

HALLGARTEN & COMPANY

Coverage Update

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Soma Gold

(TSX-V: SOMA, FSE: A14YF1, OTCQB: PRSRF)

Strategy: LONG

Key Metrics			
Price (CAD)	\$0.51		
12-Month Target Price (CAD)	\$1.22		
Upside to Target	139%		
12 mth high-low	\$0.10-\$1.90		
Market Cap (CAD mn)	\$30.50		
Shares Outstanding (millions)	59.8		
Fully Diluted (millions)	75.4		
	FY19	FY20e	FY21e
Consensus EPS		n/a	n/a
Hallgarten EPS (CAD) - pro forma		\$0.06	\$0.17
Actual EPS (CAD)	(\$0.19)		
P/E - pro forma	n/a	80.7	29.4

Soma Gold

Licked back into Shape

- + Financing of over US\$4mn has been successfully achieved, as has name change and stock rollback
- + The recent purchase of the El Bagre mining complex for US\$5.5mn has Soma Gold positioned in the all-important producer category
- + Total annual gold production by the end of 2020 could be in excess of 30,000 ozs per annum
- + Latest acquisition significantly expands exploration territory, adding Nechi to the pre-existing Zara targets
- + Gold price has been on a rising trajectory of late
- ✗ A theft of gold during the vulnerable period of the transition of ownership was a slight setback but was covered by insurance
- ✗ The challenge now is to get the El Limon asset firing on all cylinders

Bulking Up in Colombia

In the first weeks of 2020, Soma Gold (more than) doubled up on its exposure to gold in Colombia with its purchase of the Operadora mines from the Colombian mining major, Mineros.

In additions to the recent purchase and refocusing the company has undertaken a management reshuffle bringing in a veteran mining policymaker as CEO, has changed its name, consolidated its stock and done a financing to close the Mineros deal.

In April we published a more detailed report on the combined entity. In this update we shall review the developments since April.

The Operadora Takeover

In early January 2020, Soma Gold's management announced that had entered into a binding letter of intent with the prominent Colombian mining group, Mineros, S.A. to acquire 100% of the shares of Operadora Mineras S.A.S. for US\$5.5mn in cash.

The purchase of Operadora includes mineral properties and all mining assets, mining & environmental permits, exploration equipment, data, inventory, and administrative assets, including the El Bagre Operation and the Nechi Gold Project located in Bajo Cauca Antioqueño in Antioquia. The land package consists of seven tenements in total with an extent of 5,800 hectares.

The El Bagre operation includes the La Ye and Los Mangos operating underground gold mines and the

Cordero gold project located in the municipality of Zaragoza, Antioquia, Colombia.

The Nechí Gold Project includes the El Catorce, Santa Elena, and Santa Maria gold exploration projects.

The Transaction

The agreement called for a two-phase purchase, starting at closing for the transfer of 60% of Operadora's shares, and the remaining 40% when the necessary permits are in place for the construction of Cordero, an additional mine portal for the El Bagre operation.

The aggregate consideration payable to Mineros for 100% of the shares of Operadora and all of its assets is US\$5.5mn in cash payable in two installments. The first installment for US\$1mn made within 30 days and the second installment for US\$4.5mn will occur by September 4th, 2020

There will be an NSR of 1% payable to Mineros for all the production of the mines, once 17,000 ounces have been produced from any of the assets involved.

As part of the deal Soma Gold has agreed to purchase electrical power from Mineros' hydroelectric plant at differing rates for different periods of the year for a term of five years.

Financing

On the 6th of July 2020, the company announced that it had closed its non-brokered private placement of CAD\$4,440,000. The private placement was originally announced on at the end of May for \$3.75 million and was over-subscribed by \$690,000. As a result, there were 29,599,997 common shares and 29,599,997 share purchase warrants issued. Each warrant entitles the holder to acquire one common share for a period of two years at a price of CAD\$0.25. Two insiders participated in the placement and subscribed to a total of 20,344,798 units for proceeds of just over \$3mn. US \$ 1 mm of the proceeds of this placement were used to make the first payment to Mineros.

Several months ago, the company effected a consolidation of its shares on the basis of 10 old shares for every one new share (and the accompanying change of name to Soma Gold Corp.) The then outstanding 303,933,649 common shares were consolidated into approximately 30,393,365 common shares. All outstanding share purchase warrants, stock options and other convertible securities were adjusted accordingly.

The company intends to raise a further US\$4.5mn in debt to make the second payment. Negotiations are presently underway with a number of potential lenders.

The El Bagre Complex

In recent years, Mineros has accumulated six contiguous tenements for a total of 3,784 ha.. La Ye and Los Mangos are Operadora's two producing mines and Cordero will be a nearby extension of the same type of operation. The first two are 1.4 km apart and share the same plant. Cordero is 2.6 km from Los

Mangos and is, in effect, an extension of the existing two operations, and shares many of the characteristics of Los Mangos.

La Ye has been in production since 2010 and Los Mangos since 2013, and both have established infrastructure, mining methods, geotechnical aspects, and a history of production.

All are shallow underground and non-mechanized operations, and share the same plant. La Ye and Los Mangos currently produce 156,000 tpa of ore. Cordero will replace some production from the existing operations as they wind down in 2020.

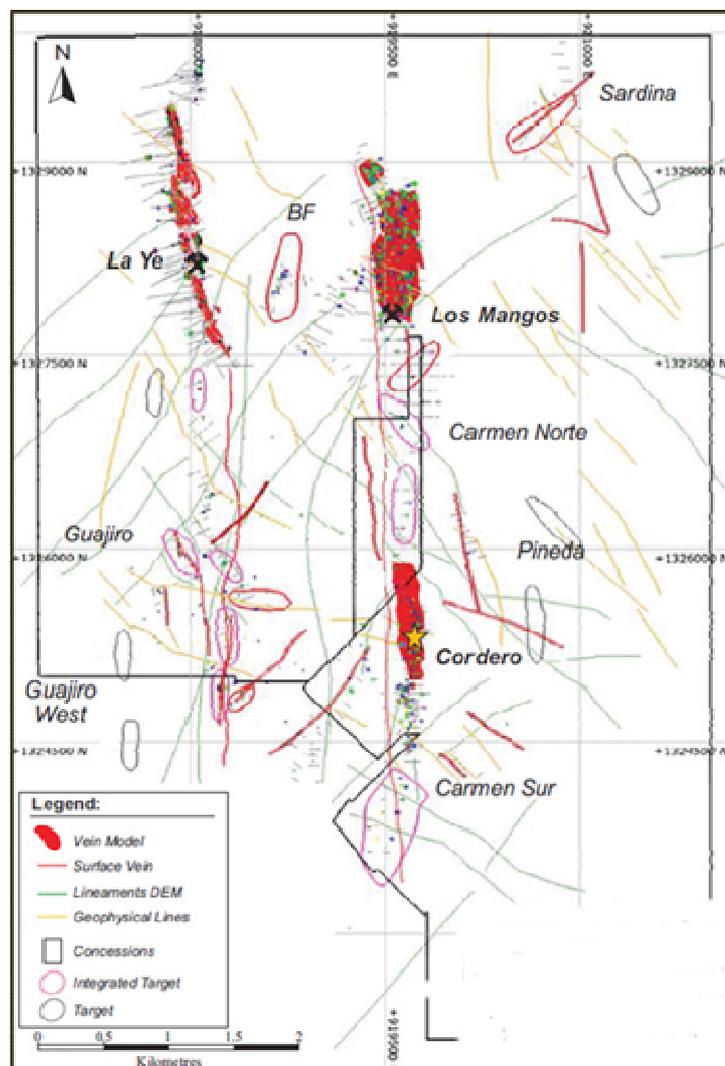
Other points of note are that the region has large skilled labor base, with the national training center for miners (SENA) in El Bagre. Also, there are no indigenous groups in the area.

La Ye

La Ye produced ~23,000 tonnes of ore in 2018 and is 250 m deep. It uses a non-mechanized, hand held cut & fill method for near vertical veins, with 30 m to 60 m level spacing. Raises are developed on either side of a stope from which mining progresses. Fill is placed using the same raises as the stope progresses. Development is hand held with pneumatic rocker shovels. Tracked ore drives are used to transport ore to a series of declines along the orebody, from where the ore is hoisted out.

La Ye is currently producing at Level 5 (450m depth) and its development goes down to Level 8 (650m).

La Ye has a fully-equipped mine camp with capacity for 52 employees with water supplied by the company. The processing capacity is 450tns per day, with plans to upgrade this to 660 tpd.



Los Mangos Mine

Los Mangos produced 128,000 tonnes in 2018 and is 185m deep. It has a similar development configuration to La Ye, however, the levels are spaced at 25m and the orebody dip is 30o to 40o. Mining is carried out by a non-mechanised, hand held room & pillar method, with some pillar robbing where possible.

Los Mangos-Icacaes is starting development and production at Level 4 (370m depth) and its development goes down to Level 6 (500m).

Below can be seen an aerial view of the El Bagre plant.



El Cordero

Since 2016, Mineros has focused its exploration activities on the Cordero vein (formerly Balvina). This project is on track to start production in late 2020 and will also use room & pillar mining.

The LOM, including Cordero, is five years. La Ye and Los Mangos will be exhausted in 2020.

Production & Processing

The processing facilities consist of:

- Crushing, concentration, floatation, leaching and smelting.
- Merrill Crowe plant with a metallurgical recovery of 85% on average

Average production in the period 2010-2017 was 20,490 ozs Au. The estimated production in 2017 was 15,000 ozs Au. In total there has been around 800,000 tonnes of ore production since 2010 with an average gold grade ore of 6 g/t with some 150,000 ozs Au produced since 2010.

The use of non-mechanised mining suits the narrow veins, but also limits the volume of production from working areas.

The actual production cost is US\$991 per oz Au Eq, including direct mining costs and SG&A.

The 2019 unit operating costs were:

- Underground Mining: US\$62 per underground tonne mined
- Processing: US\$24 per tonne processed
- G&A: US\$23 per tonne processed
- Total: US\$109 per tonne processed

The mine operates continuously on a three work-shift roster and employs 650 workers on three work shifts, 440 in the mine, 60 processing facilities, 60 planning, 80 maintenance, 10 administration. In recent years, Operadora has been subject to high labor costs due to the existence of labor union, with wages representing 49% of total cash cost. The vendors have forecast that operating costs should decrease as a percentage due to higher production and improving ore grades.

The “PEA”

As Mineros was not a foreign-listed company it did not have to prepare NI43-101 level reports on its intended extension or expansion of its mining activities at El Bagre. Nevertheless it has worked up (with consultants) a strategy for the initiation of mining at Cordero and how the revenue flows might look.

This report estimated that LOM Net Revenue would be around US\$63.6mn, however this revenue was estimated based on a gold metal price of US\$1,250 per oz for years 2019 to 2023. Already the gold price is US\$450 higher than that level and is likely to remain at least \$250 above the modelled level for all of the period in question. All of this extra increment falls straight to the bottom line.

Other metrics that the model took into account included:

- Lower production from El Bagre due to closure of the two existing mines and replacement with Cordero
- Treatment Charge/Refining Charge (TC/RC) LOM average of US\$2.19 per oz of production (includes shipment and treatment)
- Thus, unit operating costs for lower-production years after 2019 are higher, based on holding

fixed portions of costs, and reducing variable portions of costs to match production.

- LOM average unit operating cash costs of US\$1,082 per oz Au, totaling US\$57.2mn
- All-In Sustaining Cost (AISC) of US\$1,178 per ounce Au
- NSR royalty of 3.52%
- Income tax rate in Colombia between 30% and 33%

The LOM sustaining capital costs were estimated at US\$2.35mn with closure costs of US\$303,000, included in the analysis at the end of the LOM.

Clearly this plan is massively undershooting the revenue potential without necessarily over-extrapolating the gold price over the next few years. Even using a \$350 increment in the gold price, the net revenues should around US\$18mn higher over the period to 2023, just from the El Bagre operations.

Resources & Reserves

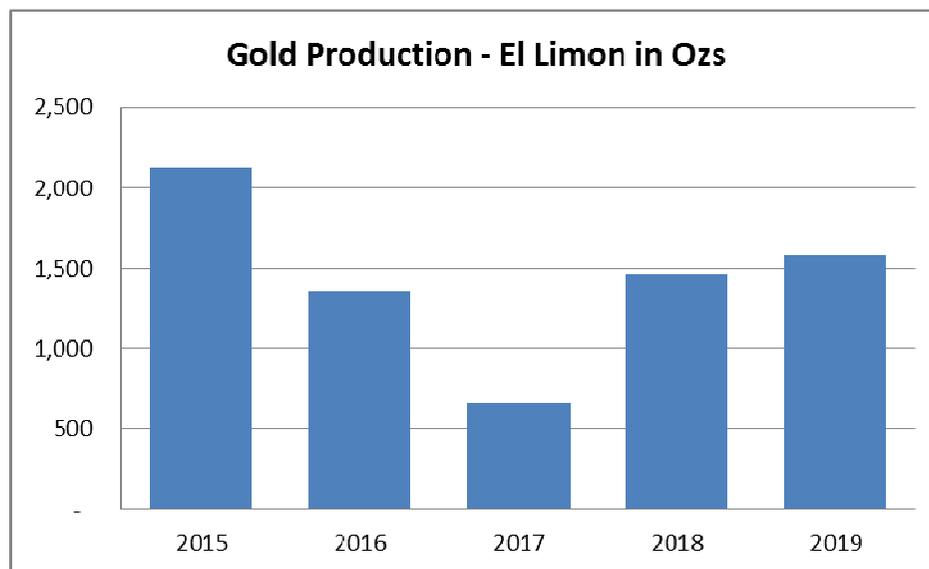
The current Mineral Reserve production profile includes a peak of 156,000 tonnes in 2019, followed by four years averaging 40,000 tonnes of ore per year. This is partially due to the inclusion of Inferred Mineral Resources in the current mine plan, which have been excluded from the Mineral Reserve schedule.

The resources and reserves when last estimated are shown at the right.

As can be seen from the chart on the following page, the projects have had a strong resource replacement trend since 2013 when the resources/reserves made a substantial leap.

Bagre Concessions (La Ye & Los Mangos)	
Reserve	Ozs Au
Proven	7,886
Probable	13,869
Resource	Ozs Au
Measured	22,126
Indicated	27,631
Inferred	43,846
Nechi Concession	
Resource	Ozs Au
Measured	20,958
Indicated	82,459
Inferred	16,761

Operadora (La Ye/Los Mangos) - Production													
	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	1Q20	Apr-May	Total
Ore	74,659	83,947	66,189	68,458	123,674	135,384	134,269	137,918	147,910	147,306	35,552		1,155,266
Au g/t	7.04	7.55	8.31	6.79	6.38	5.26	4.22	3.51	4.17				5.49
Ag g/t	31.15	26.43	30.50	21.69	19.86	14.19	7.61	5.12	7.40				15.68
Au (ozs)	16,903	20,378	17,694	14,934	25,389	22,920	18,206	15,558	19,817	15,792	3,965	2,782	194,338
Ag (ozs)	74,775	71,323	64,905	47,736	78,981	63,114	32,851	22,719	35,195	30,755	8,130	5,665	536,149
Waste (tonnes)	15,876	28,238	22,056	23,949	29,756	41,573	23,373	33,710	20,553				239,084



Earnings Outlook

Things should start to change rather quickly as far as earnings and reporting thereof is concerned at Soma.

Due to the absence of a NI43-101 on the original project the output of the El Limon mine has long remained in pre-production mode, from the Canadian accounting sense. However with the two El Bagre mines hitting the ground running (and having a NI43-101) the results of the mines should finally start to underpin the earnings statements in the quarterly financials of Soma Gold.

On the following page can be seen out model of earnings at the company over the next couple of years.

Soma Gold							
FY ended December							
CAD mns	FY21e	FY20e	1Q20	FY19	FY18	FY17	FY16
						15 mths	13 mths
Revenue - Mining	57.20	28.09					-
Revenue - Tolling	12.00	4.14					
Cost of Revenue	47.50	21.92					-
Royalty	2.01	0.99					
Refining	0.74	0.37					
Gross Profit	18.94	8.96		-	-	-	-
Selling/General/Admin. Expenses	2.38	2.19	0.46	3.35	6.50	7.22	1.93
Exploration	0.42	0.35				-	0.21
Depreciation/Amortisation							0.01
Interest Expense (Income)	0.38	0.45	0.57	2.09	2.84	2.75	-
Unusual Expense (Income)							(0.88)
Revaluation of derivative			4.25	5.32			
Other Operating Expenses					0.24	-	-
Total Operating Expense	3.18	2.99	5.28	10.76	9.58	9.98	1.26
Operating Income	15.76	5.97	(5.28)	(10.76)	(9.58)	(9.98)	(1.26)
Gain (Loss) on Sale of Assets			(1.24)	(25.02)	-	(0.25)	-
Other, Net				(0.49)	(2.13)	-	(0.07)
Income Before Tax	15.76	5.97	(3.36)	(36.27)	(11.71)	(10.23)	(2.12)
Tax	4.73	1.79	-	(3.79)	(1.02)	(0.25)	0.01
Income After Tax	11.03	4.18	(3.36)	(40.33)	(10.69)	(9.98)	(2.13)
Minorities	0.66	0.33	0.26	(0.89)	(0.55)	(0.77)	0.00
Income pertaining to Shareholders	10.37	3.85	(3.10)	(39.45)	(10.14)	(9.22)	(2.13)
Weighted Average Shares	59.80	59.80	303.44	210.46	154.99	117.56	58.21
EPS	0.17	0.06	-0.01	-0.19	-0.07	-0.08	-0.04
Gold production (ozs)	28,300	12,000	3,965	1,583	1,463	664	
Silver Production (ozs)	28,000	22,500	8,130				
Gold production - acquired (ozs)	6,000	1,800					
Gold Price (Hallgarten estimate)	\$1,600	\$1,680					
CAD:USD	1.25	1.37	1.41	1.33	1.29	1.30	

With production being declared commercial the company should finally have a topline making a clean break with the difficulties of recent years.

The operations at La Ye and Los Mangos will be running down during 2020 and Cordero will join the ranks of producing assets towards the end of this year. Combined production of both El Limon and the Operadora assets should thus be rather similar to that of just the Operadora assets in 2019. We are estimating that the combined assets could produce a positive bottom line of over CAD\$8mn in FY20.

Things should start to trend upwards in 2021 on the production front with strong potential for a further boost to the bottom line as the two producing mines start to mesh together and the tolling for artisanals reaches a firmer footing. We estimate the net revenues could be as high as CAD\$13mn for FY21.

Risks

The risks have narrowed somewhat as Soma has become more focused and now it has its financing needs largely behind it.

- ✘ Gold price weakness
- ✘ Local political unrest (i.e. resurgence of the FARC)
- ✘ Deterioration in relations with artisanal miners

With Soma Gold the risk is currently mainly with the gold price as it is for most gold miners. Our premise is for gold to stay roughly in a band between US\$1,600 and US\$1,800 for several years to come. The operations in Colombia are very low-cost with processing margins being enhanced by the credits from toll-milling of artisanal material. At the Operadora mines, the latest PEA puts the OpEx per ounce at slightly over half the current gold price providing a substantial cushion against an extended period of gold price weakness.

Colombia's government is pro-mining (and Soma's concessions are not in one of the areas with "local difficulties").

Relations with artisanal miners should stay good as having a bespoke processing operation is very much in their interest.

As for expanding resources, the concessions in Colombia are vast with enormous potential for gold mineralisation (as the artisanal presence proves).

The One that Got Away

One of the risks we had not figured in when writing our last update was that of theft. However, in a rather slick operation the company was the subject of a sting that resulted in a dore bar of 475 equivalent gold ounces being stolen from the La Ye mine in El Bagre, Colombia, on June 10.

The thieves took advantage of a change in the protocols during the transition as a result of the recent

acquisition of Operadora by Soma. An armed group of individuals entered the mine site after a gold pour but before the doré was transported by helicopter to the refinery in Medellin. No employee was injured during the theft. The police and Colombian military visited the minesite and an active investigation is under way. The gold was insured and the company expects a full recovery. New protocols and a full security review have been instituted.

Perversely, the theft had the effect of alerting investors to the fact that Soma had become a producer of meaningful amounts of gold and the company's stock has been strengthening ever since.

Conclusion

Soma Gold's management has shown that they are not ones to let the grass grow under their feet. Since discarding the Arizona operations it has doubled up, in effect, its focus on Colombia.

The company will have its own doré output augmented with throughput from tolling for artisanal miners. As artisanal miners must sell their ore at a discount to its gold content due to lack of alternatives, Soma Gold is positioned to make meaningful margins on its processing irrespective of the direction of the gold price.

The purchase of Operadora added the operating gold project of El Bagre (with three mines) and then the Nechi exploration assets. The purchase creates a significant contiguous concession package in Colombia, when added to the existing Zara concessions and El Limon projects. In addition to an operating gold mine and plant, the purchase will incorporate a veteran team of operators, engineers, and geologists, and exploration equipment that creates an important center of gravity for the exploration and development of all the company's assets in Colombia.

Therefore we reiterate our **Long** rating on Soma Gold in the Model Mining Portfolio with our 12-month target price being CAD\$1.22.

Wednesday, July 8, 2020



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