Reduce Investment Risk by Avoiding Primary Silver Miners

Description

It has been a tough time for silver miners and investors. While gold has rebounded to be trading at over U$1,285 per ounce since falling to under US$1,200 in late-2018 silver continues to languish as the stagnant outlook for the white metal weighs on its value. Silver is stuck below US$16 an ounce and there are signs that it will be some time before the white metal rallies. That negative outlook and the declining profitability of many primary silver miners makes any investment in a silver miner a risky play.

Even with the gold-to-silver ratio hovering at around a historically high, 85 ounces of silver being required to buy an ounce of gold, there are signs that silver will remain flat and is not undervalued relative to gold. This is because there is growing evidence that the close relationship between gold and silver is breaking down because of faltering popularity among investors for the white metal and weaker than anticipated industrial demand.

Stagnant outlook for silver

The latest slump in silver has sparked speculation that many primary silver miners will struggle to be profitable and generate enough capital to invest in adequate mine maintenance and development. This is especially the case for those miners operating aging silver mine that are past their peak.

A key reason for this is the negative fundamentals impacting silver. This includes growing mine supply that precipitated a 35.3-million-ounce surplus during 2018, which was 7% greater than a year earlier. While some pundits are claiming that silver production will decline during 2019, this is unlikely to alleviate that significant supply overhang.

The sharp impact this is having on prices is being magnified by contracting demand for the white metal. During 2018, physical demand for silver plunged by 3% year over year. This was triggered primary by a growing lack of investor interest in silver bars and coins as well weak industrial demand for the precious metal.

Surprisingly, preliminary data indicates that the consumption of silver by the photovoltaic industry contracted during 2018. It was the supposed importance of silver in the fabrication of photovoltaic cells and growing demand for solar energy, which many analysts asserted would be a powerful tailwind for the white metal. This hasn't occurred because of technological advances and the implementation of efficiencies in the manufacturing process for solar arrays reducing the volume of silver required. Manufacturers are also actively seeking cheaper substitutes for the precious metal has led to less silver being used in their production.

Declining profitability and mine quality

That makes many primary silver miners, especially those with high cost operations like **First Majestic Silver** (TSX:FR)(NYSE:AG), which reported 2018 all-in sustaining costs of US$14.95 per silver ounce produced, unattractive investments. In the case of First Majestic, such high AISCs indicate that it will struggle to be profitable in the current operating environment. In many cases those high costs and the resultant poor profitability can be attributed to aging silver mines, which require the investment of significant amounts of capital to improve their operations.

You only need to look at First Majestic's La Parilla mine, which has been in operation since 2004 to see evidence of these issues. The average silver grade for 2018 was 120 grams of precious metal per ton of ore (g/t), which was 13% lower than 2017 and significantly lower than the 158 g/t reported for 2014. A similar phenomenon is occurring at First Majestic's San Marin mine, which commenced production in 1983 and was acquired by the miner in 2006. The average 2018 ore grade of 218 g/t was 9% lower than the 239 g/t reported a year earlier.

In such circumstances it is difficult to understand how First Majestic can operate profitability with many of its aging mines experiencing sharp declines in ore grades and recovery rates. This trend isn't only confined to First Majestic it is industry wide and highlights why many of the major primary silver miners are risky unattractive investments.

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