Now Is the Time to Buy Pan American Silver Corp. (TSX:PAAS)

Description

While the outlook for silver remains poor, the white metal has rallied significantly since hitting its lowest price since January 2016 to be trading at US$15.74 an ounce. Even after that strong rebound, silver is still down by 10% over the last year. There is, however, speculation that silver — along with gold — has entered a new bull market and will move higher over the course of 2019, making now the time to bolster exposure to primary silver miners. One intriguing play, even if silver remains weak, is **Pan American Silver** (TSX:PAAS)(NASDAQ:PAAS).

Latest transformative deal

What makes Pan American an intriguing investment is its transformative acquisition of deeply troubled miner **Tahoe Resources**. The deal, with a base price of almost US$1.1 billion, is expected to close during the first quarter of 2019 and will add the world-class Escobal silver mine to Pan American's portfolio. That mine has been stuck in limbo since Tahoe was forced to shutter operations after its licence was suspended in July 2017 by Guatemala's Supreme Court.

While Tahoe's management claimed to have a path to re-opening Escobal, it appears that a change of ownership could be the only potential means of recommencing operations. This is because of strong community opposition to Tahoe and the mine, along with allegations that the company had run roughshod over local and indigenous communities.

There is every likelihood that Pan American can ultimately restart operations at Escobal. The mine is a critical contributor to Guatemala's economy, and it has a long history as well as familiarity with working in Latin America, which should see it well equipped to resolve the issues that have sparked considerable opposition to the mine.

If Pan American is successful in re-opening Escobal, it could add up to 21 million ounces of silver to its precious metals production at low all-in sustain costs (AISCs) of US$8.63 per silver ounce produced. In an operating environment where silver is trading at almost US$16 per ounce, that would give the miner's profitability and earnings a solid lift, with Escobal estimated to be responsible for 22% of the post-acquisition company's revenue.

The deal will also more than double Pan American's reserves to 1.2 billion silver equivalent ounces, which will be 48% weighed to silver and 33% to gold compared to 49% and 23%, respectively, prior to the transaction. The significant increase in gold reserves is particularly positive, because the yellow metal recently broke through the psychologically important US$1,300-an-ounce barrier. That will give Pan American's post-transaction earnings a solid lift.

Portfolio of quality assets

This isn't the only reason Pan American is an appealing contrarian play on silver. For the full year 2018, the miner modestly missed annual silver production guidance, reporting output of 24.8 million ounces compared to a forecast of 25-26.5 million. This shortfall was caused by operational outages at Pan American's Dolores and San Vicente mines in Mexico and Bolivia, respectively.

Nonetheless, Pan American reported some impressively low 2018 cash costs of US$3.35 per silver ounce produced, which were towards the lower end of its revised 2018 annual guidance of US$2.80-3.80 per ounce produced. That underscores the profitability of Pan American's mining operations and its ability to generate cash flow, despite a difficult operating environment.

The miner anticipates that 2019 silver production will grow between 7% and 11% compared to 2018 to be as high as 27.5 million ounces. Cash costs and AISCs are forecast to increase when compared to 2018 to as high as US$7.50 and $12.80 per ounce, respectively, Pan American's operations will remain profitable with silver trading at over US$15.70 per ounce.

In fact, the miner's 2019 projections were calculated using an average annual silver price of US$14.50 per ounce, which is well below the current spot price, boding well for greater profitability during the year, especially if silver firms to US$16 per ounce, as many analysts are predicting.

Pan American's rock-solid balance sheet further enhances its appeal. At the end of the third quarter, it had considerable liquidity comprised of US$253 million in cash and an additional undrawn US$300 million on an existing credit facility. It also had total debt of a very manageable US$8.4 million, making it capable of weathering sustained downturn in silver.

Why buy Pan American?

While the outlook for silver remains bleak, it will rise in value as gold rallies, because of its closely correlated relationship to the yellow metal, and that will help to lift Pan American's market value. The primary silver miner's opportunistic tilt at Tahoe, once completed, will add some world-class assets to its portfolio and make it a leading publicly listed primary silver miner. While the deal includes some troublesome assets, notably the Escobal mine, the considerable upside they offer, if Pan American can commence operations in Guatemala, far outweighs the risks. This, coupled with a rock-solid balance sheet, makes Pan American an extremely attractive contrarian play on silver.

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