gravelly syllable as it crackled through a radio set. Indeed, *this* speech wasn't even intended for British listeners – it was a special broadcast for the ear of American statesmen. The National Broadcasting Company which we know today simply as NBC, not even ten years old at the time, had arranged to transmit this special message over the Atlantic from London.

Churchill was going through a period of his life which he would later refer to as his "wilderness years". He was out of power, and his influence was on the wane. He had lost his position as Chancellor of the Exchequer in 1929, and had not been invited to the cabinet of the coalition government formed in 1931.

Not only had he lost his control over Britain's finances in 1929, he had lost control of his own as well. His investment portfolio, heavily weighted with US stocks, had been crushed by the Wall Street Crash that year. While he retained his seat as MP for Epping, at age 57 his finest hours seemed behind him – not ahead.

History of course, had other plans. And so did Churchill.

While his career and financial situation had taken damage, Churchill had not taken his hand off the pulse of global affairs – and in 1932, the world was in the midst of an economic heart attack.

It would be two more years before the crisis gained the formal title of the Great Depression, but in Britain, the destruction was reaching its peak. Unemployment in some areas of the country had reached 70%, and trade with other countries had suddenly halved.

The brutal misery had led many to question the merits of capitalism itself, and had begun listening to political beliefs long ignored at the fringe. In 1931 the governor of the Bank of England, Montagu Norman, had written to his counterpart at the French central bank with a prediction that capitalism would collapse within a year unless "drastic measures" were taken to save it.

The letter made it to the newspapers, and Norman had a nervous breakdown soon after. Before he escaped on a cruise liner heading for Canada, it was rumoured he insisted that ration books be printed in the event of a full-scale currency collapse across Europe and civilisation resorted to barter.

Churchill may have been in the wilderness, but the world was on the brink. And he had something to say about it.

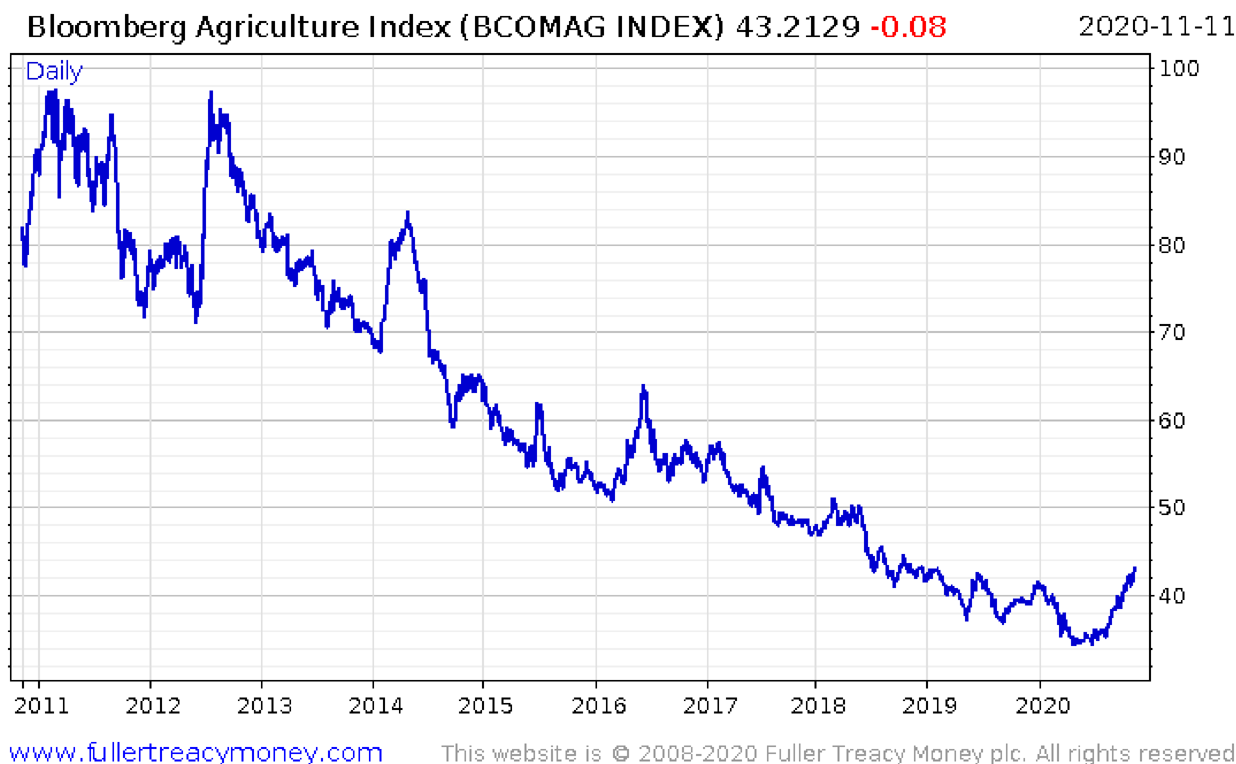
Seated in the broadcasting studio, he made his case:

> *I believe something has gone wrong with the monetary system. It no longer affords men and nations an adequate means of exchanging what they are capable of producing. Gold, having been cornered and hoarded, has gone up 70% in value in the last five years, and the price of everything else, measured by gold, has fallen.*
>
> *See what that means. The farmer has to plow a 1,700 yard furrow in order to pay off as much mortgage or overdraft to the bank as he could have paid by plowing a 1,000 yard furrow only five years ago. All debts have nearly doubled and yet creditors feel as badly off as debtors.*
>
> *Among all other commodities, silver has fallen to a miserable level. I am not going to plunge into the thorny jungles of currency, but surely the fact that silver is denied all rank or recognition, the fact that the difference in price between silver and gold is greater than it has ever been, the fact that less silver was produced last year than for centuries, ought to excite the concern of world statesmen.*
>
> *Silver is the money of all Asia. Silver is the money of a billion human beings, and it ought not to be treated with as little regard as if it were a sack of potatoes. Silver has always been the comrade and ally of gold. Surely we would do well to consider more carefully the part it has to play in our world housekeeping.*
>
> *It is this hideous process of deflation which is the main cause of all our troubles. What are we going to do about it? Are we going on gaping at each in this helpless way while every morning the efforts of all the producers of new wealth are written down remorselessly and every day sees a narrowing prospect of life and labour for mankind?*

Eighty-eight years on, and Churchill's wisdom still rings true. Indeed, the economic conditions he lists share an uncanny resemblance with our current situation.

Something *has* gone wrong with the monetary system – just take a look at the endless use of the printing presses by our central banks. Gold *has* gone up 70% in the last five years – and that's just in dollar terms (it's up 100% in pounds at the time of writing). Accordingly, the price of almost everything else has fallen in value relative to it.

Farmers are under grave pressure to repay debt and to stay afloat. Agricultural commodities have been in a brutal bear market which has put immense strain on profitability, and the use of business loans to keep things afloat.

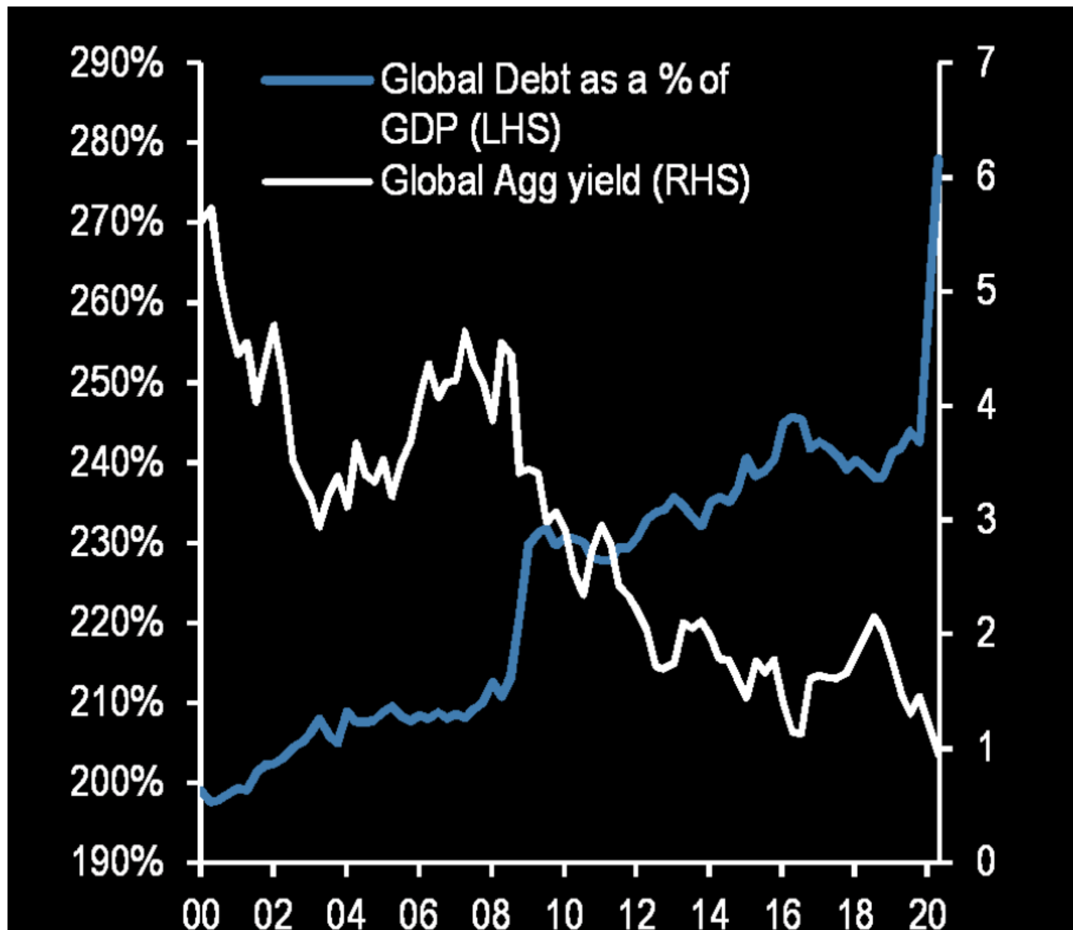


The example Churchill gave of the farmer needing to plough a longer furrow to produce the same yield to pay off debt has other comparisons to today too – like the "shrinkflation" phenomenon where prices have increased or risen for products which have become smaller.

While Churchill refers to debts nearly doubling, here in the present day global debt has not just doubled, but more than *tripled* in the last 20 years. And the economic activity which would be required to service that debt hasn't managed to keep up at anything like the same rate.

Just as back then, creditors feel as badly off as debtors. Debtors struggle to grow out of their debt shadow because global economic growth has been anaemic since the financial crisis. Creditors struggle because they now earn next to nothing for loaning out their money.

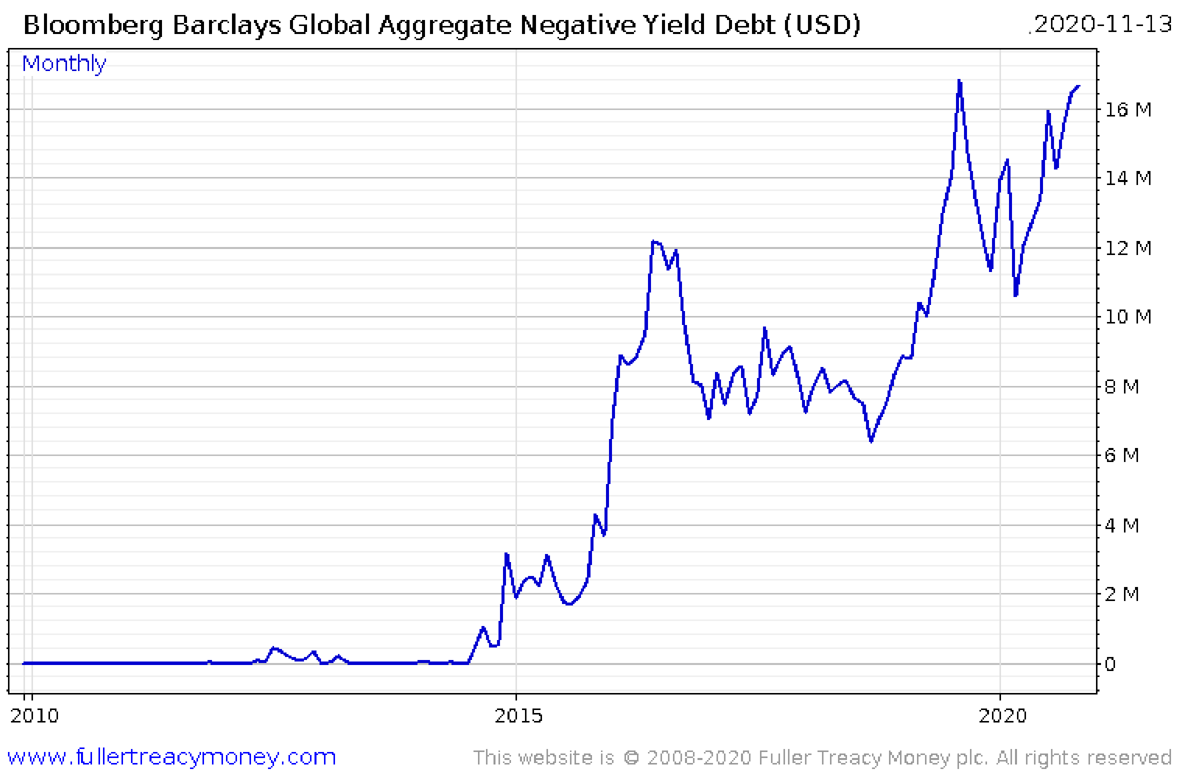
In the following chart, in blue, you can see the level of world debt as a percentage of global economic activity, while in white you can see the average interest earned on the loan:



Source: The Market Ear

But in some sectors of the debt market, it gets a lot worse than the 1% yield you can see in that chart. The interest that can be earned on some loans has gone so low, that lenders are earning less than nothing for their trouble – and that's before you even account for inflation.

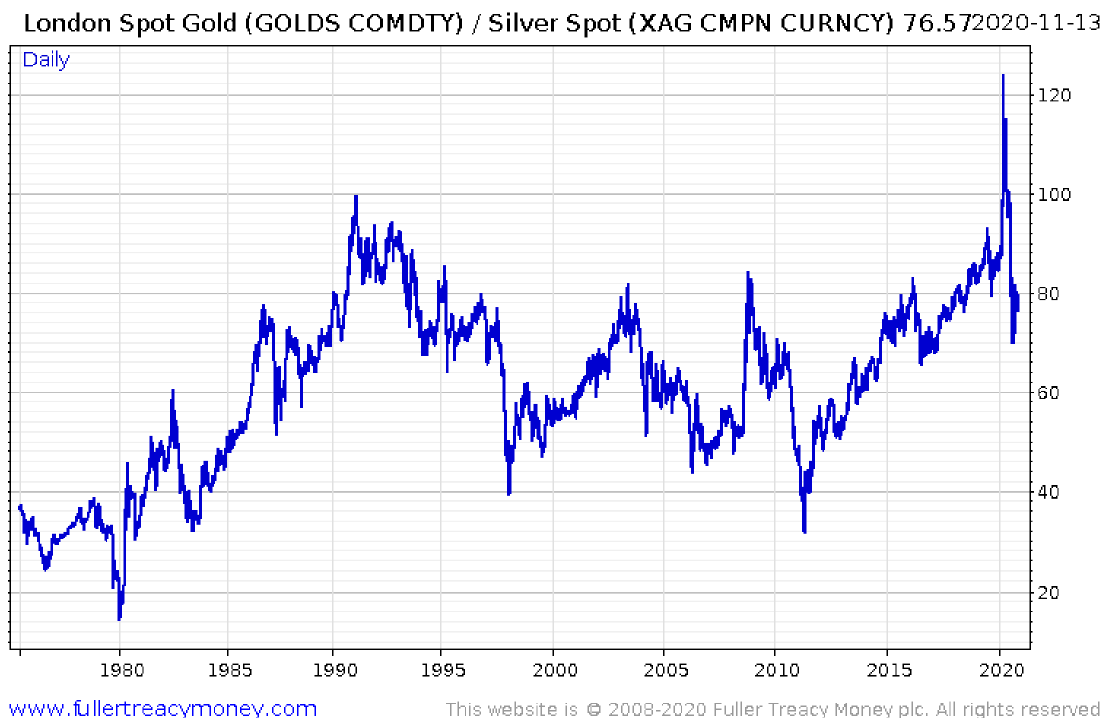
This perverse phenomenon didn't exist a decade ago, yet now there is $16 trillion of such debts in existence. Talk about lenders feeling "badly off"…



Global stock of negative yielding debt. 1 unit = $1 million

And as Churchill observed back then, the price difference between gold and silver has become extreme.

While the cost of gold in silver has been flying high for the last decade, during the chaos in March it would have cost you more than 120 troy ounces of silver to buy a single troy ounce of gold.



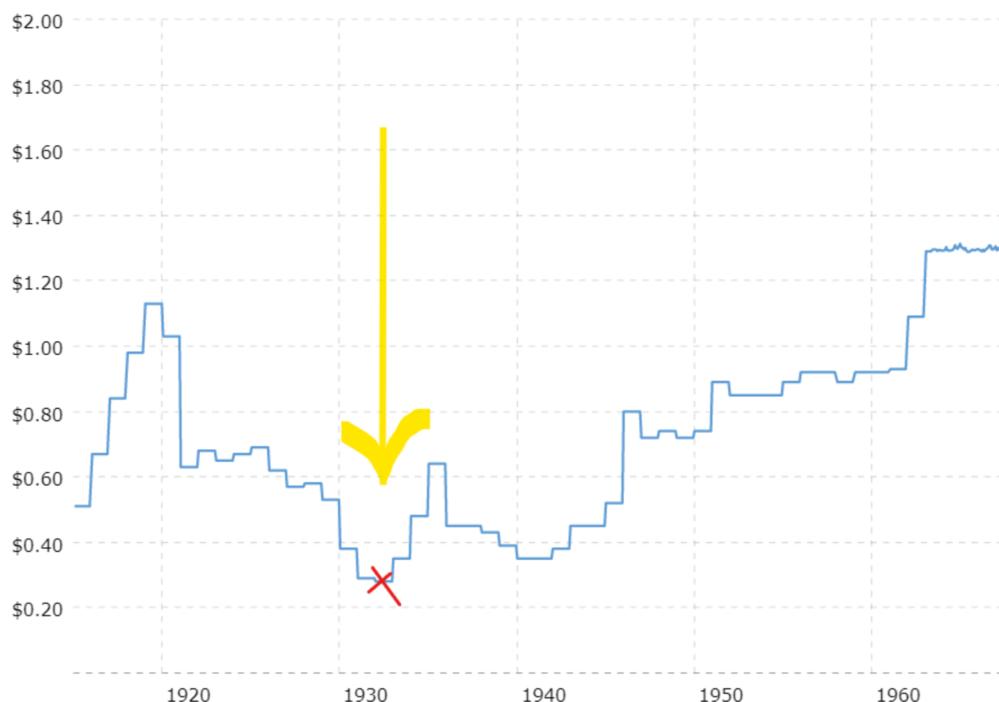
The cost of gold in silver has declined a little since, but the disparity is still vast by historical standards. Market analysis firm Incrementum reported earlier this year that 2019's annual average gold/silver ratio of 86 was a phenomenon that has only been exceeded in 6% of all recorded financial history.

While silver production has not collapsed as it had in Churchill's time, silver ore grades have been declining in recent years and due to silver's low price, little capital has been invested in expanding output.

Silver is still relied upon as a store of wealth for vast tracts of Asia. Deflation is again the problem facing economies in the developed world. And just as in Churchill's time, silver is paid little attention by investors and consumers, as its price relative to gold would attest.

Churchill made that broadcast in an appeal to US statesmen, in the hope that the US and UK could use silver's then-monetary status to help ease the economic crisis facing the world. Ultimately, his call for a transatlantic study on silver was unheeded however; Churchill remained in the wilderness, and his broadcast submerged into the annals of history.

But that doesn't mean his speech was without merit. Let me show you just *when* he made that speech on a chart of the silver price.



Silver's status as both money in coins and a physical commodity are the reason for the right-angled price movements
Source: [MacroTrends]

Churchill made that speech at the total bottom of the silver market, when it was 28 cents an ounce. When the silver price rose above that level soon after – it would never be so cheap ever again.

While US politicians weren't listening to Churchill's pleas, investors should have. And so should we today – for history is rhyming. Once again, the stage is being set for a soaring silver future.

The silver round that accompanies this report is inscribed with the words "*Ad Lunam*", or "to the moon", to describe the surging higher prices we expect to see in silver in the years to come.

Gold may be the metal associated with the sun, but silver is its lunar counterpart – smaller, and responsible for driving investors insane. It's the white wolf of the commodity market that will howl through the 2020s – a story we expect you'll see plastered over the financial press when the great surges it is capable of arrive.

Don't repeat Isaac Newton's mistake

The word "silver" and "money" are interchangeable in 90 languages – such is silver's grand history as a currency.

We Brits are of course no exception to this, with our pound "sterling". It all began for us in the mid-8th century with King Offa of Mercia who minted silver pennies from silver deposits in Cornwall, with 240 pennies minted from one pound of silver – or one pound "sterling". People cut the pennies into halves and quarters for smaller denominations creating "shillings", meaning "a piece cut off".

These coins were so reliable and high quality that they were adopted as a currency throughout Europe – a bit like how the US dollar is adopted as a currency in less stable countries today. Twenty-four million of those pennies would go on to be paid for Richard the Lionheart's ransom when he was captured by an Austrian duke on his way back from the Crusades.

Silver's value through the medieval period in England was roughly an 11th of gold, to put last year's 86 figure, and March's 120 figure that I mentioned earlier, in context. Other periods and civilisations cherished silver even higher: Caesar's Rome had a gold/silver ratio of 7.5; for the Mesopotamians it was 6; and during the Menes era in ancient Egypt, silver was worth an incredible 2.5th that of gold (imagine that today – silver would be £570 an ounce!).

These ratios do not have the same importance that they used to, as neither silver nor gold are used as money any more, and silver is mostly mined now as a by-product of mining other metals rather than for its own sake. This makes silver supply from mines to the market almost unrelated to its price – which may well lead to a very volatile upswings in its price, but more on that later.

I point out the historical gold-to-silver ratios to illustrate just how much more highly valued silver has been throughout economic history; to point out just how heavily investors privilege gold over silver in our current environment, despite both being precious metals.

While gold is of course the great preserver of wealth, it has little industrial application. Silver's double role as both an industrial metal and a precious metal

will serve it well in the years to come as governments across the world debase their currencies and try to stimulate industrial output.

At the same time, gold's high profile as a preserver of wealth could see gold ownership penalised in the future (a dynamic which boosted silver's price when gold was banned in the US in 1933). Silver's lower profile makes it less likely that such a penalty would be inflicted. Silver total demonetisation may well aid it in the years to come, for its price is less tied to the monetary regime and instead limited only to that of the market's imagination.

We believe investors today are making the same mistake as Sir Isaac Newton during his second career as Master of the Royal Mint. Newton was responsible for establishing a fixed exchange rate between the two monetary metals – a bimetallic standard – and made the error of significantly overvaluing gold over silver. Silver subsequently vanished from circulation as citizens didn't want to spend it for less than it was worth. Investors who hold only gold to protect themselves from future monetary debasement will miss out heavily if silver returns with a vengeance.

Claim silver's golden medal

Silver this year has behaved similarly to its performance in 2008. This alone is a reason to take interest in the metal, for silver roared in the years after 2008. There's a twist this time, but we'll get to that in a moment.

In 2008, silver was having a good year until Bear Stearns and then Lehman Brothers went broke. This triggered a dash for cash across financial markets as all players tried to reduce risk and sit in liquid, safe assets. Silver, being a very volatile asset, took a 50% loss on the chin as traders dumped their exposure to the metal to meet margin calls for which cash is the only cure.

Source: Fuller Treacy Money

Ironically however, in the real world, the everyman was seeing the financial system on the brink of collapse, and was reaching for the safety of monetary metals to preserve his wealth. The silver inventory of precious metals dealers and mints alike were suddenly sucked dry by concerned investors who wanted the real thing.

While the "spot" price of silver – set in financial markets due to the vast volumes of silver that is traded there – was going down… the price of obtaining physical silver in the real world was soaring. Bullion dealers were charging vast premiums above the spot price for the silver they could get their hands on.

Once the dust settled on the crisis, and traders were no longer in a panic, precious metals began pricing in the scale of the money printing programmes from central banks. While gold started the race first, it came in second as silver gained better momentum after a year. While gold soared over 260% from its lows, silver quintupled.

Source: Fuller Treacy Money

This year, we've seen the first half of a similar story. Silver started the year strong, but then lost a third of its value in March when the Covid-19 panic arrived. Once again, it was whacked as margin calls were made, risky assets were sold, and cash became king.

Once again, in the real world, physical silver became scarcer. The US Mint temporarily ran out of product as were bullion dealers, and premiums were spiking as the everyman sought silver to protect his savings.

And once the dust settled and the central banks got printing, gold and silver were off to the races. While silver doubled in just a few months and has outperformed gold thus far. But if the pattern of '08 continues, silver could have much further to rise:

Silver in blue (right hand scale), gold in green

While gold rises first of the two metals, silver rises fastest. The prospect of silver's momentum arriving with force in the next year or so is reason alone to take an interest in the metal. But there's reason to take an even rosier outlook on the white metal, if you take a deeper look at what drives precious metals prices.

Gold booms from central bank largesse, silver booms from government largesse

Silver broadly follows the gold price, but with greater volatility – in both directions.

What drives both metals however, is the direction of *real interest rates*. This is the "nominal" interest rate you can earn at a bank or in a sovereign bond, minus the prevailing rate of inflation.

When real interest rates rise, fiat money becomes more valuable – for it can earn interest above the rate of inflation without taking much risk. This is bad for precious metals prices, for gold and silver do not yield any interest.

It's when real interest rates are falling that precious metals do well – for this is when paper money is losing its value and cannot retain its purchasing power without taking on investment risk.

While real interest rates falling is positive for both precious metals, the manner *in which they fall* can favour one over the other. Real interest rates can fall by nominal (or "regular") interest rates going lower, inflation going higher, or both.

Gold is more sensitive to nominal interest rates than silver. And silver is more sensitive to inflation than gold.

This is likely due to gold's status within the monetary system as a reserve asset similar to a bond – hoarded and traded by central banks. Silver's inflation sensitivity is likely due to its use in industry, giving it more exposure to the real economy.

In recent years, real interest rates have fallen because nominal interest rates have been falling – not because inflation has been rising. This, we believe, is about to change.

The 2008 financial crisis was a debt crisis. In its wake, governments tried to reduce their debt levels and cut their spending with austerity measures. This is not something that produces high inflation. But real interest rates fell as central banks cut short-term interest rates and lowered long-term interest rates with their quantitative easing measures.

Gold was heavily buoyed by this and has remained relatively high all the way since then, even after its 2011 peak as real interest rates – via nominal interest rates - have remained low.

Silver however, floundered and crashed after its 2011 peak when the inflation that had been expected failed to arrive.

The Covid crisis however, is not a debt crisis. There will be no reduction to government expenditure – quite the opposite. Government spending has substantially increased as a consequence of it – the UK government is now spending half of the country's GDP.

There is no political will to reduce debt. In fact, the International Monetary Fund (IMF), a key endorser of reducing debt levels after the financial crisis, has taken a U-turn and is now saying that developed nations should be taking advantage of the low interest rates to borrow and spend much more.

From the Financial Times, earlier this year:

> *Most advanced economies that can borrow freely will not need to plan for austerity to restore the health of their public finances after the coronavirus pandemic, the IMF has said in a reversal of its advice a decade ago.*
>
> *Countries that have the choice to keep borrowing are likely to be able to stabilise their public debt by the middle of the decade, Vitor Gaspar, head of fiscal policy at the fund, told the Financial Times. That would mean they would not have to raise taxes or cut public spending plans…*
>
> *The IMF's words will be seized upon in the US and across Europe as giving the green light to countries to invest out of the recession, rather than tightening their belts as happened in the previous decade.*
>
> *The fund's advice is a reversal of the message given in the same publication a*

> *decade ago at the equivalent stage in the financial crisis. Then, it warned that "many countries face large retrenchment needs going forward".*
>
> *The fund's internal auditor subsequently assessed that it had been too quick to advocate austerity in 2010-11, and the IMF has now substantially revised its guidance. This time around, more needs to be done to foster a strong recovery before considering the health of countries' public finances, the IMF emphasised…*

Meanwhile, central banks have been laying the groundwork to make sure debt never stops the government from spending money…

Again, from the FT:

> *The UK has become the first country to embrace the monetary financing of government to fund the immediate cost of fighting coronavirus, with the Bank of England agreeing to a Treasury demand to directly finance the state's spending needs on a temporary basis … This direct monetary financing of government would be 'temporary and short-term', the Treasury said in its statement…*
>
> *'As well as temporarily smoothing government cash flows, the [Ways and Means] Facility supports market function by minimising the immediate impact of raising additional funding in gilt and sterling money markets,' it added.*
>
> *It said any drawings on this facility would be repaid as soon as possible before the end of the year.*

"Monetary financing of government" means the central bank creating money and giving it directly to the government with no intermediation by the market or necessary limit.

Similarly, the central bank of New Zealand has also made it clear just how willing (and interested) it is in supporting its government's spending programme.

From Bloomberg – and to clarify, "direct monetization" means the same as "monetary financing":

> *Governor Adrian Orr said Tuesday he remains open minded about buying the nation's debt directly from the state, as the central bank mulls more policy responses to tackle the coronavirus crisis. The RBNZ has said it would purchase NZ$33 billion ($20 billion) of government bonds over a year in secondary markets. The need for massive government spending to pull New Zealand's economy through the coronavirus crisis, and a growing number of advocates for debt monetization around the world, make it a real possibility for the RBNZ.*
>
> *"Direct monetization, I know, has been heresy, taboo for a long time, but it's only a long time in our lifetime," Orr said. "It's not a mysterious issue. It's just not how we've run business."…*
>
> *Direct debt monetization comes with "as many risks as opportunities," said Orr, as he talked about the potential for high inflation if a central bank isn't independent. "There's no free lunch, but you shouldn't rule any option out," he added.*

A couple of years ago, the chief economist at a major fund management firm told me about an informal survey Mervyn King had conducted while he was the governor of the Bank of England.

He asked the Bank of England economists what they thought would be the most potent form of economic stimulus, explicitly framing the question with the caveat “if there were no political constraints”.

The answer came back clear as a bell (though the results were never publicly released): monetary financing of infrastructure, or to be blunt, printing money at the bank of England and giving it directly to the government to build infrastructure.

Baron King is no longer at the Bank of England – and it appears those political constraints aren’t either.

We are in the very early days of central banks stepping up to the plate of directly handing freshly printed cash to the government – but the foundations are being laid.

After the financial crisis, it was central banks who did most of the “work” to try and stimulate economic activity with interest rate cuts and quantitative easing, while governments worked to pay down debt.

We are entering a period where central banks are exhausted with interest rates already at 0 or negative across much of the developed world, and the baton has been firmly passed into the hand of governments to keep economies functioning.

When central banks were in control, the money they created was pushed into the financial system, and mostly just depressed interest rates – being very good for gold. But now the money is coming from governments and being pushed into the real economy, causing inflation – this will be good for silver. We are moving from a monetary regime of central bank dominance which favours the gold investor, to one of government dominance, which favours the silver investor.

When you consider that the main driver of silver consumption is still being held back by the Covid crisis, the case for silver to outperform as the world begins to recover becomes very compelling. Both industrial demand for silver and ornamental demand (jewellery and silverware) have been heavily hit by the Covid recession – and the pair make up 80% of annual silver consumption.

Only 20% of annual silver demand comes from investors. This year’s price rally is really quite remarkable when you consider that it was just this side of silver consumption that’s carried the day. When economies reopen, and those major two drivers of silver start to rise again, silver is primed to move much higher.

And when you consider what governments will be spending this money on, the outlook for silver shines even brighter. All over the developed world we are seeing calls for investment in green infrastructure, which would require vast amounts of silver to implement. Solar panels and electric vehicles already form major components of silver’s industrial consumption, and governments driving further growth in the sector will serve to put a floor beneath the silver price.

And increases in silver demand may not be met swiftly from the supply side. Silver's lacklustre performance since its peak nine years ago has led to a lack of investment in silver mining and exploration – it would take a long time to get new silver supply online were there to be a significant rise in the silver price.

Some three quarters of freshly mined silver comes from non-silver mines, where the silver is being extracted as a by-product as the company is primarily after a different metal. An increase in the silver price will not make these miners try and increase their silver output for their priority is the output of a different metal (like copper or gold).

Industrial recycling of silver, which makes up 12% of total annual supply, may also not be forthcoming in the event of higher silver prices, for industrial production is still on the backfoot from the Covid crisis, and will take time to recover.

As Incrementum pointed out recently, the only two sources of silver supply which are not in a state of stagnation or contraction are recycled jewellery and silver coins – items which are less likely to be sold if we see a silver price rise.

If you don't mind not having silver in your own possession you may wish to own your silver through services such as BullionVault.com, which charge lower premiums for silver purchases and will keep your bullion safe and sound.

Silver doesn't pay an income, of course, and the value can be volatile. Keep in mind that the Financial Conduct Authority – the FCA – does not regulate the physical precious metals market, meaning you won't have access to the Financial Ombudsman Service or Financial Services Compensation Scheme.

Additionally, there's another way to get access to silver…

Physical Silver ETF

Because of the dubious nature of the "paper" silver market (futures) and the controversies over whether or not there is actually enough physical silver to make good on all the paper claims there are (like the $SLV Silver ETF), investment firm Sprott saw an opportunity.

Sprott has created a publicly traded investment trust that is fully backed by silver. It's the convenience of an ETF, but with physical silver officially stored. The trust only owns "fully allocated and unencumbered" silver – it has not been leased out or promised by somebody else. It's all there, kept in a vault maintained by the Royal Canadian Mint.

Depending on the market interest in silver, shares in this trust can sell at a premium (worth more than the silver they represent) or at a discount (where the shares are being priced less than the physical silver they represent).

Shares in this ETF represent an opportunity to buy physical silver, but at paper prices (the spot price set in the markets with no bullion dealer premium), with no VAT. While physical silver in your own possession is a great "unplugged"

investment, if you want to play silver purely as a speculative asset, the Sprott Physical Silver Trust may be worth further research.

And now, this is where I leave you in the capable hands of Nickolai Hubble. For as it is written in Ecclesiastes, “A lover of silver will never be satisfied with silver” – and I expect you’ll want to know about the potential opportunities in silver mining now…

Regards,

Boaz Shoshan
Editor, Southbank Investment Research

Five silver mining stocks to keep an eye on

Nick Hubble

Most silver is mined as a by-product of mining other metals. This makes it tough to identify silver miners specifically. By some measures, there are only about three true silver miners out there.

There are "silver miners" which primarily make their money from other metals for example. And there are miners with expiring silver mines transitioning to other metals.

Given the purpose of this report, we're focusing on silver itself. And based on that, here are some silver stocks you should keep an eye on.

However, I want to be clear that the stocks listed below are not intended as trading recommendations. We won't be emailing you with updates, or telling you when to invest or divest your holdings. We include general information about them here as a starting point for your own research.

Please remember that investing in in *any* mining operation is a highly risky endeavour (a point that has been driven home to mining investors who were blindsided by Covid-19 and saw the value of their holdings fall suddenly). The price for silver may not recover as quickly or go as high as we expect, and the value of mining stocks can be affected by other factors rather than just the price of the metal they produce. Seek personal financial advice if you're unsure of the suitability of any investment.

These five companies are worth keeping an eye on as the silver story develops.

But first, some quick explanations of different terms which silver miners use.

Producing mines churn through a lot of ore to get to their precious metals. One way to evaluate a mine is how much they get though, as measure by tonnes per day, or "tpd". On the one hand, higher grade ore requires less tpd to get at the same amount of silver. On the other hand, faster processing can be more economical when other costs are factored in, so a faster processing rate is considered good.

All-in sustaining costs (AISC) is the cost, usually per ounce, once you add in all the costs associated with a mine or company. It is like a net profit measure. Cash costs are like the gross profit measure. They consider the costs on site of mining.

Last but certainly not least is the **"Ag equivalent"** or just "equiv" as you'll see in silver miners' reports. Because silver miners mine a mix of resources, it's difficult to summarise how much they actually produce in a single figure. The idea of "equiv" is to convert all other metals mined to their equivalent amount of silver. That way we get a simple measure of how much silver (plus equivalents) a mine or company produces. It makes one silver mine or company comparable to the others even though their projects produce differing combinations and mixes of silver, gold, lead, copper, and zinc.

This distinction will of course matter for our report because we want to focus

on silver specifically, not its equivalents. So, a miner with huge silver equivalent production may be less favourable than a miner with true silver production.

Thanks to the location of silver around the world, you'll notice that most of these silver miners operate in the Americas. This adds some political risk, but isn't really avoidable if you want exposure to silver specifically.

Last, but certainly not least, don't forget that Covid-19 has wreaked havoc on miners' recent financial performance results. It's become very difficult to untangle Covid-19 disruption from poor performance.

AISCs went haywire, for example, as mines shut down or had to spend big on safety. This may have created a buying opportunity, but it does mean the information we rely on less accurately represents the miners' position than usual.

1. First Majestic Silver Corp.

First Majestic claims to be "the only mining company offering its own production in the form of silver bullion for sale securely online 24/7".

60% of First Majestic's revenue comes from silver and the remaining 40% from gold.

It is mining exclusively in Mexico, the world's largest silver-producing nation. There are three producing mines, one which has been temporarily suspended and four exploration or development projects. In 2020, the three producing mines will have an AISC of around $12.59 for 11 million ounces of silver, or double that once you include its gold into the silver equivalent calculation.

- San Dimas Silver/Gold Mine is the lowest cost and largest producer, with capital expenditure continuing in 2020 to upgrade hydropower to 100% of energy needs, a third mine and a mill. It is expected to manage 2,000 tonnes per day for more than 6 million ounces of silver in 2020. AISC doubled to $13.04 in the second quarter because of Covid-19 disruption.

- La Encantada Silver Mine is expected to manage 3,000 tonnes per day for a production of more than 3.1 million ounces of silver at an AISC of around $12.59. The AISC didn't spike in the second quarter of 2020, despite Covid-19.

- Santa Elena Silver/Gold Mine has a 2020 target of 3,000 tonnes per day for 1.9 million ounces of silver, or 4.8 million ounces of silver equivalent once gold is included. At an AISC of $8.33. The AISC spiked badly under Covid-19, but the costs are reportedly once-offs.

Silver production has grown almost every year since 2009, but is expected to take a hit this year because of Covid-19.

The company has 26 drill rigs, which it is using to expand its reserves to over 150 million ounces of proven and probable reserves.

As of this writing, First Majestic has a market capitalisation of US$2.3 billion, with

221 million shares outstanding. The three-month average daily volume based on NYSE and TSX is around 10 million shares, for approximately $116 million in value.

First Majestic has $232.4 million in cash and $140 million in convertible debt.

The president and CEO Keith Neumeyer owns 1.7% of the company.

In June, First Majestic did something surprising. It entered into an agreement to buy 50% of the silver output from a Canadian mine called the Springpole Project. The terms of the deal are effectively a bet on the silver price by First Majestic: ongoing cash payments of 33% of the silver spot price per ounce, up to a maximum of $7.50 per ounce, with total consideration of $22.5 million in cash and shares over three payments. With approximately 22 million ounces of silver expected to be produced over the life of mine, this means the company is speculating on the silver price rising in coming years.

2. Fortuna Silver Mines Inc

Fortuna is a Canadian-based precious metals mining company with operations and expertise in Latin America. Founded in 2005 with its Peruvian mine, it went on to expand into Mexico and Argentina. It recently reported production of 2.1 million ounces of silver and 12,791 ounces of gold for the third quarter of 2020, a recovery from the Covid-affected second quarter which ended in a $5.7 million loss.

The company is still led by its co-founder Jorge A Ganoza, a Peruvian geological engineer with over 25 years of experience in mineral exploration, mining and business development throughout Latin America. He has led Fortuna through its growth and acquisitions since inception.

Fortuna has operations in the following locations:

- **Peru**: a 1,430 tonnes per day underground mine for 0.9 million ounces of silver, 45.6 million pounds of zinc and 28.7 million pounds of lead in 2019. The project is 100% owned with a four-year reserve life remaining after stable production for more than seven years. In the financial and calendar year 2019, the AISC silver equivalent was $14.3 per ounce, but this increased to $16.3 in first half of 2020, largely due to Covid-19.

- **Mexico:** a 3000 tpd silver and gold project in San Jose which was delivered on time and on budget with 100% interest in 2011. It also has a four-year reserve life after production peaked in 2019. Financial and calendar year 2019 ended with an AISC silver equivalent of $9.8 per ounce, which increased to $10.9 in first half of 2020. 7.9 million ounces of silver and 48.9 thousand ounces of gold in 2019.

- **Argentina:** this is the key project for Fortuna's future, but it is gold focused. The first gold was poured in October 2020, but true commercial operations will begin next year at an estimated AISC of $520 to $620 per ounce of gold. It is also 100% owned, with the 18,750 tpd open-pit mine having a 13-year reserve life. 25,000 to 28,000 ounces of gold in calendar year 2020 are already

expected, increasing to 145,000 to 160,000 ounces for 2021's calendar and financial year.

- **Exploration**: the company is exploring near its Argentina project as well as a new site in Argentina, near its Mexican mine, and near its Peruvian mine. It is also looking to acquire more in Mexico in anticipation of the current mine closing in four years' time. The exploration projects were ceased however because of Covid-19.

Total production in the first half of 2020 was as follows:

- Silver production 3.1 million ounces in first half of 2020, down from 4.6 because of Covid-19
- Gold 17.2 thousand ounces, down from 26.8 because of Covid-19
- Zinc 22.8 million pounds stable from the previous year
- Lead 14.5 million pounds, stable from the previous year.

This suggests the company has exposure to a lot of metals other than silver.

However, the company is to some extent transitioning from silver to gold with its new project in Argentina. Still, it has plenty of silver exposure remaining thanks to its lack of hedging precious metals.

The key risk of mining companies is their transition period from declining and depleted mines to the next project. Should the timing of the transition be wrong, or the exploration fail, the company can get into serious difficulty. But the opening of the mine in Argentina has reduced this risk for Fortuna.

3. Hecla Mining

Hecla's website proudly proclaims that it produces "a third of US silver" on the homepage, making it the US's largest silver producer and oldest precious metals company there too. The company is based in the US and operates North American mines (Canada, US, and Mexico), which are considered low political risk nations, especially compared to South America.

Hecla's operations include seven producing mines, with a mix of silver and gold.

Three silver-producing mines which in 2019 performed as follows:

- Greens Creek mine produced 9.9 million ounces at a cash cost per ounce of $1.97
- San Sebastian mine produced 1.9 million ounces of silver and 15,673 ounces of gold, with cash costs expected to remain between $3.00 and $4.25 an ounce in 2020

- Lucky Friday produced 632,944 ounces of silver, with an increase in production in 2020

Gold-producing mines:

- Casa Berardi produced 134,409 ounces of gold at an average cash cost of $1,051 per ounce
- The three Nevada operations produced 66,166 ounces of gold at an average cost of $1,096 as well as 181,741 ounces of silver.

Total proven reserves of silver amount to 64.8 million ounces and probable reserves an additional 147.3 million ounces. Once you throw in exploration, total inferred silver amounts to 456 million ounces and almost 5,000 ounces of gold. In other words, Hecla is a very big player and will likely remain so for a long time to come.

Hecla has a significant amount of long-term debt, but not relative to its vast assets. It has made a loss for the last four years with 2020 looking especially bad thanks to Covid-19.

The company raised its dividend by 200% last April, after consistent payouts of $0.3/share for almost four years.

Hecla deserves to be on this list for its vast reserves of silver and its low political risk from operations. However, it does need the silver price to rise over time.

4. Silvercorp Metals Inc

Silvercorp is a Canadian silver miner with mines in China since 2006. It also produces lead and zinc.

62% of net revenue is projected to come from silver, 29% from lead, 6% from zinc and 2% from gold, although gold resources have increased dramatically since 2017, so this mix will change.

Silvercorp has a 15-year mine life. Its key mine's life was recently extended by 20 years. So a lot of production is baked in.

The company pays a 0.42% dividend yield as of this writing.

Silvercorp's key projects are six mines in the Ying Mining District, which dominates the company's output. A much smaller mine is operating in Guandong and a further smaller gold project is set to begin production once permits are approved.

Proven and probable reserves are at 113.9 million ounces (including the silver equivalent of gold, but not lead or zinc).

Compared to other silver miners, Silvercorp performs well on AISC, profit margins and return on equity.

The big risk is obvious – geopolitical tensions with China. Boaz Shoshan and I both agree these will escalate. But you may not agree. Ironically enough, it seems the company will meet its guidance for this year, despite Covid-19. That's a rarity in the mining space right now and shows how geopolitical risk can work both ways…

Silvercorp also owns around 29% of New Pacific Metals Corp (CVE:NUAG), which has a silver project in Bolivia with 155.9 million ounces of "measured and indicated" silver.

5. Endeavour Silver

Endeavour is a mid-tier silver miner. According to a company presentation, the share price has a higher beta to silver price than other miners. This would mean that Endeavour is more sensitive to changes in silver prices than other mining companies.

Endeavour markets itself as one of only three true silver miners, as defined by 50% of revenue coming from silver. Now, obviously this fluctuates based on production and prices, but you get the idea.

The company doesn't mine any base metals like copper or zinc, so its exposure to the precious metals is very pure. It also doesn't hedge its exposure to precious metals, so the moves in their prices go straight to the bottom line.

The company has three producing mines in Mexico and a long list of development and exploration across South America. These are the three producing mines:

- Guanacevi Mine
  - 2.7 million ounces of silver equivalent produced in 2019
  - 1200 tpd plant
- Bolanitos Mine
  - 1.8 million ounces of silver equivalent produced in 2019
  - 1600 tpd plant
- El Compas Mine
  - 0.7 million ounces of silver equivalent in 2019
  - 500 tpd plant.

These were suspended by Covid-19, so the company has had a tough start to 2020. Still, third quarter of 2020 saw 2.4 million ounces of silver and 24,553 ounces of gold. AISC of silver and equivalents is around $17.

Endeavour has almost 44 million ounces of silver and almost 500,000 ounces of gold

in proven reserves. This includes 27 million ounces of silver and 400,000 ounces of gold at the upcoming Terranera project in western Mexico alone.

Endeavour had no debt until this financial year. A software and equipment package was recently purchased with loans, but debt is well under control.

The risks for Endeavour are clear. The company has been running at an operating loss for two years now. Eventually, its negative retained earnings will drag on the company.

We'll be watching the overall precious metals market as closely as ever for Southbank Investment Research members in the months ahead – though I would remind you again that the above companies are not recommendations. The above companies are merely companies worthy of keeping an eye on as the current silver rally plays out – and should anything change, Southbank Investment Research readers will be the first to know.

Regards,

Nickolai Hubble
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