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HALLGARTEN + COMPANY

Initiation of Coverage

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Aya Gold & Silver

(TSX: AYA | OTCBB: AYASF | FSE: A2QAQY)

Strategy: SHORT

Key Metrics			
Price (CAD)	$12.79		
12-Month Target Price (CAD)	$4.80		
Upside to Target	-62%		
12mth hi-low CAD	$6.58 - $13.17		
Market Cap (CAD mn)	$1,512.5		
Shares Outstanding (mns)	118.3		
Fully Diluted (mns)	136.8		
	FY23	**FY24e**	**FY25e**
Consensus EPS		$0.010	$0.360
Hallgarten EPS		$0.078	$0.152
Actual EPS	$0.046		
P/E	280.4	164.6	84.1

Aya Gold & Silver

Overwrought & Overpriced

- + Morocco is not the name on everyone's lips but is certainly being viewed more favorably these days and has a very long history of mining
- + Early last decade we were almost alone in promoting the virtues of Maya Gold & Silver and its interesting asset portfolio in Morocco
- + A surging market cap has enabled financing of an asset that, for a long while, was overlooked & unloved
- + Inclusion in a pseudo-Index (the TSX30) being promoted by TMX has afforded the company fleeting cachet
- + Silver is doing very well at the moment (but has not kept up with gold's move)
- ✘ Mine build is running behind market expectations, guidance for FY24 is disappointing with lower volumes and higher opex per oz, while forward PE ratio is stunningly high
- ✘ Some 60% of the institutional shareholders in Aya are US-based, which raises the suspicion that the company has become a momentum play for heavy-hitters with little mining savvy
- ✘ Company only had $49.8 mn in cash on hand as at end of FY23
- ✘ The mine life at this point is only eight years which is surprisingly short for a stock with such a hefty market capitalisation
- ✘ The insider filings are inconsistent with company's public statements
- ✘ There is no dividend at Aya, which is a big red flag for us

The Midas Touch?

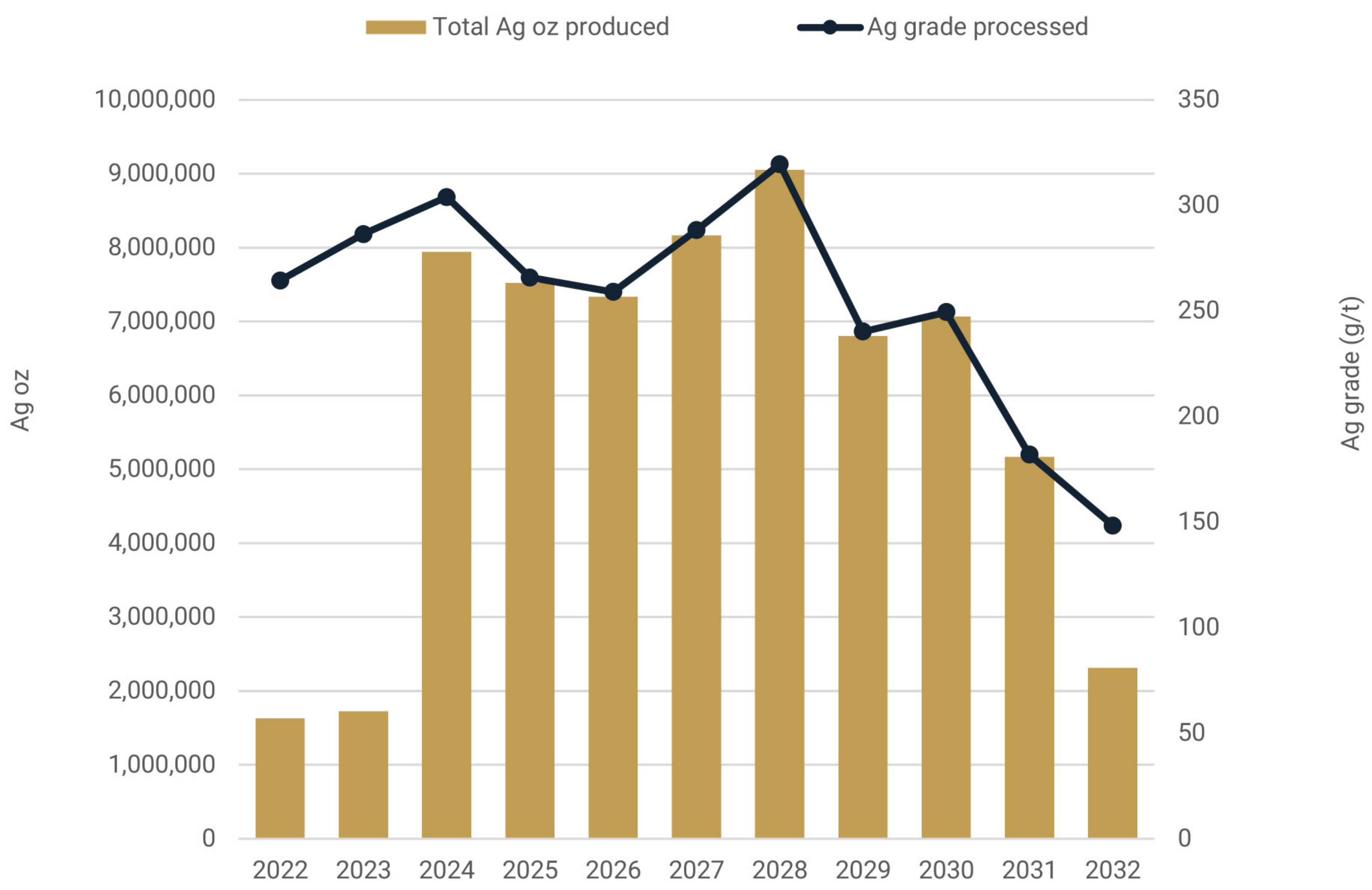
One of our best **SHORT**s in recent years (during 2021) was Aya Gold & Silver (after dropping its "M"). Much as we liked Benoit Lasalle, he is not worth $600mn. So, the market ingenues have leapt into the fray once again and pushed it well above where it was trading when we shorted it last time.

The CAD$1.5bn market cap is a joke on someone or other, but we don't intend to be the fools…. The TTM P/E ratio (not something mining investors understand or look at) is "only" 286 times. Therefore, we reinitiated a **SHORT** on Aya, with our target price this time around being $4.80. Last time it was $8.

The Money Slide

The slide on the following page from Aya's corporate presentation says to us (nay, shouts at us) that in a few short years from now, Zgounder will be on the road to extinction and, in theory, if profits have been dividended out then there will be no cash, no mine and future with the market cap at zero, down from the CAD$1.5bn currently. One can forget 2022 and 2023, for they are behind us. This leaves only eight years of LOM remaining, presuming no major discoveries are added to the mix.

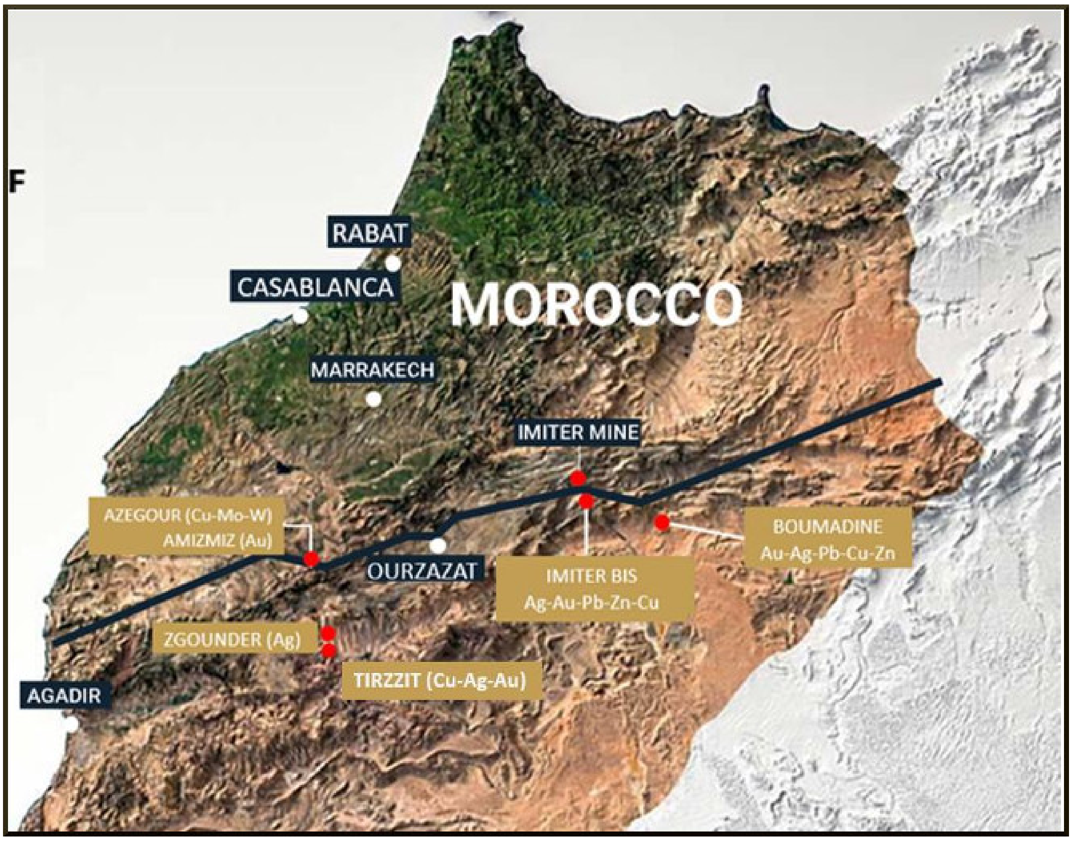
LOM Production Profile*



** Based on projections of 2022 Zgounder Expansion feasibility study. Projections include commencement of construction in Q2-2022.*

Assets

Aya Gold & Silver owns 100% of Zgounder Millennium Silver Mine S.A (ZMSM), which owns the Zgounder property. Aya also owns 85% of the Boumadine polymetallic project and owns the permits related to the Amizmiz, Azegour, Zgounder Regional and Imiter bis properties. These properties are in the Kingdom of Morocco. For the projects besides Zgounder, please refer to our Initiation in February of 2012.



Following the acquisition of Algold Resources completed in June of 2021, Aya also owns 75% of the Tijirit project located in Mauritania.

Zgounder

This silver deposit is the principal project (and mine) of Aya Gold & Silver and is located in the Anti-Atlas mountains of central Morocco, some 150km south of Marrakech and approximately 250km east of the major port city of Agadir. It is accessible via gravel road and covers some 16 kms^2.

Production History – The Mists of Time

This deposit has been around for a long while by anyone's measure. Estimates of its original initial production are in the 10th and 13th centuries. Back then veins, containing stringers of visible native silver, were mined in shallow oxidised zones. There is no information available on the mine's original silver grades, however the extensive ancient tailings from these early mining operations is estimated by BRPM (the State Mining Bureau) to have an average silver grade of 325g/t. A slag sample from the ancient smelter assayed 509g/t Ag, while two samples of ore picked up beside the ancient smelter ruins were visually estimated by geologists in recent times to contain 0.5-1.0% visible native silver.

From 1982 to 1990 the mine was built and operated by the Societe Miniere de Sidi Lahcen (SOMIL) which had identified an original reserve of 435,000 tonnes, grading 385g/t Ag. It was operated as an underground mine until placed in 1990 on a care and maintenance basis as a result of the then prevailing weak silver prices. The plant was sizeable with a rated ore throughput capacity of approximately 75-80,000 tonnes per year. A total of 500,000 tonnes of ore was treated during the SOMIL period at an average grade of 330g/t Ag.

Back on the Radar

In the early part of 1998, as a part of the Moroccan government's privatisation plans, the Zgounder Mine was put out to tender which ultimately resulted in the signing of a Letter of Intent by a TSX Venture-listed company, Icelandic Gold in November 1999. That company undertook quite a substantial amount of work then desisted due to the persistently low silver price and was transformed into Iberian Minerals and refocused on Spain. Iceland’s plan had been to double rated capacity and put through around 200,000 tonnes of ore per annum.

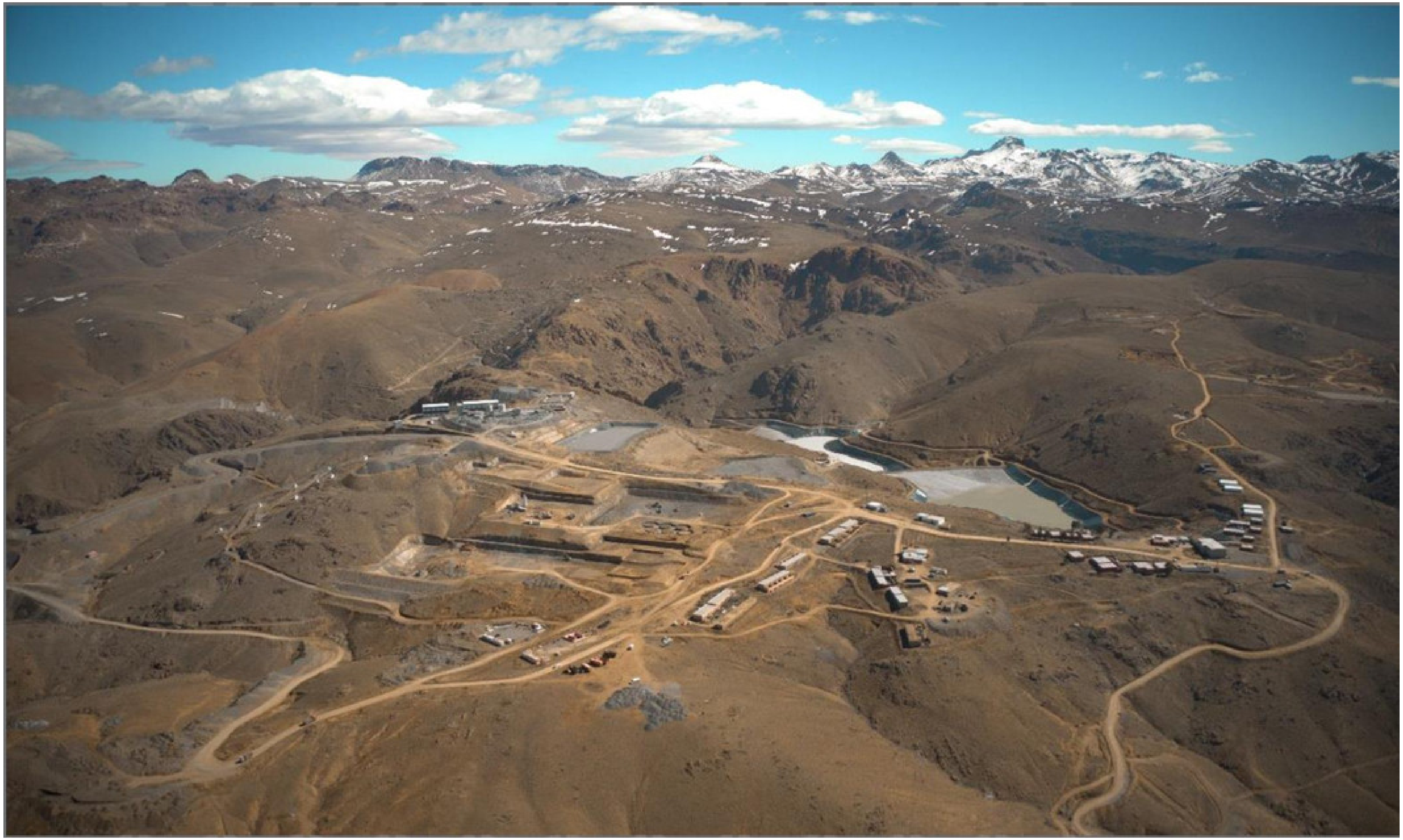
The recent history with Zgounder dates back to March 2011, when the Moroccan government entity, L’Office National des Hydrocarbures et des Mines (ONHYM), launched an international tender in order to rehabilitate and develop the Zgounder silver project. ONHYM is a state-owned company involved in the mining and oil activities of the Kingdom of Morocco.

ONHYM awarded the mine to Maya, after an international tender, and in September 2011 Maya entered into a joint venture with ONHYM to acquire 85% of the Zgounder silver deposit (via a Moroccan subsidiary, of which ONHYM would hold a 15% net carried interest). As part of its offer to the ONHYM, Maya and SGS Canada prepared a program to further explore the property, develop infrastructure and restart the underground operations of the deposit. ONHYM will retain a 3% royalty on sales.

The Geology

There are two principal silver ore zones at Zgounder, both known to be at least 800 metres in length and trending parallel in an E-W direction. The lower grade ore zone (300-500g/t Ag) is generally between 10 and 25 metres thick. The higher-grade ore zone (300-2,000g/t), located 75 metres to the north, is normally between 2 and 8 metres thick.

A report by ACA Howe International report, commissioned by Icelandic, found that the Zgounder deposit bears a strong structural, lithological and mineralogical resemblance to the major Imiter deposit, which we discussed in our previous note on Maya.



Mineralogical work conducted on Zgounder samples by Icelandic Gold identified a silver-mercury sulphide mineral with a close resemblance to imiterite, originally described from the Imiter Mine; the overall parageneses of the two deposits are very similar. The Imiter deposits are known to extend to at least 400 metres depth, though the original workings, as at Zgounder, are restricted to the upper 1-200 metres. A blind deposit has also been discovered at a depth of 150 metres with a vertical extent of 300 metres, immediately adjacent to a granitic intrusion. The intersection of granitic rocks at depth in the East Sector at Zgounder was thus of interest. The convergent fracture zones mapped at Zgounder also suggested two primary sources at depth, and in the eastern sector to the south of the known mineralisation, with potential for bonanza zones.

The Mine

During its period of control SOMIL undertook 15,383 metres of drilling, built 9,220 metres of underground drifts and crosscuts, as well as 1,200 metres of raises and ore passes.

The Zgounder Mine's South Zone, the previous principal source of ore, was accessed by horizontal adits, set 25 metres vertically apart, from a moderate to gently dipping hillside. The adits are located over a 750 metre strike length and provide direct access to ore zones and mine workings at depths of up to 250 metres. In the 1980s, approximately 40% of the South Zone's strike length was reported to be represented by economic ore. A visual examination of previous mine plans suggest a minimum of 1.0 million tonnes of potential ore grade material may be accessible from existing mine workings.

A parallel, new and potentially higher-grade source of ore, the North Zone, lying 70-100 metres north of the previous workings, had been identified by drilling after the mine's closure.

Resource/Reserve

CMT (the former owner) had performed a program of reserve extension between 2000 and 2003. It yielded a total resource of 16mn ounces Ag. They also came up with a non-NI 43-101 estimate of the geological potential of the likely extensions of the ore body exceeds 45Moz. The former owner also reported that the newly discovered North Zone exhibited higher silver grades and narrower widths thereby providing further exploration targets.

At the time we initially covered Maya, there was a historical MRE dating from 2004:

- 582,000 tonnes at 361 g/t Ag (150 g/t Ag cut-off) - (7.5mn ounces)
- 500,000 tonnes at 125 g/t Ag [surface tailings] – (2.2mn ounces)

These resource numbers were not NI 43-101 compliant.

Also, based on previous work, ONHYM had estimated (at a cut-off grade 150 g/t Ag):

- Proven reserves: 120,000 tonnes at 500 g/t Ag

- Probable reserves: 195,000 tonnes at 360 g/t Ag
- Possible reserves:267,000 tonnes at 300 g/t Ag

In 2012, Zgounder's current ore reserve was determined by the BRPM to amount to 4.58mn ounces of silver. An additional potential resource, estimated by Icelandic to be between 1.4mn and 2.5mn ounces of silver, was located in the 500,000 tonne tailings dam.

The latest reserve published by Aya looks like:

	Tonnes (K)	Ag (G/T)	Content (Ag K Oz)
Proven Reserves	2,100	288	28,748
Probable Reserves	5,490	239	42,128
P&P Reserves	**8,590**	257	70,876
Measured Resources (Incl. Reserves)	3,511	347	39,183
Indicated Resources (Incl. Reserves)	6,254	283	56,874
M&I Resources (Incl. Reserves)	**9,765**	306	96,057
Inferred Resources	196	367	6,400

This used a cut-off with a $20 per oz Ag price. These reserves include 29% open-pit and 71% underground ore.

And Hochschild?

Comparisons may be odious, but they are even more so for Aya holders and boosters when held up against Hochschild PLC, one of the main listed silver plays on the London market.

This stock, however, has only a market cap of GBP£674mn (CAD$1.149bn), so only 80% of that of Aya Gold & Silver. However, if our eyes do not deceive us, it has double the reserves in Proven & Probable resources categories and has a greater proportion in the Proven category. Hmmm…..

Hochschild Reserves	**Ag Eq k/ozs**
Proved	62,800
Probable	74,400
Total	137,200

The TSX 30 Effect

We must confess to not having heard of this index before and having given it some scrutiny we see that it is nothing but the Successful Promoters Index.

The TSX30 is a program recognizing the “30 top-performing companies” on Toronto Stock Exchange

(TSX). Eligible listed issuers are ranked based on their dividend-adjusted share price performance over a three-year period.

All indices are biased towards the outperformers because laggards are dropped at some point or another (or taken over in the case of winners and some losers). But this Index is on steroids.

It is interesting that the number of household names on the list is rather paltry. Beyond Aya, we only had name recognition of Teck Resources, General Atomic, Allkem (an Australian stock), Capstone (that spent most of last decade in the doghouse) and Bombardier. If one was to corner an average Canadian in the supermarket and asked what these stocks were and what they "sold/produced", one would probably score even lower than with us. This is far from being the Dow 30.

Aya has been carried higher by the wave of being in this "index". But as we all know so well, those who live by the index can also die by it when they fall from favour, are expelled or downweighted.

Heavyweights Come & Go

It is interesting to note the heaviness of US investors in the institutional portion of the AYA register. At over 60% of that category, this is not a common thing to see, particularly when the stock has neither a NYSE nor a NASDAQ listing, though obviously it has a market cap which would enable it to seek either.

"Large cap" stocks and the US equity markets have a bit of a relationship akin to a firestorm and a wind. The bigger the market cap gets, the more "investable" it becomes for US investors going from a "too small" categorisation to a "must have" exposure to the mining sector where there is severe depopulation of the investing options available.

Then the stock might be added to an index and the roof blows off. Over and over again, mediocre miners have achieved lift-off if they can light a firestorm under their stock price in US markets. The eventual outcome is that the company and its investors are carbonised. Not a pretty sight, but management have usually cashed out and fled the smouldering ruins by that stage.

Casting our Beady Eye

While trying to parse the shareholder data the company proffers, we were intrigued by the heavy quotient of family offices.

Then we note the Family Offices have a footnote saying that these are affiliated with board and insiders. Being the eager beavers we are, we headed off to SEDI. Some of the directors seem to know what that is, but whoever the compliance officer at Aya is, does not.

So, what do we find at SEDI with a search of Aya insiders? We find the directors & management with a grand total of 13.58mn shares (13.2% of the common stock). But…..none of the 32% of the company's stock shown above as Family Offices is reported. Since when do the family offices of insiders and management not count as insiders? The word "insider" is a clue for those who are a tad slow.

Reported Insider Holdings for AYA at SEDI

Benoit La Salle	61,221
Yves Grou	28,915
Jurgen Hambrecht	1,207,250
Nikolaos Sofronis	2,139,361
Robert Taub	9,746,262
Annie Torquia Lagace	15,450
McKenzie Watson	380,000
	13,578,459

So, in theory, the controlling parties for these family offices can be dealing like dervishes and the market would be none the wiser, despite these entities being joined at the hip with insiders. We smell a rat or gross negligence in reporting. Tsk, tsk, tsk.

Silver – Coat-tailing on Gold

Intriguingly, silver has been substantially underperforming gold in recent months. As the chart of the gold silver ration on page 13 shows the ratio worsening from around 73 to one to over 90 to one before a slight improvement for silver in recent days.

The reality of soaring inflation and the grimness of the Russian invasion of the Ukraine and Israeli destruction of Gaza have done a little to restore the old “fear factor/premium” to the yellow metal in particular. Crypto reared its head again of late and gold for once beat off that challenge. For gold/silver bulls the lassitude of precious metals in a worsening inflationary environment over the last two years and in the face of international crises seemed to disprove the metals’ role as safe havens. Then almost as if playing catch-up two years too late, gold found its footing with the Israeli invasion in a way that the Russian invasion had not, while inflation seemed to have peaked (and with it interest rates) and gold perked up. This was perverse.

For the silver/gold ratio, the best of (recent) times was March of 2021 as silver traded at 63 ounces to the gold ounce. This deteriorated massively to around 96 ozs to the gold oz, a decline of 50% before staging the latest comeback which positioned silver at around 75 ozs to the gold oz. One might be so bold as to speculate that industrial usage of silver powered the 2020-21 improvement vis a vis gold. There is no reason why silver should not get its mojo back, with industrial rationales driving an improved ratio.

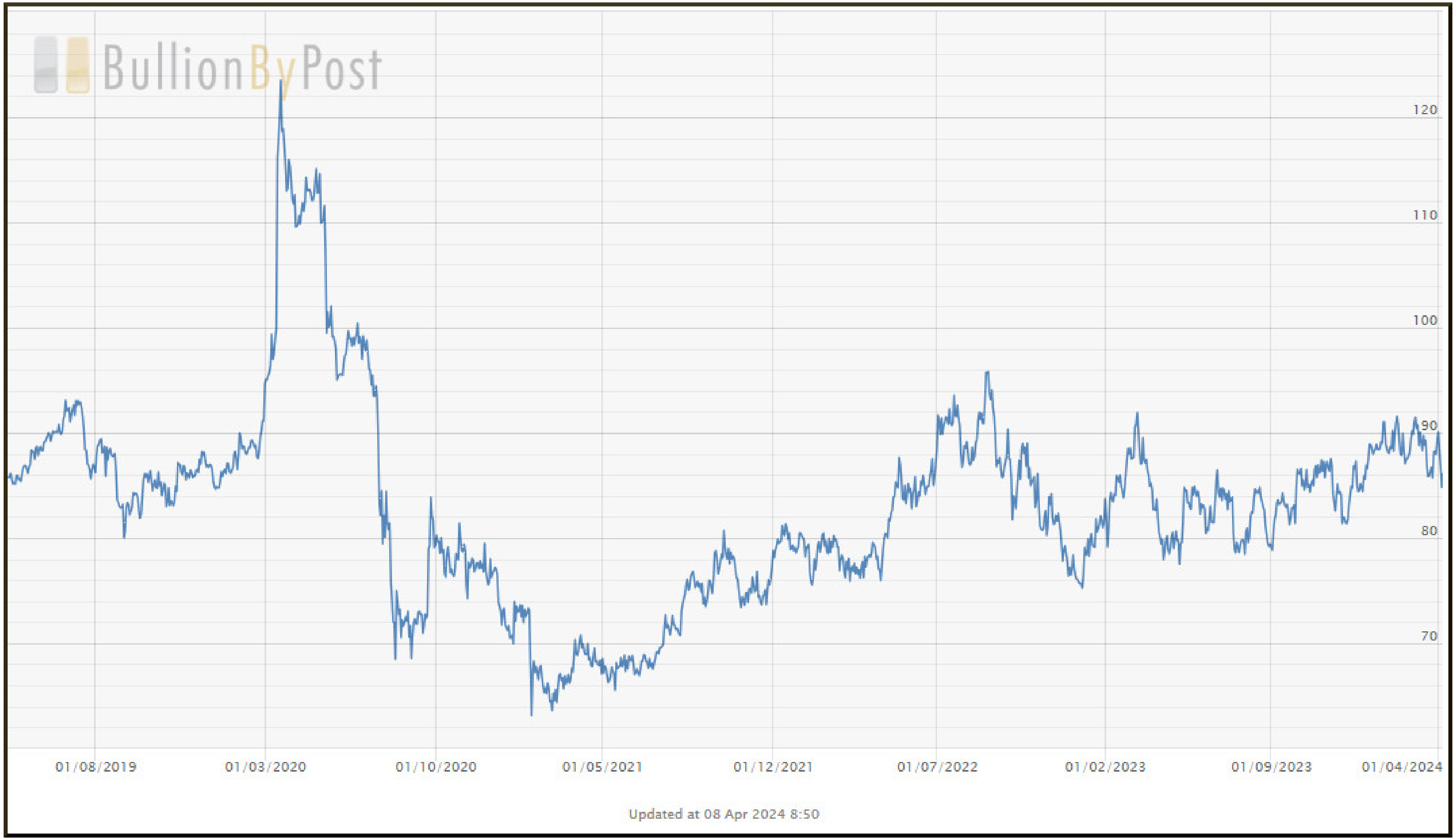
On the supply-side, the Silver Institute is forecasting total global silver supply to have a strong 2024, rising by 3% to an eight-year high of 1.02bn ozs, due largely to a recovery in mine output. Silver mine production in 2024 is projected to rise 4% to 843mn ozs, its highest level since 2018. In early February of 2024, the same institute prognosticated that global silver demand might reach 1.2bn ounces in 2024, which would mark the second-highest level on record. This makes for a strong supply-demand imbalance which would necessitate sales of silver holdings by investors. Knowing silver investors though, when a run is on, they are even less likely to let go of their holdings particularly when they were believers during the dark days.

Weak Lead and Zinc prices in the last couple of years have not helped, as there has been almost no incentive for primary miners of those metals to up production when Silver was so rangebound. The latest recovery in Silver should vastly improve the economics of those mines with sizeable by-product silver flows.

Both silver and precious metals have come in from the cold and the gold and silver bulls are forecasting breaches of the next “big round numbers” ($2500 for gold and $30 for silver). As usual they never see any stones on the road to where they want to go. The situation in the Russian/Ukrainian war looks grim with no progress towards resolution which the opprobrium heaped upon Israel might bring that event towards a ceasefire and de-escalation. But that is just a maybe..

Despite gold’s stronger run lately we see silver (even in our scenario of gold at $2,160 for the end of 2024) ending the year at $24.50. This still represents a ratio of 88 to one.

With many silver miners continuing to disappoint investors with flaccid earnings and the reality of output not reaching projections/guidance, that leaves SLV (the physical Silver ETF) as the best hobbyhorse to ride in this race.



Source: Bullion by Post

The Magic of Benoît?

We have to attribute the lift off for Maya/Aya to the appearance on the scene in 2020 of Benoît La Salle, one of the icons of Canadian mining, particularly for the francophone set.

He was appointed President & CEO of Aya Gold & Silver in April 2020, bringing with him over 25 years of experience in developing and operating mining companies in West Africa (including Guinea Burkina Faso & Nigar). In 1995, he founded Société d'Exploitation Minière d'Afrique de l'Ouest (SEMAFO) It grew from a junior explorer to a 250,000-plus ounce-per-year gold producer in West Africa, establishing SEMAFO Foundation in 2008 to support local communities.

Since 2010, he has held board positions at six public companies in addition to founding three West African-focused exploration companies and one privately-held power producer. He has been active in the non-profit sector, he is a former board director and Chair of Plan International Canada and has been Chairman of the Board of The Canadian Council on Africa since 2013.

He is a member of the *Ordre des comptables professionels agréés* du Québec. He holds a Bachelor of Commerce degree from McGill University and a Master of Business Administration degree from IMEDE, Switzerland.

We first came across him when he was president of SEMAFO and we had liked what we had heard. We later had an interaction when he debuted at Sama (the West African nickel developer, that later spawned SRG, the graphite play). SEMAFO was taken over by Endeavour Mining in 2020.

When he was replaced after 17 years as president of SEMAFO in 2012 when the company fell into losses. La Salle reportedly received a $3mn severance, on top of his annual $1mn salary.

Progress

Notwithstanding the chart showing mooted production on page 3 of this note the 2024 production will well undershoot those projections with the current state of progress (as at late March 2024) being:

Area	Progress
Process Plant	71%
Underground and Open-Pit Mines	87%
Tailings	97%
Water Management	98%
Electrical Infrastructure	76%
On-site Infrastructure	60%

Aya Gold & Silver

USD mns

	FY24e	FY23	4Q23	3Q23	2Q23	1Q23	FY22	4Q22	3Q22	FY21
Total Revenue	80.070	42.848	11.07	11.714	9.621	10.443	38.244	13.321	7.187	34.301
Cost of Revenue, Total	46.687	27.043	6.276	5.531	6.876	8.36	27.96	8.602	6.413	18.292
Gross Profit	33.383	15.805	4.794	6.183	2.745	2.083	10.284	4.719	0.774	16.009
Selling/General/Admin. Expenses	12.400	10.876	3.396	2.531	2.781	2.168	8.444	1.805	2.103	10.13
Interest Expense (Income)	3.800	-4.283	-2.884	1.385	-0.839	-1.945	-2.761	-1.619	-1.879	0.308
Other Operating Expenses	-	-	-	-	-	-	0.020	-	-	0.452
Total Operating Expense	62.887	33.636	6.788	9.447	8.818	8.583	33.663	8.788	6.637	29.182
Operating Income	17.183	9.212	4.282	2.267	0.803	1.86	4.581	4.533	0.55	5.119
Gain (Loss) on Sale of Assets	-	-	-	-	-	-	-	-	-	-
Other, Net	0.000	0	0	0	0	0	0	0	0	0
Income Before Tax	17.183	9.216	4.282	2.267	0.803	1.86	4.581	4.533	0.55	5.119
Tax	7.700	3.884	0.692	1.061	1.328	0.80	3.182	2.040	-0.122	3.845
Income After Tax	9.483	5.332	3.59	1.206	-0.525	1.06	1.399	2.493	0.672	1.274
Weighted Average Shares	122.00	116.90	119.70	118.26	114.94	114.69	105.276	105.20	105.10	98.347
EPS	0.078	0.0456	0.030	0.010	-0.005	0.009	0.0133	0.024	0.006	0.013
Ozs Ag Produced	3,150,000	1,970,562	450,046	519,000	526,703	474,813	1,880,707	661,620	451,000	1,600,646
Ozs Ag Sold	3,140,000	2,012,345	507,635	543,983	452,523	508,204	1,935,154	669,506	419,760	1,514,556
Net Realised Silver Price US$	$25.50	$21.29	$21.81	$21.53	$21.26	$20.55	$19.76	n/a	$17.12	$22.65

The upshot of this is that the company has offered guidance for FY24 of only 2.6-3.2mn ozs with a silver cash cost around 8% higher than that of FY23 at between $13.00 - $14.50/oz. The increase in cost is due to the lower grades at the mills in 2024, the additional development work needed in 2024, and the additional costs associated to the start-up of the expansion.

This lower output and higher cash cost would be a disappointment to those that had great expectations for the ramp up, but one would not know it from the stock price.

Indeed, this guidance was below even our muted expectations.

On the preceding page our estimates for FY24 are considerably below the already reduced consensus. Even our production volumes are at the high end of the revised guidance. We brace ourselves to see them come in even lower.

The company says it has stockpiled ore, and that production begins in late 2Q24 so why is the full year production so skinny when it was mooted to be nigh 8mn ozs in the studies? Again we brace ourselves for lower than expected volumes in 2025 (transposing the mooted 2024 numbers a year later).

Risks

Amongst the risks related to the Aya Gold & Silver's projects are:

- Silver price risk
- Political risk in Morocco
- Downweighting, or removal, from the TSX30
- Financing Risk

The company's main vulnerability is the Silver price and sentiment towards it. At least as long as the war in the Ukraine continues and the Gaza "campaign" drags on, we do not see much danger of the price of gold or silver retracing lower. Indeed, the longer these events drag on the greater the chance of escalation in the conflicts and thus the safe haven aspects of the precious metals will be reinforced. Beyond that we have the long-term underinvestment in new mines/capacity which has left silver with a scant pipeline of new sources of supply.

Political considerations come with the territory in mining activities and these are even more fraught when the jurisdiction is not well known or well-trammelled by foreign miners. As a kingdom with not strong parliamentary tradition, changes in policy towards mining are not even signalled in election campaigns or political manifestos but can be instituted from one day to the next by Royal command. However, the country does NOT have a reputation for arbitrariness towards miners. As for political stability, the country wobbled at the onset of the so-called Arab Spring in the first half of last decade, but then the regime managed to preserve its prerogatives largely intact. There are no other such challenges at this time.

As we believe we have shown, Aya Gold & Silver is overvalued in the stockmarket and thus destined inevitably for a correction. When this happens of course it will cease to be a TSX30 “constituent” and suffer the attendant “fall from grace” that being defenestrated from a listing such as this brings with it.

For once there is a company without a financing risk. With the market cap that Aya currently has, it should be able to execute bought deals in the hundreds of millions of dollars from its fans.

Conclusion

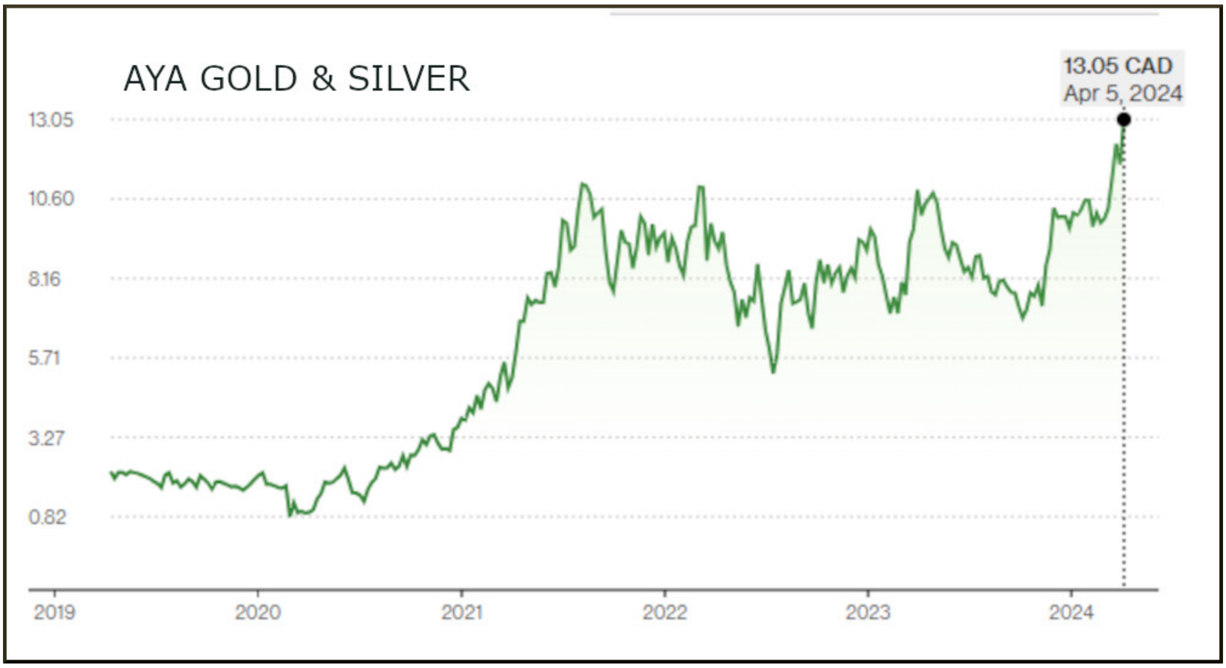
Though most developers may not believe it, capital markets can deliver the goods for some companies and Aya Gold & Silver has found itself currently in the vortex of a virtuous circle with a combination of a US-dominated “institutional” shareholder base and its inclusion in a pseudo-Index of “winners” concocted by the TSX and a slight tailwind of improved silver prices to storm to dizzying heights. Is there a Wile E. Coyote moment awaiting the unwary?

Call us dumb, call us confused… we have been called lots of things… but frankly we are boggled as to how a company making 1.3 cents per share in FY22 can be worth nigh $13 per share. That is a historical P/E of 1,000 times. And in FY22, the company made more money from interest income than it made from mining. Ahem…

We asked the question before and will ask it again, is Benoit La Salle really worth $600mn within the already ritzy market capitalization of Aya? If one is to believe the insider filings at SEDI (which we don’t) he only holds a bit over 61K shares in the entity. The mysterious affiliated “Family Offices” seemingly don’t count and disappear in a puff of smoke when the time comes for filing one’s holdings. Another advantage of this that the cynical might mention is that if certain related entities don’t do their insider filings, then the Great Unwashed don’t get to know if insiders are buying or selling into strength.

For us the only thing that Aya has going for it is the resurgent silver price and recovering sentiment towards precious metals equities in general. This higher tide is lifting many boats but in this case is sending Aya into an orbit like Halley’s Comet. However, is anyone going to take this over at its massive excess valuation over its real worth in preference to companies with larger and more diversified project bases? We doubt it.

We are (re)initiating Aya Gold & Silver with a **SHORT** rating and propose a 12-month target price of CAD$4.80.



Source: Bloomberg

Important disclosures

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