

# HALLGARTEN & COMPANY

## Coverage Update

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## Great Panther Silver (TSX: GPR, NYSE: GPL, FSE:G3U) Strategy: NEUTRAL

Key Metrics		
Price (CAD)	\$1.62	
12-Month Target Price (CAD)	\$1.70	
Upside to Target	5%	
12mth hi-low CAD	\$ 1.48 - \$ 2.95	
Market Cap (CAD mn)	\$249.84	
<b>Shares Outstanding (mns)</b>	154.2	
	<b>FY16</b>	<b>FY17e</b>
Consensus EPS		\$0.05
Hallgarten EPS		\$0.03
Actual EPS	(\$0.03)	
P/E	n/a	48.6

# Great Panther Silver

## Long-Awaited Push into Peru

- + The purchase of Coricancha from Nyrstar, for a bargain price, boosts the company's position in Lead/Zinc and diversifies it into Peru
- + Cash costs have been declining steadily in recent quarters to keep ahead of the silver price weakness
- + Sizeable cash on hand and short term deposits of CAD\$53mn
- + Guanajuato chugs along as a cash-generator
- × Torturous purchase process for Coricancha has put the company two years behind in exploiting the Zinc resurgence
- × Silver remains rangebound between \$15 and \$17 and seems likely to remain that way for the rest of this year
- × Profits from higher prices are not made obvious due to the use of forex losses to obscure them
- × Failure to pay a dividend to shareholders puts the story "offside" with us

### Expansionary Moves

Great Panther has long been associated with its Guanajuato mines in Mexico. However the company has been losing money whether silver is up or down or standing still.

Having tied itself almost exclusively to the silver market, a company cannot help but move with that trend and until 2016 that trend has not been propitious. However in 2015, sensing a change, the company made a move to diversify into Peru with the purchase of Nyrstar's mothballed precious/base metals asset there. However it retreated from the transaction and then more recently revived its interest and finally closed on the deal in late June. By dawdling it has put itself two years behind the Zinc recovery. Better late than never....

In this note, we shall review the assets acquired and attempt to forecast how these moves might play out for shareholders' benefit.

### The Transaction

Finally after a protracted two-year process, in early July the company's acquisition of the Coricancha asset was finalised. The acquisition was completed effective June 30, 2017 as a share purchase whereby the Great Panther's wholly owned Peruvian subsidiary acquired all of the shares of Nyrstar Coricancha S.A. from subsidiaries of Nyrstar. Coricancha owns a 100% interest in the CMC. The acquisition was completed pursuant to the Amended Share Purchase Agreement announced on June 14, 2017,

subsequently amended to address certain follow-on agreements (the "Final Share Purchase Agreement"). Under the terms of the Final Share Purchase Agreement, Great Panther will pay a purchase price to Nyrstar comprising US\$0.1 million to be paid shortly following closing, and earn-out consideration of up to US\$10.0 million. Under the earn-out, Nyrstar will be paid 15% of the free cash-flow generated by the CMC during the 5-year period after which the CMC is cumulative free cash-flow positive.

The CMC is a fully permitted polymetallic mine that includes an operational 600 tonne per day flotation and gold BIOX® bio-leach plant along with supporting mining infrastructure. The CMC has been on care and maintenance since August 2013. The CMC property comprises more than 3,700 hectares in the prolific Central Polymetallic Belt and production at the mine dates back to 1906. Gold-silver-lead-zinc-copper mineralization (approximately 80% gold-silver by value) occurs as massive sulphide veins that have been mined by cut and fill extraction methods.

### GPR enters Peru as Nyrstar Exits

Our original enthusiasm for the base metal refining and smelting group Nyrstar was due to its campaign of vertical integration in the wake of the 2008 crisis which saw it go on a buying spree of beaten down zinc mining assets around the globe. Amongst the assets it picked up at that time was a mine in Peru. The long doldrums in the zinc price (until recently) and the dull management of the group (combined with the travails of Talvivaara) led to it going through an extended period of a low share price which allowed Trafigura to build up a substantial stake. This allowed Trafigura to force through some management changes at the top.

In May 2015, Nyrstar announced a deal which essentially began its withdrawal from South America. The company optioned its mothballed Coricancha mine in Peru to Great Panther, which paid \$1.5mn for the option, with the possibility of extending it for another year for the same amount. Great Panther also agreed to invest \$2mn in the first year of exploration operations at the mine and \$3mn in the second year. GPR had the right to buy the mine for \$5mn at any time during the option period. However, GPR eventually stepped away from the transaction. Then reactivated negotiations when Zinc resurged.

Nyrstar bought a majority stake in the mine



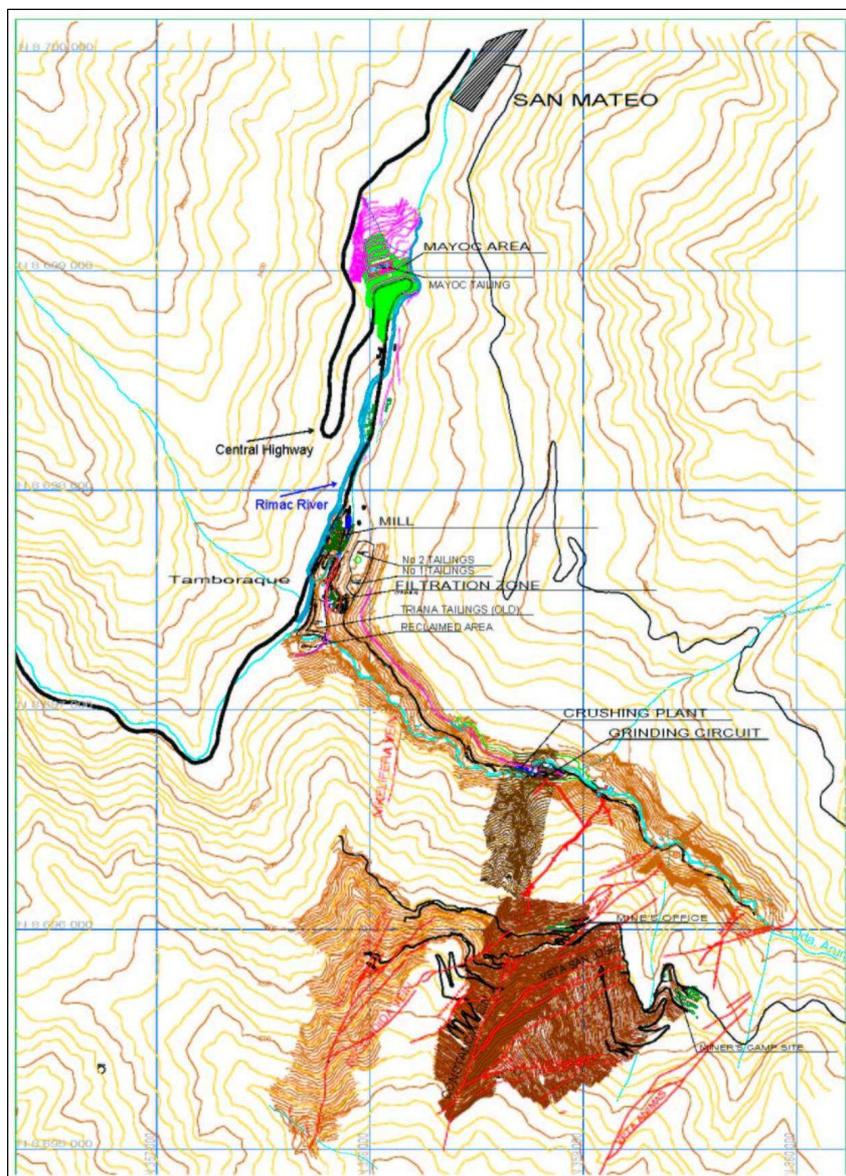
from Gold Hawk Resources for \$15mn in 2009 and then fully acquired the rest in 2010 for an additional payment of \$4.4mn. The Coricancha mine has a production history dating back to 1906. It has been shut since 2013 and is fully permitted with an operational 600 tpd flotation and BIOX® bio-leach plants along with supporting mining infrastructure.

### The Coricancha mine

The mine is located in an area of abrupt relief ranging from 2,990 to 4,500 meters in elevation above sea level. The property comprises more than 3,700 hectares in the prolific Central Polymetallic Belt. Gold-silver-lead-zinc-copper mineralization (approximately 80% gold and silver) occurs as massive sulphide veins that have been mined underground by cut and fill methods.

The concentrator and main office is located immediately off the Central Highway, 90 km east of the city of Lima. The Central Highway is the main highway from Lima, passing east over the Andes Mountains, down to the town and smelter of La Oroya, and on to the eastern part of the country. It is a principal transportation route for food, fuel, mining products and heavy materials.

Access to the mine is via a narrow, 25-km long, gravel road starting at the town of San Mateo, a small town located 5 km east of the concentrator. Travel time from Lima is two hours to the concentrator and about three hours to the mine. Public busses provide daily public transport from San



Mateo to Lima. The national Central Railway passes through the property with loading facilities at the crushing plant.

### **Resource**

As a Belgian-listed company, Nyrstar does not have to dance to the tune of NI43-101. Thus the best available in terms of resource at this time is an historical Mineral Reserve and Resource Estimate for Coricancha comprising:

- a Proven and Probable Reserve of 0.64 million tonnes at a grade of 4.35 g/t gold, 149.12g/t silver, 0.32% copper, 1.77% lead and 2.6% zinc
- a Measured and Indicated Resource of 0.89 million tonnes at a grade of 5.04g/t gold, 174.62g/t silver, 0.42% copper, 1.97% lead and 3.11% zinc
- an Inferred Resource of 4.88 million tonnes at a grade of 4.91g/t gold, 224.54g/t silver, 0.48% copper, 1.57% lead and 2.98% zinc

This represents 13.5 million silver equivalent ounces (Ag eq oz) in Proven and Probable Reserves, 21.96 million Ag eq oz in Measured and Indicated Resources and 124.6 million Ag eq oz in Inferred Resources.

### **Past Production**

Under the ownership of Gold Hawk, approximately 30 active stopes were required to achieve production of 600tpd, almost all using the cut-and-fill or shrinkage mining method. The principal stoping method for the near-vertical veins was overhand cut-and-fill, with backfill mainly obtained from development waste. Under Nyrstar's ownership, other mining methods such as longhole were tried without success. Mining was semi-mechanized with ore haulage principally undertaken by locomotives, and scoops used for short distance haulage. Some drilling was undertaken with an electro-hydraulic drill jumbo, but development and production drilling were principally accomplished with hand-held jackleg drills.

The crusher and mill are located at the mine portal (at 3,140m above sea level). The concentrator, flotation circuit and BIOX<sup>®</sup> facility are located at a lower elevation, along the main highway near the Rimac River. The concentrator produces zinc, lead and copper concentrates, and a gold-rich flotation concentrate which is treated in the BIOX<sup>®</sup> facility, ultimately resulting in the production of a Au-Ag doré. At a processing rate of 600tpd, average annual production would be approximately 21,000 oz Au, one million oz Ag, 4,400t Zn, 2,100t Pb and 400t Cu. Tailings from the processing plant were hauled by rail and/or trucks to the Chinchán dry-stack tailings storage facility, approximately 40km from Coricancha.

### **Next Steps at Coricancha**

Nyrstar has agreed to be responsible for the cost of reclamation work (and any associated fines) that Coricancha will undertake at the CMC, related to certain legacy tailings facilities, subject to agreed

maximum amounts. In addition, Nyrstar will maintain the existing CMC mine closure bond for three years.

Great Panther's plans include further evaluations of the current mine and processing infrastructure, mine rehabilitation and development in preparation for underground drilling, environmental studies, and the initiation of a preliminary feasibility study. Depending upon the outcome of the PFS, capital investments in support of restarting operations could commence in 2018. Great Panther is currently working on an updated mineral resource estimate for the CMC, which is expected to be completed towards the end of the third quarter of 2017.

### Earnings & Outlook

One can see why Great Panther was in the doldrums for so long but it is hard to work out why it should have staged such a stellar recovery considering that the stock price has recovered so much and yet the top line revenues have not shown a commensurate recovery with the silver price due to the declining production at the company's legacy mines in Mexico.

<b>GREAT PANTHER SILVER</b>							
In Millions of CAD							
	<b>FY17e</b>	<b>FY16</b>	<b>FY15</b>	<b>FY14</b>	<b>FY13</b>	<b>FY12</b>	<b>FY11</b>
Total Revenue	59.70	61.88	56.22	54.39	53.95	61.14	57.82
Cost of Revenue, Total	41.00	39.86	51.85	60.55	53.31	41.93	30.9
Gross Profit	18.70	22.02	4.37	-6.16	0.64	19.21	26.92
Selling/General/Admin.	5.90	5.71	6.09	6.78	7.54	9.88	8.47
Exploration & Development	7.20	6.08	6.17	4.59	2.39	2.38	0.93
Depreciation/Amortisation	0.16	0.14	0.20	0.31	0.30	0.21	0.1
Unusual Expense (Income)	0.00	1.68	2.3	11.74	12.04	-	-
Other Operating Expenses	-	-	-	-	-	0.03	0.05
Total Operating Expense	54.26	53.47	66.61	83.97	75.58	54.43	40.48
Operating Income	5.44	8.41	-10.39	-29.58	-21.63	6.71	17.34
Net Finance Result incl. forex	1.50	-11.01	3.24	-1.181	-	-	-
Gain (Loss) on Sale of Assets	-	-1.68	2.30	0.01	-	-	-
Other, Net	0.00	0.00	0.00	-0.173	0.49	-0.27	0.53
Income Before Tax	6.94	-2.61	-7.16	-30.94	-16.21	9.71	13.49
Tax	1.74	1.51	0.00	2.07	-3.48	4.2	1.98
Income After Tax	5.21	-4.12	-7.16	-33.01	-12.73	5.51	11.51
Diluted Average Shares	156.00	154.22	140.86	139.15	138.15	138.71	135.4
Diluted EPS	0.033	-0.027	-0.051	-0.24	-0.09	0.04	0.08
Silver Ozs	2,030,000	2,047,260	2,386,028	1,906,645	1,711,215		
Gold Ozs	19,000	22,238	21,740	16,461	15,714		
Silver Price Assumption (USD)	\$17.00						

With operating income of \$8.41mn in FY16 well may we ask why the bottom line is negative and then

we see an \$11mn negative for forex adjustments. This line item is a hoary old chestnut of Canadian miners operating in LatAm and a good way of “hiding the good stuff” from greedy shareholders who might be demanding a dividend. However the tax number gives it away as clearly tax authorities in Canada or Mexico or both are not having it that the company is loss-making and they have moved in for their pound of flesh. Not knowing which of the claimants has made this tax charge against the company makes it hard to work out what the tax rate being charged is and thus what the assessed taxable profit might be. In our humble opinion it would suggest something between \$6-7.7mn in real pre-tax profits which comes in at a respectable operating margin of \$61mn in topline revenues. Which then begs the question “where is our dividend”?

### **Risks**

As an experienced operator with a long trajectory in Latin America, Great Panther has a much better chance of avoiding pitfalls than a neophyte miner in the region might be able to do. Nevertheless there are always risks for even the most seasoned miner. Amongst these, for Great Panther, are:

- Silver price risk and, to a lesser extent, gold price risk
- In the case of Coricancha, base metals prices, particularly Zinc, are key in the ultimate viability and margins of the operation
- Guanajuato’s operations are key to funding other parts of the nascent GPR so that mine’s performance is vital to expansion plans
- Peruvian conditions are currently good, but a deterioration could impact the Coricancha restart

The issue of prices is more important than anything else. With the new Coricancha bolt-on GPR is diversifying into Zinc, one of the metals with the strongest upside potential at this time. It also mitigates its exposure to the fickle and lackadaisical precious metals space.

The health of Guanajuato is vital to the rest of the enterprise in providing cashflow to fund development in Peru. Ongoing profitability from this cash-cow should pay for the development of the other properties.

### **Conclusion**

As a pure silver play during the great silver boom we found Great Panther to be worthy, but not outstanding. First Majestic had given us a real phobia for Mexican silver stories with its “all for us, none for you” (non-) dividend story. Also we were never believers in silver at points north of \$25 and at \$50. However down where silver is now we are inclined to view it as slightly undervalued with potential to move nearer to the \$20 over the next two years (irrespective of gold’s doldrums).

However since our last note on GPR, when we posited a target price of 84cts this stock has soared and then slumped. In light of the potential to only make a bit over 3 cents per share in the current FY we would have to say on existing assets the company is overvalued. The factor that rescues it from receiving a Short rating from us is its putative move into Zinc in Peru.

More exciting for us than silver has been the revival of Zinc over the last 12 months with a 100% higher move from the recent lows. Some of this enthusiasm for Zinc’s price dynamic is seeping through the mining space but precious few producers have acted upon this. It is probably because GPR already has a zinc/lead component in its income mix through the Topia Mine that it originally wanted to be a “first mover” in the space with its opportunistic optioning of Nyrstar’s Coricancha Lead/Zinc/Silver complex in Peru. It then dropped the ball and thought it would game the Zinc market. Then Zinc came storming back to life and GPR has (luckily) managed to revive the transaction but is two years behind where it would have been if it had continued with Plan A.

The move on Coricancha is a case of better late than never though, as in one step, it rebalances future production more towards base metals and diversifies GPR away from its traditional stamping ground of Mexico.

We have changed our previous **Long** call (due to the stock having long ago passed our former target price of 84 cts) to a **Neutral** with a twelve-month target price of \$1.70.



## Important disclosures

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