



Should You Buy This Mining Mega-Merger?

Description

In November, **Pan American Silver** ([TSX:PAAS](#))([NYSE:PAAS](#)) agreed to buy **Tahoe Resources** (TSX:THO)(NYSE:TAHO) for \$1.07 billion in cash and stock. According to the companies, the move will create the “world’s premier silver mining company.”

As a resources company, Pan American knows that scale matters. Of course, the buyout would allow it to consolidate all back-office expenses and reduce two pricey management teams to just one. The buyout also provides new levels of diversification (Tahoe Resources has some gold exposure) and give the company additional assets to leverage for taking on new financing.

But trouble is already brewing.

New company, new risks

Immediately, an analyst from **Royal Bank of Canada** downgraded Pan American stock, saying the transaction adds a “world-class silver mine in Escobal at a discount,” but that the combined company’s risk profile has “increased materially.”

The higher risk profile was demonstrated weeks later when a few non-profit firms filed to block the buyout, accusing both companies of hiding key risks. Yet, just one week after the filing, shareholders of Pan American and Tahoe Resources voted to complete the takeover.

Apart from how the market has reacted, is now the time to buy either company?

Only one way to win

Unless a competing bid arises, Pan American will soon pay \$3.40 per share for Tahoe Resources stock, slightly below today's current trading price, suggesting there are still some investors out there that believe the current bid will be trumped. So, if the deal is executed under the current agreement, buying Tahoe Resources stock today would ensure you a negative return.

But what about buying Pan American stock?

The entire deal relies on the success (or failure) of a single project: the Escobal mine, which is the third-largest silver-producing asset in the world. Since 2017, it's been closed due to complications with the local Xinca population. Pan America's first order of business will be to smooth relationships with local groups and leaders.

"This will take a lot of listening and discussions with the communities to make sure that we understand their needs," said Pan American CEO Michael Steinmann. "We're very early in this process. There's absolutely no rush."

Before its closing, the Escobal project was generating 20 million ounces of silver per year at attractive all-in costs. According to Pan American's management team, Escobal has enough silver reserves to continue record production for another decade. Importantly, they believe it has "enormous" exploration potential, meaning the runway could be extended further.

In 2018, Pan American produced just 24.8 million ounces of silver, below its target of 25-26.5 million ounces. Struggling results essentially make the Tahoe Resources buyout a bet on the future of the company.

If the mine is restarted over the next year or two, the deal will undoubtedly be a winner, especially considering the bargain price Pan American is set to pay. If the mine remains shuttered, it's easy to see shareholders losing.

Should you take this bet?

In response to court documents filed in September, Tahoe Resources couldn't comment on when the mine might be reopened but noted that the Guatemalan government completed similar reviews in less than six months. But that suggestion is misleading. There's a real chance that the mine will take years to reopen.

The management teams from Pan American and Tahoe Resources may remain publicly optimistic, but other leaders in the mining industry are more skeptical. Recently, Guatemala was ranked as the world's "least attractive region for miners" in a survey of mining executives.

If you're looking to gain exposure to rising gold or silver prices, stay far away from this deal. Investing in Pan American stock today is simply a bet on a single mine reopening — a bet with little reliable information to work with.

CATEGORY

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2. Metals and Mining Stocks

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