

Pan American Silver

Yamana bid overshadows Q322 results

Results and acquisition
update

Metals and mining

17 November 2022

Price **US\$14.9**
Market cap **US\$3,136m**

Net cash (US\$m) at Q322, excluding short-term investments	84.6
Shares in issue	210.5m
Free float	100%
Code	PAAS
Primary exchange	TSX
Secondary exchange	NYSE

Share price performance



%	1m	3m	12m
Abs	(4.1)	(16.4)	(46.6)
Rel (local)	(13.2)	(9.1)	(36.6)
52-week high/low	US\$29.95	US\$13.64	

Business description

Pan American Silver is one of the largest global primary silver producers and a sizeable gold miner with operations in North, Central and South America since 1994. The company owns eight producing operations, the currently suspended top tier Escobal silver mine and a number of large-scale advanced exploration projects.

Next events

EGM to approve Yamana acquisition Q123

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Weaker commodity prices and unabating cost pressures continued to suppress Pan American Silver's (PAAS's) performance in Q322. However, at the top line, these were largely offset by higher gold sales, while lower inventory adjustments and other operating costs resulted in a 90% q-o-q boost in EBITDA. That said, the Q3 results were clearly overshadowed by PAAS's joint bid to acquire Yamana Gold for c US\$4.8bn. Contingent on shareholder approvals, the deal will be transformational for PAAS, adding four large-scale and low-cost producing silver and gold projects in Latin America and more than doubling its annual EBITDA.

Year end	Revenue (US\$m)	EBITDA (US\$m)	EPS* (US\$)	DPS (US\$)	P/E (x)	Yield (%)
12/20	1,338.8	469.1	0.57	0.22	26.1	1.5
12/21	1,632.8	593.2	0.60	0.34	24.8	2.3
12/22e	1,540.8	296.6	(0.26)	0.45	N/A	3.0
12/23e	1,582.9	483.9	0.53	0.44	28.0	3.0

Note: *EPS is normalised, excluding exceptional items.

Proposed Yamana Gold acquisition

On 4 November PAAS announced that together with Agnico Eagle it has made a definitive binding offer to acquire all issued and outstanding common shares of Yamana Gold. As part of the transaction, PAAS will acquire four producing silver and gold operations and several advanced development projects in Latin America, along with all remaining assets and liabilities (including cash and debt). In 2021, Yamana's Latin American assets produced 9.2Moz of silver (PAAS: 19.2Moz) and 0.53Moz of gold (PAAS: 0.58Moz) and generated combined revenues of US\$1.8bn and EBITDA of US\$1.1bn. The acquisition consideration of US\$4.8bn values Yamana at an FY22e consensus EV/EBITDA of 5.6x.

Q322 results: No respite from cost pressures

PAAS reported flat quarter-on-quarter revenue of US\$339m as lower commodity prices and broadly similar production were compensated for by higher gold sales. EBITDA of US\$34m was up 89% q-o-q. The company lowered its FY22 silver production guidance to 18.0–18.5Moz (from 19.0–20.5Moz) and retained its gold production target of 550–605koz. While guided cost ranges for both segments remained unchanged, the company noted that silver cash costs and AISC and gold cash costs could overshoot due to continuing cost pressures. We have updated our estimates to reflect the results, lower commodity prices and slightly higher costs.

Valuation: All eyes on the Yamana bid

While we reduce our standalone cash flow valuation of PAAS to US\$25.4/share (from US\$27.5) on lower estimates and marginally higher weighted average cost of capital (WACC), we realise that the current market focus is solely on the Yamana bid. Our preliminary calculations suggest a pro forma FY22e consensus EV/EBITDA of just 6.5x for the combined company, which compares to PAAS's current consensus FY22e EV/EBITDA of 10.5x and in our view represents an undemanding multiple. Additional support to PAAS share price should come from Agnico Eagle's decision to buy up to US\$150m in PAAS shares on the market, representing c 5% of the company's equity.

Proposed Yamana Gold acquisition

On 4 November 2022 PAAS announced that together with Agnico Eagle (AEM; US\$21.8bn) it has made a definitive binding offer to acquire all issued and outstanding common shares of Yamana Gold. Yamana's board of directors determined that the PAAS/Agnico offer represented a superior proposal to the transaction between Yamana and Gold Fields announced in May 2022. On 8 November, it was further reported that Gold Fields has terminated its Yamana bid and that the plan of arrangement that Yamana entered on that day with PAAS and Agnico Eagle has become effective. The special shareholder meeting of Yamana, scheduled for 21 November to approve the Gold Fields arrangement, has therefore been cancelled.

According to the terms of the PAAS/Agnico offer, the acquisition consideration of US\$4.8bn consists of 153.5m PAAS shares (c 42% of the company's share capital post transaction), a US\$1.0bn cash contribution from Agnico Eagle and 36.1m Agnico Eagle shares. This would value each Yamana share at US\$5.02 based on the pre-announcement closing price as of 3 November (US\$5.22 at 15 November; see Exhibit 1). The offer values Yamana at 5.6x FY22e consensus EV/EBITDA, which we believe is a reasonable multiple when compared to PAAS's own consensus-based valuation of 10.5x and given the quality of Yamana's assets (and the fact that this valuation essentially excludes all non-producing assets such as MARA), as well as the current uncertain market conditions. The transaction requires shareholder approval from PAAS (simple majority of 50%+1 of the votes) and Yamana (two-thirds of the votes). Shareholder votes are expected to be held in January 2023 and the transaction is anticipated to close in Q123.

Exhibit 1: Yamana Gold acquisition consideration details and implied valuation

	#	Share prices at 3 November 2022	Value (US\$m)	Share prices at 15 November 2022	Value (US\$m)
PAAS shares (m)	153.5	15.2	2,340	14.9	2,282
Agnico Eagle shares (m)	36.1	41.2	1,485	48.1	1,736
Cash consideration			1,000		1,000
Total equity			4,825		5,018
Yamana shares (m)			961.0		961.0
Equity per share (US\$)			5.02		5.22
Yamana cash, Q322			539.2		539.2
Yamana debt, Q322			773.9		773.9
Termination fee			300.0		300.0
Adjusted net debt			534.7		534.7
Implied EV			5,360		5,552
Yamana FY21 EBITDA			940.1		940.1
Yamana FY22e EBITDA			961.1		961.1
Implied FY21 EV/EBITDA			5.7		5.9
Implied FY22 EV/EBITDA			5.6		5.8

Source: Company data, Edison Investment Research, Refinitiv

As part of the transaction, at closing Yamana will transfer its interests in its Canadian assets, in particular in the Malartic mine and Wasamac, to Agnico Eagle. In turn, PAAS will acquire four producing silver and gold operations and a number of advanced development and expansion projects in Latin America (see Exhibit 2), along with all the remaining assets and liabilities (including cash and debt), thereby increasing its asset portfolio to 12 currently producing projects.

In 2021, Yamana's Latin American assets produced 9.2Moz of silver (PAAS: 19.2Moz) and 0.53Moz of gold (PAAS: 0.58Moz; Yamana total 0.88Moz). Yamana reported combined revenues of US\$1,815m and EBITDA of US\$1,083m for the period, implying an impressive margin of 60%. The latest production guidance from both companies suggests that Pan American's FY22 pro forma silver and gold output would increase to approximately 29–30Moz and 1.1–1.2Moz, respectively. In addition to the currently established producing operations, Yamana's Latin American assets have

an advanced expansion potential that could increase the company's production by 260–330k gold equivalent ounces (GEO) per annum, according to Yamana management.

Yamana's assets are low-cost operations. In 9M22, the four Latin American mines reported cash costs ranging from US\$559/oz to US\$1,001/oz (GEO) and all in sustaining costs (AISC) in the US\$775–1,410/oz (GEO) range. (We note however that this cost reporting differs from the one used by PAAS, which reports costs on a by-product basis.) At the same time, these projects generated US\$905m in revenues (US\$1,207m annualised) and US\$518m in mine EBITDA (US\$691m annualised). For FY22, Yamana's guidance implies a very competitive combined cash cost of US\$710/oz (GEO) and AISC of US\$981/oz (GEO) at its LatAm operations.

Exhibit 2: Yamana's Latin American assets to be acquired by PAAS (FY21 numbers)

Asset	Country	Production		Cash cost	AISC	Revenue	Mine EBITDA	P&P reserves	
		Silver, koz	Gold, koz	US\$/oz (GEO)	US\$/oz (GEO)	US\$m	US\$m	Gold, koz	Silver, koz
Jacobina	Brazil	0	186.2	566	738	336	230	2,938	0
Cerro Moro	Argentina	5,582	80.0	848	1,228	277	125	457	22,180
El Penon	Chile	3,587	176.4	673	932	402	246	933	29,383
Minera Florida	Chile	0	84.8	881	1,224	158	73	430	3,011

Source: Yamana Gold, Edison Investment Research

At end September, Yamana's capital structure consisted of US\$539m in cash and US\$774m in debt, implying net debt of US\$235m (we note that Yamana also has US\$1.4bn in long-term tax liability). PAAS has very low gearing with a Q322 net cash position of US\$119m, including US\$34m in short-term investments and US\$153m in gross cash. Taking into account the termination fee to Gold Fields of US\$300m (50% payable by PAAS), the combined company would have pro forma net debt of c US\$415m. Based on FY22 consensus EBITDA estimates of US\$283m for PAAS and US\$961m for Yamana (source: Refinitiv), and adjusting for Canadian Malartic's (Yamana owns 50%) annualised 9M22 EBITDA of US\$342m, this translates into pro forma combined EBITDA of c US\$902m and implies a net debt to EBITDA ratio of only c 0.5x. Of note is that the company's liquidity could be further enhanced by the recently announced cash and shares offer for Maverix Metals from Triple Flag, which values the company at US\$606m, or c US\$103m for PAAS's 17% interest. It also excludes G&A synergies, which PAAS estimates at US\$40–60m per year.

Overall, we believe that the proposed acquisition has clear rationale for PAAS as it allows the company to acquire established silver and gold operations that are low cost, generate substantial cash flows, have relatively long mine lives with expansion potential and are located in the region where PAAS has significant operational expertise. If successful, the deal will cement PAAS's position as one of the largest independent silver producers and following the anticipated launch of Escobal (20Moz pa historical silver output, c 15Moz feasibility study average), should bring the company's combined silver output close to the market leader Fresnillo (FY21: 53Moz). On the flip side, the deal would further increase PAAS's exposure to Latin America, which has relatively high political and economic risks. It will also increase the share of gold in the sales mix (and we view the gold price outlook as more uncertain compared to silver), although it should improve as the company brings Escobal back into production.

Q322 results: No respite from cost pressures

Lower commodity prices and unabating cost pressures continued to suppress PAAS's financial performance in Q3, but at the top line level were largely offset by the higher gold sales. As a result, the company reported flat quarter-on-quarter revenues of US\$339m. Similarly, silver and gold production and silver sales were broadly unchanged versus Q222 at 4,537koz, 128.8koz and 4,263koz respectively. At the same time, gold sales increased by 13% q-o-q to 134.7koz thanks to the strong production performance at La Arena and Shahuindo. Total cash production costs were slightly down in absolute terms mainly due to the lower non-cash net realisable value (NRV)

inventory adjustments at the project level, which coupled with the reduction in other operating expenses resulted in an 89% q-o-q increase in EBITDA to US\$34m.

However, in unit terms cost pressures remained visible during the quarter, with the silver segment cash cost increasing 21% q-o-q to US\$14.6/oz and the gold segment cash cost rising 5% to US\$1,184/oz. At the project level, the biggest cost increases in the silver segment were seen at the La Colorada mine (US\$12.4/oz, +32% q-o-q), which suffered from lower silver grades and general inflationary and supply chain cost pressures. In the same vein, cash costs at Huaron were under pressure, up from US\$4.7/oz in Q222 to US\$10.9/oz in Q322. In the gold segment, the most notable cost increases came from the Timmins mine, which saw the cash cost rising 11% q-o-q to US\$1,748/oz. At the same time, the gold segment saw a 21% sequential reduction in quarterly AISC due to the lower NRV adjustments at Dolores.

Exhibit 3: PAAS quarterly results summary

US\$m unless stated	Q322	Q321	Difference, %	Q222	Difference, %
Silver production, koz	4,537	4831	(6.1)	4,537	0.0
Silver sales, koz	4,263	4869	(12.4)	4,252	0.3
Silver segment cash cost, US\$/oz	14.6	11.9	22.7	12.1	20.8
Silver segment AISC, US\$/oz	18.0	16.3	10.2	17.3	3.9
Gold production, koz	128.8	142.6	(9.7)	128.3	0.4
Gold sales, koz	134.7	170.0	(20.8)	119.3	12.9
Gold segment cash cost, US\$/oz	1,184	922	28.4	1,132	4.6
Gold segment AISC, US\$/oz	1,614	1,176	37.2	2,051	(21.3)
Revenue	338.9	382.1	(10.9)	340.5	(0.5)
Cash production costs	(275.1)	(199.4)	44.6	(288.3)	(4.6)
D&A	(77.9)	(68.5)	8.4	(74.3)	4.8
Other operating costs	(37.0)	(20.3)	547.3	(131.7)	(71.9)
EBIT	(51.1)	93.8	N/A	(153.8)	(66.8)
EBITDA	33.9	152.3	(88.2)	17.9	89.2
PBT	(69.3)	100.8	N/A	(166.8)	(58.5)
Net profit attributable to equity holders	(71.5)	70.9	N/A	(174.0)	(58.9)
Adjusted net profit	4.8	60.3	N/A	(67.3)	N/A

Source: PAAS, Edison Investment Research

Despite the recovery in adjusted earnings, the company still recorded a free cash outflow during the quarter as capex of US\$69m and dividend payments of US\$23m outweighed the improved cash flow generation (net operating cash flow of US\$54m vs US\$21m in Q222). Yet, the company remains well capitalised with a net cash position of US\$119m (including short-term investments of US\$34m and gross cash of US\$153m) and US\$500m in an available sustainability linked credit facility. In line with its dividend policy, PAAS declared a cash dividend of US\$0.11/share for the quarter.

Updated FY22 guidance, earnings estimates

With its Q322 results the company has also partly updated its FY22 production and cost guidance. PAAS now expects to produce 18.0–18.5Moz of silver (from 19.0–20.5Moz) and 550–605koz of gold (unchanged). According to the company, the revised silver production outlook is mainly due to the lower production at Dolores and lower silver grades at La Colorada. PAAS expects grades at Dolores to improve to near reserve levels (proven and probable reserves grade of 317g/t) towards the end of 2022.

On the cost side, while the company left its cash cost and AISC expected values unchanged for both segments, it noted that in the silver segment costs could be above the high end of the range due to ongoing supply chain disruptions and market distortions affecting the input costs. Earlier, PAAS guided silver segment cash costs of US\$10.7–12.2/oz and AISC of US\$14.5–16.0/oz.

Similarly in the gold segment, cash costs are expected to be above the previously announced guidance range of US\$970–1,070/oz, while AISC is anticipated to be within the earlier announced range of US\$1,450–1,550/oz (excluding NRV adjustments).

We have revised our earnings estimates to reflect the Q322 results, updated production and cost guidance and the recent commodity price fluctuations. We now model silver production of 18.4Moz in FY22, a reduction of 5% versus our prior estimate, and gold production of 563koz, down 1%. We have also adjusted our cost estimates and now expect a silver cash cost of US\$12.3/oz (from US\$11.1/oz) and a gold segment cash cost of US\$1,116/oz (US\$1,090/oz), reflecting the ongoing industry cost pressures. Our revised gold segment AISC excluding NRV adjustments of US\$1,467/oz (from US\$1,453/oz) is within the company's guidance.

All in all, the above adjustments lower our FY22 revenue estimate by 5% to US\$1,541m and our EBITDA estimate by 26% to US\$297m. We have also lowered our FY23 estimates, with EBITDA down 5% to US\$484m, mainly due to the higher cost expectations as a result of the higher FY22 cost base. However, if the Yamana acquisition goes ahead, which we believe is highly likely, our current FY23 estimates for PAAS will become less relevant. We plan to revise them following the anticipated shareholder approvals of the proposed transaction.

Exhibit 4: PAAS revised estimates

(US\$m unless stated)	FY22e old	FY22e new	Difference, %	2023e old	2023e new	Difference, %
Silver price, US\$/oz	21.9	21.7	(0.9)	23.6	23.6	0.0
Silver production, Moz	19.3	18.4	(4.9)	20.0	20.0	(0.1)
Silver segment cash cost, US\$/oz	11.1	12.3	10.8	10.2	11.2	9.5
Silver segment AISC, US\$/oz	15.1	15.9	5.2	13.5	14.5	7.1
Gold price, US\$/oz	1,830	1,800	(1.6)	1,749	1,749	0.0
Gold production, koz	570	563	(1.2)	577	583	1.1
Gold segment cash cost, US\$/oz	1,090	1,116	2.4	1,020	1,037	1.7
Gold segment AISC, US\$/oz	1,582	1,629	3.0	1,288	1,302	1.1
Revenue	1,614.9	1,540.8	(4.6)	1,581.1	1,582.9	0.1
Cash production costs	(1,078.9)	(1,107.1)	2.6	(942.0)	(967.5)	2.7
Royalties	(40.1)	(35.7)	(11.1)	(37.5)	(35.8)	(4.5)
Depreciation and amortisation	(297.8)	(299.3)	0.5	(291.7)	(289.9)	(0.6)
Exploration, care and maintenance	(55.2)	(62.0)	12.3	(52.5)	(56.0)	6.7
General and admin	(40.6)	(39.3)	(3.1)	(39.5)	(39.8)	0.6
EBIT normalised	102.3	(2.7)	N/A	217.8	194.0	(10.9)
EBITDA	400.1	296.6	(25.9)	509.5	483.9	(5.0)

Source: PAAS, Edison Investment Research

Valuation update: All eyes on the Yamana offer

We have updated our cash flow-based valuation of PAAS to US\$25.4/share from US\$27.5/share on lower earnings estimates and a slightly higher WACC (7.3% vs 7.2% due to higher risk-free rate). This valuation excludes any impact of the proposed acquisition of Yamana. We will update our valuation of PAAS following the votes by shareholders expected in January 2023. In terms of the share price drivers, although cost pressures and supply chain disruptions continue to be the main features of the financial performance in the industry, the recent better than expected October US inflation data provided renewed support to gold and silver prices, increasing expectations of less pronounced interest rates hikes and a milder economic slowdown. For silver this potentially also means lower industrial and physical demand erosion. Based on Refinitiv data, silver exchange traded fund (ETF) holdings seem to have bottomed out in late August and are now c 2% above these levels (although they are still c 5% lower year to date).

Exhibit 5: PAAS pro forma relative valuation (US\$m)

Equity (364m shares at the current share price of US\$14.9*)	5,402
Yamana net debt, Q322	234.7
PAAS net cash, Q322	118.7
Termination fee	300.0
Combined enterprise value	5,768
FY22e combined consensus pro forma EBITDA	902
Implied EV/EBITDA (x)	6.5

Source: Company data, Edison Investment Research. Note: *Share price as of 15 November.

When it comes to PAAS's valuation however, all eyes are now on the proposed Yamana takeover and the way it will affect the value of the combined company. Our 'back of the envelope' calculations (see Exhibit 5) suggest a pro forma FY22e consensus EV/EBITDA multiple of 6.5x for the combined company. This compares to PAAS's current consensus FY22e EV/EBITDA multiple of 10.5x (Edison: 10.2x). Although PAAS's exposure to gold will increase – and it appears that gold companies in general command somewhat lower valuations compared to the top tier independent silver producers – in our view this is an undemanding multiple. We note that this valuation excludes any likely synergies (but also transaction-related costs) and value contributions from the non-producing assets. Assuming US\$40–60m pa in estimated G&A cost savings would lower the implied pro forma multiple to just 6.4x. Additional support to PAAS share price should come from Agnico Eagle's decision to purchase up to US\$150m in PAAS shares on the open market. At the current share price, this represents c 5% of the company's equity.

Exhibit 6: Financial summary

	US\$m	2020	2021	2022e	2023e
Year end 31 December		IFRS	IFRS	IFRS	IFRS
INCOME STATEMENT					
Revenue		1,338.8	1,632.8	1,540.8	1,582.9
Cash production costs		(696.7)	(925.5)	(1,107.1)	(967.5)
DD&A		(254.5)	(303.0)	(299.3)	(289.9)
Royalties		(27.5)	(36.4)	(35.7)	(35.8)
Gross Profit		360.2	367.9	98.7	289.8
G&A		(36.4)	(34.9)	(39.3)	(39.8)
Other operating costs		(109.2)	(42.9)	(62.0)	(56.0)
Operating profit (before amort. and excepts.)		214.6	290.2	(2.7)	194.0
EBITDA		469.1	593.2	296.6	483.9
Other operating expenses		(5.5)	30.7	(2.7)	0.0
Exceptionals		0.0	0.0	(54.5)	0.0
Reported operating profit		209.1	320.9	(59.8)	194.0
Net Interest and finance expense		(20.1)	(16.2)	(22.0)	(19.9)
Profit Before Tax (norm)		194.5	274.0	(24.7)	174.2
Investment income (loss)		63.0	(59.7)	(17.5)	0.0
Profit Before Tax (reported)		252.0	245.0	(99.3)	174.2
Reported tax		(75.6)	(146.4)	(28.0)	(61.0)
Profit After Tax (norm)		118.9	127.6	(52.7)	113.2
Profit After Tax (reported)		176.5	98.6	(127.3)	113.2
Minority interests		(1.4)	1.1	1.3	1.5
Net income (normalised)		120.4	126.5	(54.0)	111.7
Net income (reported)		177.9	97.4	(128.6)	111.7
Average Number of Shares Outstanding (m)		210	210	211	211
EPS - basic normalised (\$)		0.57	0.60	(0.26)	0.53
EPS - normalised fully diluted (\$)		0.57	0.60	(0.26)	0.53
EPS - basic reported (\$)		0.85	0.46	(0.61)	0.53
Dividend (\$)		0.22	0.34	0.45	0.44
BALANCE SHEET					
Fixed Assets		2,577.0	2,517.4	2,434.4	2,346.4
Tangible assets		2,415.0	2,344.6	2,216.5	2,128.5
Investments		71.6	78.7	123.7	123.7
Other		90.4	94.2	94.2	94.2
Current Assets		856.9	1,001.2	792.9	825.5
Inventories		406.2	500.5	448.9	463.9
Receivables		127.8	128.2	126.6	130.1
Cash		167.1	283.6	128.3	142.6
ST investments		111.9	51.7	51.7	51.7
Other		43.9	37.3	37.3	37.3
Current Liabilities		(361.8)	(387.7)	(367.1)	(340.2)
Creditors		(281.9)	(306.1)	(321.5)	(304.8)
Short term borrowings and leases		(12.8)	(14.1)	(14.1)	(14.1)
Other		(67.0)	(67.5)	(31.5)	(21.3)
Long Term Liabilities		(466.3)	(494.9)	(444.9)	(394.9)
LT debt and leases		(20.7)	(31.8)	(31.8)	(31.8)
Other long term liabilities		(445.5)	(463.1)	(413.1)	(363.1)
Net Assets		2,605.8	2,636.0	2,415.3	2,436.8
Minority interests		(3.3)	(4.5)	(5.8)	(7.3)
Shareholders' equity		2,602.5	2,631.6	2,409.5	2,429.5
CASH FLOW					
Operating Cash Flow		176.5	98.6	(127.3)	113.2
D&A, exceptionals, other		280.5	498.9	513.0	368.2
Working capital movement		97.0	(71.1)	(25.0)	(35.1)
Tax		(81.6)	(129.2)	(133.0)	(121.0)
Net Interest		(10.0)	(5.1)	(5.9)	(6.1)
Net operating cash flow		462.3	392.1	221.8	319.3
Capex		(178.6)	(243.5)	(270.3)	(201.9)
Acquisitions/disposals		22.5	45.8	0.0	0.0
Equity financing		4.7	0.6	0.0	0.0
Dividends		(46.2)	(71.5)	(94.7)	(92.6)
Other		59.1	(2.3)	0.0	0.0
Net Cash Flow		323.8	121.2	(143.2)	24.8
Opening net debt/(cash), including ST investments		77.9	(245.5)	(289.4)	(134.2)
FX and other		(0.5)	(77.3)	(12.0)	(10.5)
Closing net debt/(cash), including ST investments		(245.5)	(289.4)	(134.2)	(148.4)
Closing net debt/(cash), excluding ST investments		(133.5)	(237.7)	(82.4)	(96.7)

Source: Pan American Silver, Edison Investment Research

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