The Silver Mergers – a Zero Sum Game

For centuries, indeed millennia, churches told their followers, particularly the poor and the meek, that they should not look for a reward for their sufferings in this life, but in a later life. Then in the middle of the 19th century the poor came to their senses and decided that Marx's description of religion as the opium of the masses might actually have some truth in it. The poor have not been so meek and accepting of their lot in life ever since, or at least not in the West.

I was reminded of this philosophy of accepting your lot and awaiting a very much delayed reward when I initially encountered First Majestic Silver in New York back last decade. Frankly its "gospel" stuck in my craw more than most. Basically it was a story of a never ending spiral of added ounces in resources and production rising on the back of this. However it struck me as thin gruel so I had the temerity to ask the question "what about a dividend?'.

Now I knew what Oliver Twist felt like when he asked "Please sir can I have some more?" I was told that the investors' reward was going to be in higher valuation not in mere piddling dividends. To the crowd of New Yorkers this supercilious approach from management did not go down well. Believe it or not there are investors out there who think that a dividend is a good thing. Maybe there is also good reason why the company rarely (never?) showed its face in London where a dividend is *de rigueur* for a producer in any metals. In Australia one is run out of town when production starts if one thinks one does not need to share the largesse with shareholders through an annual (or more frequent distribution).

Time Rolls On

Fortunately for First Majestic there were enough Canadian investors who were prepared to put up with not even getting a “widow’s mite” and the company was able to wash and repeat with generations of punters happy to let management get paid while they did not.. If reward in some financial afterlife was so great then why didn’t management work for free as well, taking their reward only in shares?

The problem for those who did believe this story is that the stock is now wallowing near decade-lows down from over $25 when the NY crowd was told “heaven can wait”. *Seems more like hell to us..*

Spreading the Joy

So now we have First Majestic in its latest announcement saying that it has agreed a friendly merger with Silvercrest. The latter is a stock we have liked in the past.

If approved, SilverCrest’s Santa Elena Mine would be First Majestic’s sixth producing silver mine, with the mine projected to produce in a range of 4.7 million to 5.1 million silver-equivalent ounces in 2015.

First Majestic had recently claimed that its five operating mines in Mexico produced 3.8 million silver-equivalent ounces in the second quarter and are on pace for production of between 15.3 million and 17.1 million in 2015.

Under the agreement, First Majestic would acquire all of common shares of SilverCrest for 0.2769 of a share of First Majestic plus C$0.0001 in cash per SilverCrest common share. First Majestic would issue approximately 32.8 million common shares, assuming no exercise of existing SilverCrest options, valuing SilverCrest's equity at approximately CAD$154 million (or a value of C$1.30 per SilverCrest share). After the transaction, the current shareholders of SilverCrest would hold 21% of the outstanding shares of First Majestic.

About the only consolation is that shareholders of SilverCrest will receive shares in a newly formed company, New SilverCrest, which will hold certain exploration assets currently held by SilverCrest and First Majestic.

What SVL Holders are Getting

Well may SVL shareholders ask who is rescuing whom here? First Majestic's statement of first quarter highlights stated:

- Generated revenues of $54.6 million
- Mine operating earnings amounted to $5 million
- Net earnings after taxes amounted to a loss of $1.1 million or earnings per share of ($0.01)
- Adjusted earnings per share (a non-GAAP measure) of $0.00, after excluding non-cash and non-recurring items
- Cash flow per share (a non-GAAP measure) of $0.15
- All-in sustaining cost was $13.88 per payable silver ounce
- Total cash cost, net of by-product credits, was $8.22 per payable silver ounce
- Average realized selling price for silver was $17.05 per ounce compared to the quarterly COMEX average price of $16.70
- Cash and cash equivalents of $22.4 million held at the end of the quarter this was down from $40mn at the start of the quarter.. yikes..

After the end of that quarter, First Majestic completed a CAD$30 million bought deal private placement, issuing 4,620,000 common shares at a price of CAD$6.50 per share (of which holders have lost a third of their money already). Wasn't the reason for NOT paying dividends that the company would be self-financing? Seems not…

The progression of results in recent years was a profit of $103mn in FY11, down to $88.9mn in FY12, then a fall into a loss of $38mn in FY13 and a loss of $61mn in FY14.

Conclusion

Going all biblical we may ask “What profiteth it a man to produce 20 million silver ounces per annum and have so little to show for it?”. Our memory is fuzzy but we cannot remember the word for a type of scheme where the first investors in take their money out and then those attracted by the story of the first ones’ profits throw their money in but alas find diminishing returns and ultimately can’t get out when they find the exits blocked by debris. Any suggestions?

Meanwhile if First Majestic can provide us with a compelling reason to think that this company will ever bear fruit (for shareholders) in this lifetime then we might be tempted to overcome our long-held (and justified) wariness of the story. Silvercrest can probably do better.