Trickle Research

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

# Research Update & Allocation Increase

FORTITUDE GOLD CORP.

## Fortitude Gold Corp.

**(OTCQB: FTCO)**

**Report Date: 03/07/23**

**12- 24 month Price Target: $9.25**

**Allocation: *5**

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

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

**Closing Stock Price at This Allocation Upgrade (Closing Px: 03/06/22): $6.22**

**Prepared By:**
**David L. Lavigne**
**Senior Analyst, Managing Partner**
**Trickle Research**



**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.

As a quick retrospective, we started covering Fortitude nearly 2 years ago (April 2021), although we had covered Gold Resource (GORO) prior to that, from which Fortitude was spun out. In that initial coverage, we estimated fiscal 2021 revenues and fiscal 2022 revenues of $65 million and $66 million respectively. Their actual numbers came in *well above* our estimates: $74.4 million and $82 million. The Company outperformed our original earnings estimates as well, as fiscal 2021 actuals reflected $.74 per fully diluted share versus our estimate of $.28, while fiscal 2022 reflected $.61 versus our estimate of $.36. Obviously, we adjusted our projections as we moved forward, but again, they crushed our original estimates, and that success was a combination of better realized grades, better realized recoveries, lower production costs and higher (albeit not significantly) gold prices than we initially modeled. In short, they have performed better organically than we anticipated, which frankly does not surprise us.

What *does surprise us*, is that despite the strong fundamental performance, the stock has generally underperformed our price targets. Our original 12-24 month price target in April 2021 was $8.75. We subsequently raised/established a new 12-24 month price target in March 2022 (from $8.75 to $9.25). Again in retrospect, the stock breached our initial target in early June 2021 shortly after the initiation, and subsequently traded down thereafter, although it did trade back through $7.50 in April 2022. However, it has spent 2023 to this point trading in the $5s and $6s. (Although, we would add, those who purchased the shares on our initiation date at $5.26, have since received $.865, or about 16% of their original purchase price back in dividends). We think some of the compression in the stock since the beginning of 2023 has been related to the price of gold. As **Chart 1** reflects and as one might expect, FTCO generally trades in high positive correlation with gold prices:



**Chart 1.**

As **Chart 2** below reflects, gold prices were under some pressure from mid/late January through late February (2023), as was FTCO. We should have been raising our allocation when the stock traded under $5.50.

**Chart 2**


Along the lines of the charts above and to reiterate a point we raised in the initiating coverage, owning Fortitude should probably be predicated on a positive view of gold prices. That is, those who do not like gold at these levels, probably should not like FTCO for the same reason. (Although, we would argue, hedging a portfolio against things one *is not* anticipating is prudent). In the initiating coverage, we addressed what we felt was an emerging backdrop that would favor gold (rising inflation, global unrest, untenable fiscal policy and others), and we continue to hold that view. To be clear, we are not, nor have we ever been "gold bugs" per se but we like gold here. In fact, we are surprised, given the fruition of the backdrop we referenced, that gold is not higher. (On the other hand, we would add, FTCO has proven to be a low-cost producer and as such would fare much better than many of its comps).

Setting aside gold prices, we would also reiterate a headwind that we think FTCO has faced since its entrée into the public market in late 2020. We think the street continues to discount FTCO shares because it does not strategically focus on building reserves. Management has consistently (over the 17+ years we have followed them) prioritized resources toward production (and resulting dividends) over exploration. We understand the street's logic around the importance of building reserves, which becomes perhaps more acute once an enterprise *starts producing*. (There are plenty of public comps in FTCO's enterprise range that do not produce anything). As we addressed in our 2QF22 update in August 2022,

> *It is clear to us that the Company is beginning to set its sights on the development of additional resources. To clarify, given the defined life of Isabella Pearl (at least as it is delineated to this point), it is clearly necessity for them to find more resources to mine to maintain the current production profile. Further, we are comfortable suggesting that the greater plan is to increase the production profile in the future, and current exploration/development is the basis for that endeavor. In our view, while production from the current exploration program(s) is certainly not an imminent event, we think continued success on the exploration side will provide visibility into*

*the maintenance of current production levels as well as perhaps the inference of increasing production levels, which in turn should speak to higher (and in our view more appropriate) valuations.*

In our view, the string of exploration announcements the Company has made over the past several months regarding what we view as constructive results from County Line and Golden Mile, clearly reflect the accelerated focus on the exploration and identification of new reserves and by extension new projects. Frankly, in our view, one of the more interesting development announcements they made addressed *"multiple high-grade gold drill intercepts below the Isabella Pearl open pit. Oxide intercepts include 3.05 meters grading 15.15 grams per tonne gold (g/t) within 21.34 meters grading 7.21 g/t gold, and 18.29 meters grading 3.72 g/t gold. Non-oxide intercepts include 6.10 meters grading 12.17 g/t gold within 41.15 meters grading 6.25 g/t gold"*. To translate, we think it is more likely than not that FTCO will be producing more out of Isabella Pearl than the current reserve profile implies (although we have always believed that on some level).

In the context of the above narrative(s), we must wonder if some of the weakness in the stock may also be related to the comparative operating numbers F22 vs. F21. Specifically, as **Table 3** below reflects, on a comparative basis, one could argue that Fiscal 2022 was a poor comp to Fiscal 2021. That is, revenues were down roughly 10%, while operating income was down roughly 24%. On the other hand, in the context of their accelerated exploration and development efforts, we would point out that in fiscal 2022, the Company spent an additional $6.2 million on exploration (ostensibly to identify more reserves) relative to fiscal 2021. Without those charges, the Company would have reflected roughly the same pre-tax income as 2021 on 10% ($8 million) fewer revenue. To translate, from an operating standpoint, we think F2022 vs. F2021 was a favorable comp.

| CONSOLIDATED STATEMENTS OF OPERATIONS - USD ($) $ in Thousands | 12 Months Ended | |
|---|---|---|
| | Dec. 31, 2022 | Dec. 31, 2021 |
| **CONSOLIDATED STATEMENTS OF OPERATIONS** | | |
| Sales, net | $ 74,379 | $ 82,109 |
| **Mine cost of sales:** | | |
| Production costs | 25,443 | 26,661 |
| Depreciation and amortization | 13,294 | 14,728 |
| Reclamation and remediation | 247 | 156 |
| Total mine cost of sales | 38,984 | 41,545 |
| Mine gross profit | 35,395 | 40,564 |
| **Costs and expenses:** | | |
| General and administrative expenses | 5,787 | 11,443 |
| Exploration expenses | 11,591 | 5,396 |
| Other expense, net | 55 | 190 |
| Total costs and expenses | 17,433 | 17,029 |
| Income before income and mining taxes | 17,962 | 23,535 |
| Mining and income tax expense | 3,278 | 5,669 |
| Net income | $ 14,684 | $ 17,866 |
| **Net income per common share:** | | |
| Basic | $ 0.61 | $ 0.75 |
| Diluted | $ 0.61 | $ 0.74 |
| **Weighted average shares outstanding:** | | |
| Basic | 24,017,381 | 23,875,631 |
| Diluted | 24,196,847 | 24,108,365 |



Looking ahead, we think visibility around additional resources/future production is improving. We submit, there is more work to be done delineating proven and probable resources to justify a new project(s), but we are becoming increasingly comfortable with the notion that they will indeed be adding new reserves, new projects, and new production to replace current Isabella Pearl. Moreover, as we noted, we believe it is likely that they will also add resources at Isabella Pearl and ultimately produce beyond the current identified resource there. In short, as we look out to fiscal 2024 and 2025, our view is that they will be producing on at least one additional project and perhaps two. If we are correct (even in some combination) about these assessments, we would expect production in 2024, 2025 and into the foreseeable future markedly beyond the current average thresholds of 10,000 ounces of gold per quarter. In our view, that notion underpins our current price target. We would add, while we submit there are still plenty of unknowns around the economic feasibility of potential new reserves, including things like prevailing grades, recoveries, and other usual suspects, we believe that a scenario where County Line and Golden Mile get to production, and Isabella Pearl's life is extended a few years by additional discoveries below the current pit, could provide a basis for price targets closer to $20 than to $10. Further, we do not think it is a stretch to suggest that Management's sights are set on something along those lines as well. To edify, barring $3000 gold, that sort of scenario (according to our model) assumes eventual production levels at both County Line and Golden Mile commensurate with current production levels at Isabella Pearl, lower grades than are currently being realized at Isabella Pearl, and $1,750 gold. Obviously, those are all hypothetical, but our point is, we believe the Company is building reserve momentum that we do not think is being reflected in the value of the shares. Moreover, the Company's cash position at 12/31/22 stood at $45 million (just shy of 1/3rd of the entire market cap) making their (debt free) enterprise value approximately $4.46. We would add, their current inventory represents another approximately 1/3rd of the market cap, the large majority of which we believe is sitting on the leach pad. In addition, for fiscal 2022, they generated EBITDA of $31 million, which means that on an enterprise value basis, the stock is trading at approximately 3.5x EBITDA. The wild card that is gold prices notwithstanding, we remain quite bullish on Fortitude Gold. We are reiterating our 12-24 month price target of $9.25 which we will be revisiting as resource visibility continues to improve, and we are raising our allocation from 4 to *5 based the metrics we laid out above.



**Projected Operating Model**

| **Fortitude Gold Corp.** | | | | | | |
|---|---|---|---|---|---|---|
| **Projected Operating Model** | | | | | | |
| **By Trickle Research LLC** | | | | | | |
| | (estimate) | (estimate) | (estimate) | (estimate) | (estimate) | (estimate) |
| | 3/31/23 | 6/30/23 | 9/30/23 | 12/31/23 | Fiscal 2023 | Fiscal 2024 |
| Consolidated Statements of Operations (000's) | | | | | | |
| Sales, net | **$ 19,504** | **$ 19,080** | **$ 19,080** | **$ 19,080** | **$ 76,743** | **$ 77,439** |
| Mine cost of sales: | | | | | | |
| Production costs | $ 6,930 | $ 6,330 | $ 6,030 | $ 6,030 | **$ 25,320** | **$ 28,032** |
| Depreciation and amortization | $ 3,252 | $ 3,263 | $ 3,270 | $ 3,275 | **$ 13,060** | **$ 13,536** |
| Reclamation and remediation | $ 42 | $ 42 | $ 42 | $ 42 | **$ 168** | **$ 202** |
| **Total mine cost of sales** | **$ 10,224** | **$ 9,635** | **$ 9,342** | **$ 9,347** | **$ 38,548** | **$ 41,770** |
| Mine gross profit | **$ 9,280** | **$ 9,444** | **$ 9,738** | **$ 9,732** | **$ 38,195** | **$ 35,669** |
| Costs and expenses: | | | | | | |
| General and administrative expenses | $ 1,890 | $ 1,882 | $ 1,882 | $ 1,882 | **$ 7,536** | **$ 7,550** |
| Exploration expenses | $ 3,167 | $ 2,985 | $ 2,972 | $ 2,972 | **$ 12,097** | **$ 11,874** |
| Other expense, net | $ 75 | $ 75 | $ 75 | $ 75 | **$ 300** | **$ 300** |
| Total costs and expenses | **$ 5,132** | **$ 4,942** | **$ 4,929** | **$ 4,929** | **$ 19,933** | **$ 19,724** |
| Income before income taxes | **$ 4,147** | **$ 4,503** | **$ 4,809** | **$ 4,803** | **$ 18,262** | **$ 15,946** |
| Provision for income taxes | **$ 933** | **$ 1,013** | **$ 1,082** | **$ 1,081** | **$ 4,109** | **$ 3,588** |
| **Net income** | **$ 3,214** | **$ 3,489** | **$ 3,727** | **$ 3,722** | **$ 14,153** | **$ 12,358** |
| Net income per common share: | | | | | | |
| Basic | **$ 0.13** | **$ 0.14** | **$ 0.15** | **$ 0.15** | **$ 0.58** | **$ 0.51** |
| Diluted | **$ 0.13** | **$ 0.14** | **$ 0.15** | **$ 0.15** | **$ 0.58** | **$ 0.51** |
| Weighted average shares outstanding: | | | | | | |
| Basic | **24,128,280** | **24,180,363** | **24,232,447** | **24,284,530** | **24,206,405** | **24,414,738** |
| Diluted | **24,329,457** | **24,401,658** | **24,475,870** | **24,552,296** | **24,439,820** | **24,414,738** |

## General Disclaimer:



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.**