May 01, 2024

THE LONG PULL: Portfolio Updates (APM.V & GENK)

Two more portfolio companies reported earnings this week: Andean Precious Metals (APM) and GEN Restaurant (GENK).

I cover those earnings and discuss the key points from each report.

Then, I explore a new potential copper play (if we ever get a pullback).

Also, if you didn't watch last week's *MOHO Idea Lunch #4***,** check it out here. We got a ton of great feedback, and it sounds like more of you are using Koyfin. Our goal with that webinar is to create a system for idea generation, information gathering, and portfolio/industry management.

The more eyes we have on similar things, the better our odds of finding that next great trade setup.

Alright, onto the report.

Andean Precious Metals (APM.V): Good Quarter Despite Guided Issues

APM is our small/mid-tier gold and silver producer. The company has two operating assets:

- **San Bartolomé:** A 5Moz open pit silver mine and processing facility in Bolivia
- **Golden Queen:** A 50-60Koz open pit gold mine in California

The elevator pitch on APM is that it used to be a small, profitable, single-asset 5Moz silver producer in Bolivia, trading at a discount to net current asset value.

Today, it's a multi-asset and global mid-tier precious metals producer that doubled production via its transformational Golden Queen acquisition while PM prices inflect to new highs.

Management owns over 50% of the company, with roughly zero shareholder dilution. It consistently buys back stock under its NCIB (Normal Course Issuer Bid) program. In fact, the company bought back 5M shares this quarter (~14% of total shares at the current buyback rate).

APM is one of the cheapest miners on the market, but it has some growing pains, some of which we saw this quarter.

For example, like AFM.V last year, APM saw production issues due to adverse weather at its San Bartolome mine (from earnings call, emphasis mine):

> *"Our total planned throughput experienced an important reduction compared to Q1 2023. This decline can be attributed to heavy rainfalls and thunderstorms around the Potosi area, which adversely affected our operation during the quarter and delays in third-party material deliveries."*

The weather delay reduced production output by roughly 40% from its Bolivian processing facility.

My assumption is that those additional ounces will be sold in Q2 and that this is just a normal fluctuation for a mining-producing company.

However, weather delays can become more frequent. If that happens, you have to discount future cash flows to a greater degree because the probability of receiving those payments on time is reduced.

The other issue was the fire outbreak at the Golden Queen mine in California.

Now, this is an event that I consider more one-time in nature. Unless there's some random arsonist around, I don't expect fire issues to happen in Q2.

Not only did the fire reduce the company's potential output – even though they beat expectations – it also increased AISCs to over $2000 per ounce, resulting in negative cash flow.

However, management said on the earnings call that it expects revenue margins and profits to increase in Q2 and the rest of the year. They even reaffirmed their initial 2024 guidance of roughly 60,000oz from Golden Queen and 5Moz from their Bolivian silver mines.

The final potential issue involves the company's NCIB program. On the earnings call, an analyst asked about the NCB program and whether it would be renewed after the current one expires.

Management balked at the question and said they would reassess the opportunities and options available to their capital once they extinguish the current NCIB.

Some investors probably got spooked by this response because part of the entire thesis is that APM will eventually return to shareholders via buybacks.

That said, they also opened new offices in Sweden and Texas. I don't know why you would do that unless you plan on adding production assets in those two jurisdictions. This is interesting, but I can't underrate it at this point because I have no idea if that's what they're actually doing.

Now, I want to discuss price action, and I'm considering playing this trade over the next quarter or two.

The stock sold off in the initial trading hours following the earnings report before closing above the 50-day moving average of CAD 0.89.

I bet management spent a good portion of the day buying shares from loose hands, around CAD 0.85 per share.

Here's how I'm managing this trade over the next quarter.

I have a short leash for small to mid-junior mining companies with one or two assets.

Yes, these issues in Q1 seem temporary, and management should be able to fix them by Q2. But there is a huge graveyard of junior mining companies whose management teams say they will fix things but don't.

Management said that Q2 will inflect revenues, profit, and margins, and I will hold them to that. If we don't see a material improvement in those metrics and/or the stock price falls below yesterday's lows, we will exit the position and reassess with a clear mind and a fresh PNL.

The good news is that both silver and gold prices have risen since Q1. I expect those higher prices to flow through to the bottom line as 8 PM generates profits and uses those profits to complete the current NCIB program.

I want to see higher profits by next quarter and for management to tell us they will use those profits for a new NCIB program or another acquisition.

The type of acquisition matters, too. I prefer open-pit heap bleach mines. These are easy-to-manage mines with generally low operating costs and a quick initial up-and-running time if care and maintenance were previously neglected.

Consider that management experience. But we don't know if they have experience with underground mines, which are more complex and more costly.

That said, if we break free from this falling wedge, I think it's a great spot to add to our position or, if you're a new collective member, to get a starter position.

Alright, onto GENK.

GEN Restaurant (GENK): Early Innings of Large Growth Opportunity

GENK is a Korean barbecue restaurant where you can eat buffet-style food. The company has 40 stores throughout the West Coast and recently bought out its remaining franchisee partners.

The thesis is simple. GENK offers a tremendous value proposition for individuals and families that want good quality Korean barbecue at a reasonable price.

Customers cook their food, which reduces square footage costs. The food itself also comes in ready-to-serve packets, which reduces employee costs and training.

These cost savings allow GNK to charge lower prices and still generate 15 to 20% store-level EBITDA margins.

When I first wrote about the company, the stock traded at less than one-time sales while generating positive free cash flow and using that cash flow to invest in more store openings.

Management also owns stock and has recently bought on the open market over the past month.

GENK reported solid Q1 2024 earnings. Revenue growth increased by 16%, they added 3 new locations, and expanded EBITDA margins to 16.6%. The best part is that the company grew with cash from operations.

There are only a few significant drivers to focus on:

- The number of new store openings
- Same-store sales growth
- EBITDA margins

The rest is noise. As Bruce mentioned in our Slack channel, GENK has yet to penetrate the East Coast market.

In other words, the existing stores still have higher-than-average labor costs and a larger SGMA allocation spread across fewer stores.

These dynamics change with each new store opening. Labor costs will decline as the company moves from high-cost to low-cost labor states.

Short-term cash flow will look “bad” as the company reinvests into new store openings. But we’re only at 40 stores. The company outlined a path to 200-250+ stores. Profits *should* look “ehh” for a while.

The growth plan should double the size of the company by 2026-2027 (earnings transcript, emphasis mine):

> *“As we look at our broader expansion plan, we have strong forward momentum and remain highly confident in our ability to achieve our 5-year plan that we discussed when we went public.*
>
> *In addition to the 2024 and 2025 restaurant developments I mentioned, we expect to develop 20 to 30 new restaurants, totaling between 70 to 80 by the end of 2026.*
>
> *We will have more than double the company's size since our IPO. Our attractive unit-level economics positions us well to deliver notable profitable growth and expand shareholders' value over the next three years. We're doing all this primarily using free cash flow with minimum debt.”*

You’re paying <1x management’s estimate of 2026 revenues at today’s prices.

GENK gapped 12% in early trading Wednesday and hovers around +6% as of this writing.

We’re happy to hold what we believe is a long-term compounder-like stock.

New Copper Play: Amerigo Resources (ARG.TO)

Amerigo Resources (ARG.TO) is the copper version of Sylvania Platinum (SLP.L).

The company produces ~62Mlbs of copper annually via historical and fresh tailings from the world’s largest underground copper mine, El Teniente (see below).

El Teniente's existing mine life has ~80 years remaining. Management also owns 21% of the company, and its interests are aligned with those of shareholders.

ARG's deal with El Teniente works like SLP.L's deals with its mines (from the SLP write-up, emphasis mine):

> *"SLP goes to "host" mines and says, "You're not doing anything with these tailings and waste rock from your chrome mines. Let us pay you to take these tailings and waste off your hands.""*

The difference is that ARG takes relatively small amounts of low-grade copper ore from El Teniente, not an offtake like silver or zinc.

It's a win-win scenario. ARG gets low-cost copper tailings, and El Teniente makes more money giving the tailings to ARG than it would trying to mine/process the low-volume, low-grade ore.

Here's how the costs work.

ARG pays royalties for the tailings on a sliding scale with copper prices (see below).

($/lb)	
Cu price	**Royalty**
$ 3.00	$ 0.72
$ 3.20	$ 0.80
$ 3.40	$ 0.89
$ 3.50	$ 0.93
$ 3.60	$ 0.98
$ 3.80	$ 1.07
$ 4.00	$ 1.17
$ 4.20	$ 1.27
$ 4.40	$ 1.38
$ 4.60	$ 1.48
$ 4.80	$ 1.59

Anything beyond $4.80/lb requires a meeting to "reset" royalty factors. But royalties increase ~$0.10/lb for every ~$0.20 increase in copper price.

Other cash costs include smelting/refining charges, transportation costs, inventory adjustments, and molybdenum by-product credits (see below).

($/lb)	
Moly price	**Credit to Cash Cost**
$ 14.00	$ (0.22)
$ 16.00	$ (0.25)
$ 18.00	$ (0.29)
$ 20.00	$ (0.32)
$ 22.00	$ (0.35)
$ 24.00	$ (0.38)
$ 26.00	$ (0.41)
$ 28.00	$ (0.45)
$ 30.00	$ (0.48)
$ 32.00	$ (0.51)
$ 34.00	$ (0.54)

The company's Q1 2024 cash cost was $1.96/lb (see below).

(Expressed in thousands)	Q1-2024 $	Q1-2023 $
Tolling and production costs	37,116	39,170
Add (deduct):		
Smelting and refining charges	6,237	6,661
Transportation costs	403	464
Inventory adjustments	(169)	166
By-product credits	(5,454)	(8,039)
Depreciation and amortization	(5,773)	(4,986)
DET royalties - molybdenum	(1,032)	(1,806)
Cash cost	31,328	31,630
Copper tolled (M lbs)	16.00	16.52
Cash cost ($/lb)	**1.96**	**1.91**

It's a simple operation. But there are two other reasons why I like this idea.

One is that the company has already spent $100M in expansion capex to reach this point. This means they only need maintenance/risk mitigation capex going forward.

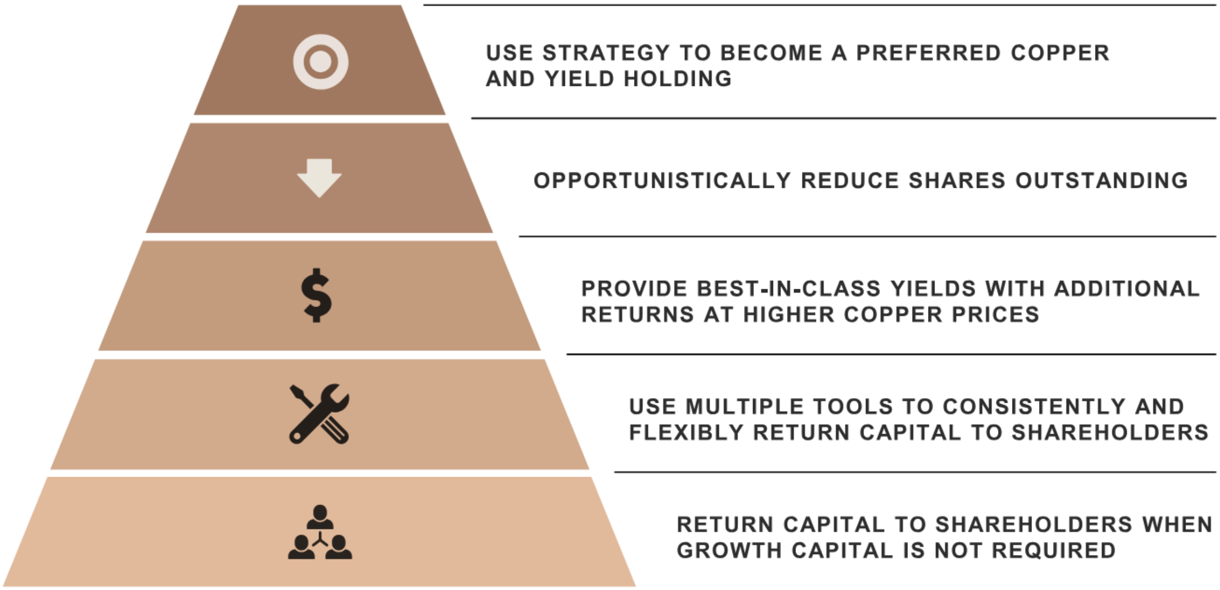
ARG's Capital Return Policy: So Good It Would Make The Next Allocator's Book

The other reason is that ARG uses all that free cash flow to return capital to shareholders. For example, the company has returned $60M to shareholders since 2021 … $37M in dividends and $24M in buybacks (see below).

(Expressed in millions)	Shares repurchased $	Dividends Paid $	Total $
2021	8.9	2.8	11.7
2022	12.3	15.7	28.0
2023	2.6	14.6	17.2
2024	-	3.7	3.7
	23.8	36.8	60.6

That's why I love these tailings/offtake businesses. You don't need a ton of capex; instead, you can become a capital return machine.

Foundations of the Capital Return Strategy



The company outlined its 2024 shareholder return plan in the latest earnings call (emphasis added):

> *"So this is where we are now in Amerigo: strong copper prices, stable operations, controlled costs, low CapEx, declining debt levels, and a proven capital return policy.* ***The quarterly dividend of CAD 0.03 per share is our live or die cash obligation to shareholders****, and it is very safe under these conditions.* ***We are building up our cash decision to the desired target of $25 million****, which happens very quickly under current copper prices.*
>
> ***Additional cash will be distributed to shareholders via performance dividends, share buybacks or a combination of both.*** *As a reflection of the increasingly positive market sentiment,* ***the questions I received from shareholders have changed from at what copper prices at quarterly dividend save to whether we will be buying back shares of paying our performance dividend.*** *The Board of Directors analyzes multiple elements to determine how best to allocate surplus cash for the benefit of shareholders."*

ARG will have over $25M in the bank with copper at $5/lb, which means performance dividends, regular dividends, debt reduction, and potential buybacks.

Modeling The Next Three Years

Here's my napkin model for the next three years.

Unit Economic Model	2024	2025	2026
Copper Production	62	63	64
Avg. Copper Price	$4.50	$5.00	$5.50
Total Revenue	$279.00	$315.00	$352.00
AISCs ($/oz)	$2.50	$2.81	$3.16
Total Costs	$155.00	$177.19	$202.50
Net Profits	**$124.00**	**$137.81**	**$149.50**
Less Capex	-$15.00	-$18.00	-$20.00
Free Cash Flow	**$109.00**	**$119.81**	**$129.50**
Total Free Cash Flow	**$109**	**$120**	**$130**
Current EV	$256	$256	$256
EV Yield	**42.63%**	**46.86%**	**50.65%**
Capital Allocation	**2024**	**2025**	**2026**
Year-end Cash	$124	$213	$302
Dividends (Reg + Perf)	$20	$24	$26
Debt Paydown ($7m/yr)	$7	$7	$7
Buybacks (opportunistic)	$3	$10	$15
Post Allocation Cash	$94	$172	$254
Market Cap to EV			
Market Cap	**$232**	**$232**	**$232**
Cash	$94	$172	$254
Debt	$32	$25	$18
Enterprise Value	**$170**	**$84**	**-$5**
Cumulative Shareholder Return	**2024**	**2025**	**2026**
Dividend	$20	$24	$26
Buyback	$3	$10	$15
Debt Paydown	$7	$7	$7
Total Shareholder Return	**$30**	**$41**	**$48**
Annual Shareholder Yield	11.73%	16.04%	18.77%
Sum of 3YR Shareholder Return	$119		
Shareholder Yield	46.55%		

A few things to highlight. I assumed ~$2.50/lb in AISCs will grow ~12.5% annually to $3.16 by 2026.

I also assume that ARG returns ~$30M in cash to shareholders in 2024, $41M in 2025, and $48M in 2026.

Please take these numbers with a grain of salt. I used historical shareholder returns and my views on what management should do with the cash going forward.

Here's the crazy part.

ARG will be a **negative EV** company by 2026 if copper prices stay around $5/lb and they only spend on maintenance/risk mitigation capex.

They won't *actually* trade at a negative EV. By 2026, management will either increase buybacks and dividends or eliminate the debt altogether.

Thinking About Valuations: Dividend Model

Another way to think about future value is the expected dividend yield.

What would be a reasonable dividend yield for a low-risk, low-cost 60Mlbs+ copper producer in a higher-price environment? 5-7% sounds good.

A 5% dividend yield implies a $520M+ market cap, or double its current price.

Let's head to the charts.

Technicals: Potential VBO on the Monthly Chart

ARG is breaking out of a two-year symmetrical triangle on the monthly time frame (see below).

There are two ways to trade this. One way is to buy the monthly breakout bar on a close above the upper Bollinger band.

The other way is to wait for a pullback within the weekly time frame to get more size.

We'll wait to see how this month's bar closes before putting the trade on.

Either way, we have plenty of copper exposure now. But when an idea works, I want to press and squeeze as much juice from the lemon as possible.

Until next week.

Your Value Operator,

Brandon