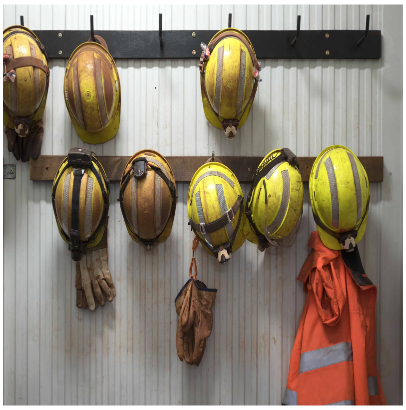

Ignore Weak Silver and Buy This Miner

Description

Silver continues to languish at under US$15 per ounce, despite gold recovering earlier this month to trade at around US$1,230 an ounce. The gold-to-silver ratio has widened sharply to require 84 ounces of silver to purchase an ounce of gold compared to 75 ounces a year ago. This has many pundits claiming that now is the time to boost exposure to silver, despite fundamentals indicating that the white metal will remain stagnant for the foreseeable future.

Nonetheless, this should not deter investors from making a contrarian investment in **Fortuna Silver Mines** (TSX:FVI)(NYSE:FSM). After substantially outperforming silver, its stock plunged significantly in recent months to see the miner down by 20% for the year to date.

Now what?

Fortuna's latest announcement concerning its third-quarter 2018 operational results disappointed the market, despite silver output expanding by a healthy 11% year over year to 2.2 million ounces. This because the miner's gold production dropped by 6%, while lead fell by 1% for the same period.

Preliminary costs per tonne of ore milled at Fortuna's mines for the third quarter also compared to the equivalent quarter in 2017. For that period, it reported cash costs for its San Jose mine in Mexico of US$63.30 per tonne of ore processed, which was around 2% higher than a year earlier. While for the Caylloma operation in Peru, they were US$88.53 per tonne of ore processed, which was a worrying 16% greater.

This will impact Fortuna's overall operating expenses, as expressed by its consolidated all-in sustaining costs (AISCs) for the quarter, especially with gold and lead production having fallen leading to lower by-product credits. It should be noted, however, that the costs reported were preliminary and could be revised when Fortuna releases its official third-quarter report.

Nevertheless, the miner remains an appealing play on precious metals, because of its open-pit Lindero project located in Argentina. It has an estimated mine life of 15 years and will produce, on average, 96,000 gold ounces annually over its operational life with anticipated AISCs of US$802 per ounce produced. This underscores the profitability of the property in an operating environment where gold is trading at over US$1,230 per ounce.

Lindero is on track to commence commercial operations during the third quarter 2019, despite some delays in building the mine camp. That will be an important step for Fortuna, because it will reduce its dependence on silver, helping to minimize the impact of the poor outlook for the white metal on the miner’s finances.

During September 2018, Fortuna reported some credible results for its drilling program at the mine. This indicates the considerable potential held by the asset and the potential to boost its gold reserves from the 1.7 million already reported. Any increase in reserves at the Lindero property should give Fortuna’s value a solid lift.

So what?

The negative outlook for silver will weigh on Fortuna’s market value for the foreseeable future, but when the Lindero project comes online, its earnings will grow at a decent clip. When Fortuna can consistently demonstrate to the market that the mine has successfully commenced operations in accordance with its projections, the company’s stock will soar, especially if gold remains trading at over US$1,200 an ounce.

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