Make a Contrarian Bet on Firmer Silver by Investing in this Miner

Description

As gold continues to firm it is pulling its poorer cousin silver higher. The yellow metal has gained 2% since the start of 2019, recently breaking through the psychologically important US$1,300 an ounce barrier. For the same period, silver has gained 5% to be trading at around US$15.75 per ounce. And this, along with the gold-to-silver ratio requiring 82 ounces of silver to purchase a single ounce of gold has led to speculation that silver is undervalued relative to gold. That according to silver bugs makes now the time acquire primary silver miners.

While the outlook for silver remains stagnant because of weaker industrial demand and an ongoing supply surplus, the white metal will move higher because of its relationship to gold. Some analysts believe that because of firmer gold, silver will rally to as high as US$16.50 per ounce. Such an environment makes now the time for investors to making a contrarian bet on smaller silver miners operating quality low cost assets with solid balance sheets. One that stands out is **Sierra Metals Inc.** (TSX:SMT)(NYSEMKT:SMTS).

Quality assets and growing production

The miner, which owns three operational mines**,** the Bolivar and Cusi mines in Mexico as well as the Yauricocha mine in Peru**,** reported record ore throughput for 2018 at its Mexican operations. As a result, 2018 full-year silver production shot up by 17% year over year to 2.7 million ounces. Sierra Metal's copper and gold production also grew quite strongly, rising by 27% and 25%, respectively. That saw the miner report total 2018 annual production of almost 18 million silver equivalent ounces.

This solid production growth can be attributed to higher ore throughput and head grades. Those improved ore grades combined with expanded metals output means that operating expenses for the year should fall on a per ounce produced basis leading to lower all-in sustaining costs (AISCs).

Sierra Metal's third-quarter 2018 results highlight the success of its moves to reduce AISCs. For that period, AISCs fell by 23% year over year to US$10.21 per silver equivalent ounce produced, highlighting the profitability of its operations despite weaker silver. Lower costs coupled with moderately firmer metals prices and higher production should give Sierra Metal's 2018 earnings a healthy boost.

For 2019 the miner anticipates that production will continue to grow at a healthy clip, to be 21.8 million silver equivalent ounces, which is 21% greater than 2018. Along with an ongoing focus on controlling costs and firmer silver that will give Sierra Metal's earnings a solid boost.

The miner's attractiveness as an investment is further enhanced by its solid balance sheet. Sierra Metals finished the third quarter 2018 with cash of US$29 million and total debt of US$60 million, which is a mere 0.64 times trailing adjusted EBITDA, thereby indicating that it is quite manageable. That solid balance sheet will help to insulate the miner from the impact of a sustained downturn in the price of silver.

Sierra Metals reserves and production will grow over the long term because it is actively involved in a range of exploration and development activities at its Cusi, Bolivar and Yauricocha properties, including installing new infrastructure and ball mills at Bolivar and Cusi and expanding shafts and adding a tunnel at Yauricocha.

Why buy Sierra Metals?

While I am not optimistic on the outlook for silver, there are signs that it will move higher because of its closely correlated relationship with gold and the fact that the yellow metal is destined to move higher during 2019. Sierra Metals, because of its growing metals production, decreased AISCs and solid balance sheet, is an attractively valued levered play on higher silver.

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