Trickle Research

Every raging river, every great lake, every deep blue sea starts … with a trickle

Price Target Upgrade

FORTITUDE GOLD CORP.

Fortitude Gold Corp.

(OTCQB: FTCO)

Report Date: 03/10/22

12- 24 month Price Target: * 9.25

Allocation: 4

Closing Stock Price at Initiation (Closing Px: 04/14/21): $5.26

Closing Stock Price at This Target Upgrade (Closing Px: 03/09/22): $7.36

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Disclosure: Portions of this report are excerpted from Fortitude Gold's filings, website(s), presentations or other public collateral. We have attempted to identify those excerpts by *italicizing* them in the text.

Fortitude reported their year-end fiscal results the other day, so we are updating some of our numbers around the guidance they provided therein. As for the fiscal year (ended 12/31/21), Fortitude comfortably exceeded our expectations for a handful of reasons we will recap below, and some of that discussion is obviously topical to fiscal 2022 and likely beyond as we.

Recall, Fortitude was spun out of one of our prior coverage stocks, Gold Resource Corporation (GORO). When they spun off Fortitude, we picked up coverage of it and subsequently terminated the coverage of Gold Resource. Part of our motivation there, among other things, was that Fortitude, unlike Gold Resource, is largely a (gold) pure play, which fit a bit better with our view of things at the time. That said, here are a few items from the year end results that we think need some color.

Regarding the comparative results, Fortitude reported Fiscal 2021 revenues of $82 million and eps of $.75/$.74 basic/diluted. Those numbers compare to our estimates of $65 million and $.28/$.28 respectively. As we suggested, they drubbed our estimates. Here are a few of the items that drove the results.

First and foremost, As the tables below reflect, the Company produced considerably better grades than we anticipated for 2021 vs. 2020. To be honest, as we look back over the 2020 reserve data, that probably should not surprise us all that much, although when it comes to projecting grades, we tend to try to choose the conservative iteration, largely because we know the consequences of erring in the other direction. To our defense, the Company noted on the earnings call that grades were *"higher than the reserve model predicted*", so we are not alone in understating the grades. Regardless they were robust, and they had a marked impact on the results and frankly on some of the other positive comparable metrics as well. We would add, we have included the respective reserve tables for 2020 and 2021 below, and they reflect comparable grades and should provide us some insights to 2022 grades, which may make us better at projecting the same.

	Year ended December 31, 2021	Year ended December 31, 2020
Ore mined		
Ore (tonnes)	598,345	643,518
Gold grade (g/t)	3.76	2.42
Low-grade stockpile		
Ore (tonnes)	8,600	160,739
Gold grade (g/t)	0.33	0.52
Pre-strip waste	-	1,346,316
Waste (tonnes)	7,159,740	4,930,262
Metal production (before payable metal deductions)[1]		
Gold (ozs.)	46,459	29,479
Silver (ozs.)	44,553	28,359

2020 Reserves Data

Description	Tonnes	Gold g/t	Silver g/t	Precious Metal Gold Equivalent g/t	Gold Ounces	Silver Ounces	Precious Metal Gold Equivalent Ounces
Isabella Pearl Mine							
Proven	684,500	5.77	39	6.23	126,900	867,200	137,200
Probable	595,600	1.71	10	1.83	32,700	187,800	34,900
Proven and Probable Total	**1,280,100**	**3.88**	**26**	**4.18**	**159,600**	**1,055,000**	**172,100**
Low-Grade Stockpile	**582,600**	**0.51**	**3**	**0.54**	**9,600**	**50,700**	**10,200**
Isabella Pearl Mine Total	**1,862,700**	**2.83**	**18**	**3.04**	**169,200**	**1,105,700**	**182,300**

2021 Reserve Data

Description	Tonnes	Gold g/t	Silver g/t	Precious Metal Gold Equivalent g/t	Gold Ounces	Silver Ounces	Precious Metal Gold Equivalent Ounces
Isabella Pearl Mine							
Proven	483,300	5.26	47	5.89	81,800	733,100	91,600
Probable	425,500	2.04	16	2.26	27,900	221,000	30,900
Proven and Probable Total	**908,800**	**3.75**	**33**	**4.19**	**109,700**	**954,100**	**122,500**
High-Grade Stockpile	**14,000**	**10.09**	**88**	**11.26**	**4,500**	**39,600**	**5,000**
Low-Grade Stockpile	**435,000**	**0.53**	**5**	**0.59**	**7,300**	**63,900**	**8,200**
Isabella Pearl Mine Total	**1,357,800**	**2.78**	**24**	**3.11**	**121,500**	**1,057,600**	**135,700**

From another angle, the Company realized a bit better commodity prices (primarily gold) through fiscal 2021 than we had modeled. While that number was not considerable, it was enough to add about $2 million to the bottom line and made up about 15% of the earnings surprise. To that point and looking over commodity prices over the last 30 days, there is no substitute for higher gold prices for the bottom line of a gold producer, which some may recall, was a portion of our original investment thesis (the potential for higher gold prices).

In addition to the above, production costs for 2021 were markedly lower than our estimates, and aside from grades and higher gold prices, represented much of the balance of the realized earnings beyond our estimates. As we alluded to above, part of the decline in unit production costs was related to the higher grades. On the other hand, much of our miss was related to our overstatement of the unit costs associated with the removal of pre-strip waste. As the chart below reflects, Fortitude removed considerably more pre-strip waste in 2021 than in 2020, which we assumed would keep production costs up. Clearly, they are driving down the unit costs of removing waste. As the chart below reflects, aggregate 2021 production costs were similar to 2020 despite the fact that they removed *45% more strip waste*. As we understand it, they plan to remove around 3.5 million tonnes in 2022 (less than ½ the 2021 total), so between our adjustments to previously overstated unit costs and roughly 1/2 as much material to move, we expect them to drive aggregate production costs lower. (We would caution, we are modeling stripping cost to inordinately impact Q1-F22 versus the remaining 3 quarters and to decrease sequentially throughout the year).

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Low-grade stockpile		
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Pre-strip waste	—	~~1,346,316~~
Waste (tonnes)	7,159,740	4,930,262
Metal production (before payable metal deductions)(1)		
Gold (ozs.)	46,459	29,479
Silver (ozs.)	44,553	28,359

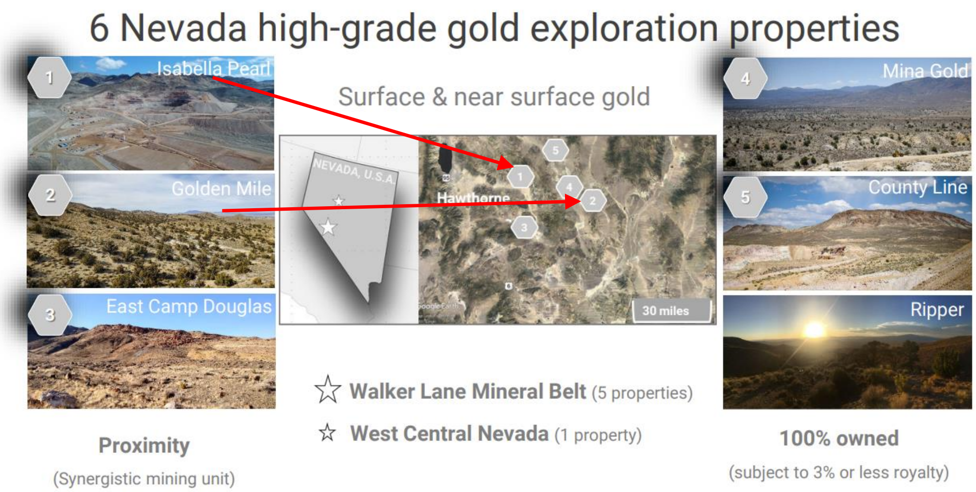
(1) The difference between what we report as "metal production" and "metal sold" is attributable to the difference between the quantities of metals contained in the doré we produce versus the portion of those metals actually paid for according to the terms of our sales contracts. Differences can also arise from inventory changes incidental to shipping schedules, or variances in ore grades and recoveries which impact the amount of metals contained in doré produced and sold.

Finally, and most obviously, part of our miss was related to the fact that they produced about 6,500 more ounces of gold than they *originally* guided to and we consequently modeled. We will address that a bit further below.

So then, that is our best explanation/excuse for understating what was on the other hand an exceptional fiscal performance for Fortitude on a variety of fronts. That said, we have made some adjustments to our model in the context of issues that we feel we understand better today than a year ago, and we think should make our 2022+ projections a bit more accurate. That said, there are a handful of issues we would like to address before we close this out.

First, as we described in the initial coverage, we have followed Fortitude management for over 15 years when they were part of the team that founded Gold Resource, the spin-off "parent" of Fortitude. From that experience, we can attest that they probably should not be underestimated, and investors should not expect them to do anything to run the business conventionally for the sake of convention, and that is a hard stop. For instance, they have, as far back as we can recall, endeavored to create consistent and predictable operating cash flows while mitigating both operational and financial risks, by trying to optimize exploration activities and avoiding debt. In addition, they have coupled that approach with robust dividends to award long-term shareholders. While some may argue that their approach comes at the expense of growth, we would reiterate our "hard stop" comment above and suggest that they are not likely to change that. That leads us to point number two.

This is just our speculation, but we think one of the objections investors may have with respect to buying/owning Fortitude, is the fact that they do not have an extensive reserve profile. Some of that view stems from our past experience with Gold Resource as well as some other resource companies we have covered in the past. To that point, as they noted on the conference call as well as in the related earnings release, *"reconciliation of ore tonnes mined to date has shown higher grades of gold in the Isabella Pearl Mine compared to the reserve model which has resulted in an increased mine life now of over 3 years at the current 40,000 annual gold ounce run rate. The Company is also aggressively moving its Golden Mile property forward towards a development decision that could extend the Company's gold production an additional 3 1/3 years for a combined 7-year mine life through 2028".* To translate, *they do not* currently have reserves to support a more typical 10-year mine life for instance. That said, *they do have* several properties they are developing at one stage or another (see below), most notably Golden Mile, which we believe they will be making a development decision on shortly and will likely be the Company's next producing asset. The point is, for as long as we have followed management (15+ years) they have always prioritized profitable cash generating operations over building deep reserve profiles. Moreover, for as long as we have followed management (15+ years) they have never stopped operating because they ran out of ore. That brings us to our next point.

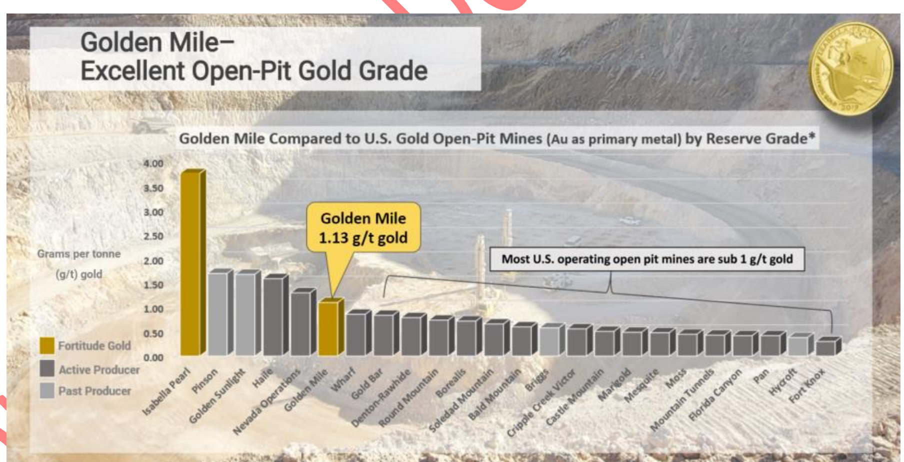


Management has provided guidance toward the annual production of ±40,000 ounces of gold for the next 3½ years based on the remaining reserve profile of Isabella Pearl, as well as the estimated 30,000 ounces of gold currently sitting on their leach pad, which represents over 80% of the low end of their 2022 production guidance of 36,000 to 40,000 ounces. Recognize, that production schedule is quite deliberate. That is, as they discussed on the call, they could likely mine and process the entire Isabella Pearl resource in much less than 3½ years if they chose to do so. As we said, the decision *not to do that* is quite deliberate, and while some may see that as counterintuitive to the notion of the "time value of money", we think the approach has merit. First, as CEO Jason Reid suggested on the call, producing the existing resource more quickly is possible but not without challenges within the framework of their existing manpower. Most notably perhaps, is that it could divert some resources away from their exploration efforts to locate and develop new resources. We think that is a viable point however, there may be an equally cogent argument that also supports their approach.

From a practical standpoint, we think it is fair to say that FTCO management believes gold will be higher in the future than it is today. Ostensibly, we think most investors in most gold producers believe the same thing or they would likely not be invested in gold producers. That being the case, setting aside the above notion of allocating available resources across the organization, on the face it is certainly not illogical to leave gold in the ground today that you think you can recover and sell at a better price tomorrow. For example, if gold finishes the month of March (2022) at current levels ($1950) the 2022 quarterly average will be approximately $75 per equivalent ounce higher than the same period in 2021. In this case, on 10,000 ounces of production, $75 per ounce would equate to an additional $750,000 of pre-tax profit, or approximately 23% more profit than they would have recognized if they could have produced and sold those ounces in 2021. Our point here is that we believe their strategic decision to allocate the production of their identified resources over a longer period time is not without merit.

Moving on, in line with their ongoing reserve information, we are modeling decreasing grades. We realize we made that mistake in our F21 estimates, and while this time around we are assuming grades closer the reserve data, we are modeling comparative decreases nonetheless. That said, they noted on the call that Isabella Pearl has demonstrated grade improvement at depth and on strike. We do not know what they will encounter as they keep digging, but it is entirely possible that grades may hold up better than we are anticipating. Frankly, we think the chance of grades being better than we are projecting are probably higher than the chance of them being lower than we are projecting.

To extend the notion, we are also modeling eventual production from Golden Mile in line with the Company's hypothetical of extending production visibility through 2028. We would caution, *that is a hypothetical,* but given our experience with management's past *hypotheticals*, we think the posture of their narrative suggests to us that they have a degree of confidence in that eventuality. We do not by the way think that is a big leap of faith in the context of the comparative industry grade data they presented on the call:



Further, in our initiating coverage we provided some comparative early drilling/exploration data from Isabella Pearl vs. Golden Mile. Our conclusion was that they were relatively comparable in terms of grade potential. Again, this is speculation on our part, but, while we have modeled eventual Golden Mile grades in line with the current resource estimates (and the illustration above), as we know, Isabella grades have improved at depth, so that *could be* the case with Golden Mile as well, in which case we may once again find ourselves underestimating their grades. We will (gladly) cross that bridge if we get there. We would add, we are modeling (again in line with Company guidance) Golden Mile capex to be provided organically, which we think is supported by the Company's $40 million cash position at 12/31/21.

To be clear, we expect them to proceed with Golden Mile. We submit, if they do not do that and/or do not find additional production to eventually replace Isabella Pearl, our estimates will likely prove aggressive. On the other hand, beyond Golden Mile, they have 4 additional projects (including their new Ripper acquisition) that we expect them to continue to explore.

To summarize, Fortitude posted exceptional results for fiscal 2021 and all signs point to comparable 2022 earnings results even though we are modeling considerably fewer ounces of gold production (roughly 38,500 ounces vs. 46,500). We expect them to be able to maintain impressive grades as they exploit Phase II at Isabella Pearl. As we noted we expect production costs to improve as they mitigate the pre-strip burden, which should be roughly half of the 2021 volume. Moreover, we expect them to process less ore tonnage thus the lower expectations for ounces recovered. Also, as they covered on the call, they should complete the transition of the project from incumbent diesel power to the electric grid interconnect, which they believe will save approximately $1 million of annual energy costs. Also, in line with guidance from the call, we anticipate monthly G&A to approximate $350,000 to $400,000, which in the aggregate will be an improvement over 2021 which included *"non-recurring stock-based compensation and onboarding incentive compensation totaling $5.5 million relating to building out the Company's staffing needs post Spin-Off which was recognized in the first quarter"*. To reiterate, we expect a decision on Golden Mile perhaps by mid-year, which we think could provide a catalyst for the stock (assuming the news is positive).

Lastly, at current levels, the dividend yield on FTCO shares is 6.6%. However, there was some discussion and perhaps frustration on the conference call regarding the price of the shares. We submit, while the stock has appreciated approximately 40% from our initiating price 11 months ago, it remains 15% under our original 12-24 month price target despite much better performance than we anticipated and higher gold prices than we modeled at the time of the initiation. That said, we are not sure that a 40% price appreciation and what is effectively a 9% yield from the initiation price should be disappointing. As we alluded to above, in our view, there should be no confusion with respect to management's plan, which is focused on providing shareholder value largely through dividends. We believe management will continue to focus on managing risks and delivering dividends. While they are not mutually exclusive (extraordinary dividends and above average growth), they do not generally happen in lock step, especially with sub $200 million companies. Put another way, if the Company were focused on growing the business, they would likely be retaining the capital instead of paying it out to shareholders. Rising gold prices aside, which we think would in fact drive the stock price higher (as it has of late), we do not think the dividend/growth correlation should be lost on anyone building expectation around substantially higher share prices.

Given the progress on multiple fronts, we are establishing a new 12-24 month price target on FTCO shares of *$9.25 and reiterating our allocation of 4.

Projected Operating Model

Fortitude Gold Corp. Projected Operating Model By Trickle Research LLC	(estimate) Fiscal 2021	(estimate) 3/31/22	(estimate) 6/30/22	(estimate) 9/30/22	(estimate) 12/31/22	(estimate) Fiscal 2022	(estimate) Fiscal 2023
Consolidated Statements of Operations (000's)							
Sales, net	$ 82,116	$ 16,486	$ 17,130	$ 17,721	$ 17,130	$ 68,466	$ 67,676
Mine cost of sales:							
Production costs	$ 26,661	$ 6,010	$ 5,280	$ 4,980	$ 4,230	$ 20,500	$ 16,500
Depreciation and amortization	$ 14,728	$ 3,417	$ 3,586	$ 3,648	$ 3,605	$ 14,256	$ 14,576
Reclamation and remediation	$ 156	$ 41	$ 39	$ 39	$ 39	$ 158	$ 165
Total mine cost of sales	$ 41,545	$ 9,467	$ 8,905	$ 8,667	$ 7,874	$ 34,914	$ 31,241
Mine gross profit	$ 40,571	$ 7,018	$ 8,225	$ 9,053	$ 9,255	$ 33,552	$ 36,435
Costs and expenses:							
General and administrative expenses	$ 11,443	$ 1,097	$ 1,107	$ 1,116	$ 1,107	$ 4,428	$ 4,416
Exploration expenses	$ 5,396	$ 1,103	$ 1,130	$ 1,143	$ 1,154	$ 4,530	$ 4,556
Other expense, net	$ 190	$ 75	$ 75	$ 75	$ 75	$ 300	$ 300
Total costs and expenses	$ 17,029	$ 2,276	$ 2,312	$ 2,334	$ 2,337	$ 9,258	$ 9,272
Income before income taxes	$ 23,542	$ 4,743	$ 5,913	$ 6,720	$ 6,919	$ 24,295	$ 27,163
Provision for income taxes	$ 5,669	$ 1,186	$ 1,478	$ 1,680	$ 1,730	$ 6,074	$ 6,791
Net income	$ 17,873	$ 3,557	$ 4,435	$ 5,040	$ 5,189	$ 18,221	$ 20,372
Net income per common share:							
Basic	$ 0.75	$ 0.15	$ 0.18	$ 0.21	$ 0.21	$ 0.76	$ 0.84
Diluted	$ 0.74	$ 0.15	$ 0.18	$ 0.21	$ 0.21	$ 0.76	$ 0.84
Weighted average shares outstanding:							
Basic	23,875,631	24,020,613	24,072,697	24,124,780	24,176,863	24,098,738	24,307,072
Diluted	24,108,365	24,037,464	24,091,233	24,145,170	24,199,292	24,118,290	24,335,697

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Portions of this publication excerpted from company filings or other sources are noted in *italics* and referenced throughout the report.

Rating System Overview:

There are no letters in the rating system (Buy, Sell Hold), only numbers. The numbers range from 1 to 10, with 1 representing 1 "investment unit" (for my performance purposes, 1 "investment unit" equals $250) and 10 representing 10 investment units or $2,500. Obviously, a rating of 10 would suggest that I favor the stock (at respective/current levels) more than a stock with a rating of 1. As a guideline, here is a suggestion on how to use the allocation system.

Our belief at Trickle is that the best way to participate in the micro-cap/small cap space is by employing a diversified strategy. In simple terms, that means you are generally best off owning a number of issues rather than just two or three. To that point, our goal is to have at least 20 companies under coverage at any point in time, so let's use that as a guideline. Hypothetically, if you think you would like to commit $25,000 to buying micro-cap stocks, that would assume an investment of $1000 per stock (using the diversification approach we just mentioned, and the 20-stock coverage list we suggested and leaving some room to add to positions around allocation upgrades. We generally start initial coverage stocks with an allocation of 4. Thus, at $1000 invested per stock and a typical starting allocation of 4, your "investment unit" would be the same $250 we used in the example above. Thus, if we initiate a stock at a 4, you might consider putting $1000 into the position ($250 * 4). If we later raise the allocation to 6, you might consider adding two additional units or $500 to the position. If we then reduce the allocation from 6 to 4 you might consider selling whatever number of shares you purchased with 2 of the original 4 investment units. Again, this is just a suggestion as to how you might be able to use the allocation system to manage your portfolio.

For those attached to more traditional rating systems (Buy, Sell, Hold) we would submit the following guidelines.

A Trickle rating of 1 thru 3 would best correspond to a "Hold" although we would caution that a rating in that range should not assume that the stock is necessarily riskier than a stock with a higher rating. It may carry a lower rating because the stock is trading closer to a price target we are unwilling to raise at that point. This by the way applies to all of our ratings.

A Trickle rating of 4 thru 6 might best (although not perfectly) correspond to a standard "Buy" rating.

A Trickle rating of 7 thru 10 would best correspond to a "Strong Buy" however, ratings at the higher end of that range would indicate something that we deem as quite extraordinary..... an "Extreme Buy" if you will. You will not see a lot of these.