

Dynacor Gold Mines Inc (DNG:TSX)

Current Price (April 1, 2022) Price: \$3.38

RECOMMENDATION: SPEC BUY

CASH RICH GOLD MILLER REPORTS 2022 GROWTH GUIDANCE, DESPITE RISE IN VALUATIONS & DIVIDEND REMAINS ATTRACTIVE IN SUPPORTIVE GOLD PRICING ENVIRONMENT – MAINTAIN HIGHER RISK SPEC BUY



Industry: Gold - Processor
Recommended: July 2017
Recommendation Price: \$2.00
Yield: 3.04%
Market Cap: \$131.23 Million
Shares Outstanding: 38,919,359
Fully Diluted: 39,709,890

Focus BUY Portfolio

SELECTED QUARTERLY DATA

(US\$)		
Income Statement	Q3 2021	Q3 2020
Revenues	\$61,941,662	\$24,089,094
NI	\$3,517,777	\$1,249,203
EPS (diluted)	\$0.09	\$0.03
EBITDA	\$7,229,000	\$2,687,000
EBITDA Per Share	\$0.19	\$0.07
Diluted Adj. EBITDA Share	\$0.18	\$0.07

RATINGS (Q3 2021)

VALUE	
P/E (TTM)	10.56
Adj. P/EBITDA (TTM)	4.48
Adj. EV/EBITDA (TTM):	3.71
P/S (TTM):	0.53
P/FFO	7.04
P/B:	1.40
Current Ratio:	3.61
D/E:	0.02

Headquartered in Montreal, Dynacor is a dividend-paying ASM (artisanal and small-scale mining) gold ore industrial corporation. The company's activities consist of the production of gold and silver from the processing of purchased ore and the exploration of its mining properties located in Peru.

Dynacor purchases its ore from government-registered producers in various regions of Peru and then processes it at its wholly-owned milling facility to produce gold and silver, which is sold internationally at market prices. Dynacor has a very simple business model. The company purchases ore from small-scale miners (artisanal miners) in various regions of Peru, processes it at its wholly-owned Veta Dorada mill and sells the extracted gold and silver internationally at market prices. As a result, the profitability of this business depends on two factors:

- A margin between the price of ore purchased and the market price of gold – the higher the margin the better.
- Throughput (the amount of ore processed) - the higher throughput the better.

A higher gold pricing environment encourages more small-scale mining which grows Dynacor's ore supply and creates profitable growth.

Dynacor also owns the rights on three mining properties, which are in the exploration stage. This includes its flagship exploration gold, copper, and silver prospect, the Tumipampa property. It does not have any properties in commercial production.

2022 GUIDANCE

On February 23, 2022, Dynacor reported its financial and capital expenditure guidance. The 2022 financial forecast is based on an average gold price of US\$1,810 per ounce. Gold closed today at US\$1,910.90 per ounce.

- Revenues in the range of US\$200 - \$220 million (C\$254 - \$279 million) representing growth of 8-16% over the 2021 September revised guidance and 4-14%

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- over 2021 final production sales.
 - Net income in the range of US\$11-\$13 million (US\$0.28-\$0.33 EPS), (C\$0.36 - \$0.42 EPS) representing growth of 22-37% over the 2021 September revised guidance.
 - Cash flow from operating activities in the range of US\$14 - \$16 million (US\$0.37 - \$0.42 CFPS), (C\$0.47 - \$0.53 CFPS).
 - Capital budget in the range of US\$ 5- \$8 million.
- Assumes 2022 average CA/US exchange rate of 1.27:1.*

Dynacor forecasts gold and silver sales of between US\$200 million to US\$220 million. Based on its 2022 capital budget, operating activities, and expansion development, management expects to generate significant additional free cash flow in 2022. Dynacor's 2022 capital budget ranging between US\$5 - \$8 million includes sustainable capital at the Veta Dorada plant, additional capacity expansion to follow the 25% increase in 2021, and a US\$1.0 million, 2,735-meter 8-hole diamond drilling program at Tumipampa, the company's gold exploration property in Peru.

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DIVIDEND INCREASE

On November 16, 2021, Dynacor announced its board of directors approved a 25% increase to the company's monthly dividend. The monthly dividend will increase to Canadian 0.83 cents from 0.67 cents and on an annual basis to \$0.10 from \$0.08 per common share starting in January 2022. This marks Dynacor's 3rd dividend increase since the company paid its first dividend to shareholders in October 2018.

GROWTH POTENTIAL

Long-Term Growth Plan

On June 19, 2018, Dynacor published a summary of its strategic plan to update its shareholders and the market on the steps management is taking to transform the company into the leading processor of gold mineralized material produced by arti

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sanal mining worldwide. Given the restrictions imposed during the global pandemic, the timeline of this strategic plan has been moved forward, but progress has been shown and despite record growth in 2021, the company continues to position itself for growth in 2022 and beyond if the gold price continues to be relatively supportive.

Southern Peru Existing Plant (Veta Dorada) Potential Expansion

In May 2016, Dynacor completed the construction of a 300-tonnes per day (tpd) (104,000-tonnes per year (t/y)) ore processing plant (Veta Dorada Plant) which was designed to be readily upgraded to 435 tpd, which has already been completed, and eventually 600 tpd (208,000 t/y), subject to permitting by the Ministry of Energy and Mines of Peru (MEM), by using additional processing equipment. Its location close to the PanAmerican highway is, as well, a competitive advantage. The company has the cash on hand to move forward with Veta Dorada plant expansion to 600 tpd in 2022. A decision has yet to be made in this regard and will depend on the consistency of the ore supply at Veta Dorada which is currently exceeding capacity.

Northern Peru Potential New Plant Expansion

Long term, the potential for Dynacor to replicate its current modern Veta Dorada plant located in Southern Peru in Northern Peru to serve the burgeoning ASM market in this region.

Senegal Expansion

On June 11, 2019, announced it has signed a Letter of Intent (LOI) with “KN Equipments Inc.” and “Fonds Souverain d’Investissements Stratégiques” of Sénégal (FON-SIS). The company set in motion to strategically expand its business globally by forming a jointly-owned company to operate in Senegal. The new company would start by building an upgradable ore processing plant in Senegal. On July 15, 2020, Dynacor announced the completion of its due diligence phase to expand its ore-processing business to an international level by building an ore-processing pilot plant operation in Senegal. The new company will initially build a 100-150 tonnes-per-day (TPD) ore-processing facility, with an expandable design to 300 TPD. The budget to build

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the 100-150 TPD plant is approximately US\$10 million. The new company is to invest US\$4 million, of which Dynacor's total share would amount to 51% or US\$2.04 million together with KN Equipments and FONSIS investing an additional US\$1.96 million. The balance of the US\$10 million is to be financed by local Senegalese banks.

Supply & Location: The material (ore) is to be supplied by the local miners from the three regions, Tinkoto, Bantaco and Kharakhena. In addition to the three (3) ASM properties, there are twenty (20) other significant ASM areas, including seven sites at Kharakhena, eight sites at Tinkoto and five sites at Bantaco. There is a high probability that they will supply gold ore to Dynacor. A satellite imagery study by Japosat Satellite Mapping discovered seventy-six (76) additional ASM operations signaling the future potential to grow Dynacor's Senegal ore-processing division into a much higher capacity. Dynacor is reviewing a site located in the hub of the ninety-six (96) ASM properties, east of Kedougou on the road towards Kharakhena and near the Gambia River. The prospective plant site is 80 km to Kharakhena, 75 km to Tinkoto and 40 km to Bantaco.

Senegal & ASM in Africa: With a high-growth economy of 6%, Senegal is one of Africa's most stable and gold-rich countries hosting thousands of ASM miners. Mining in Senegal at the artisanal level started in the Sabodala area in the 1960s, but it took place more extensively in the 1990s. In the last decade, the ASM industry has increased dramatically with people from southeast Senegal, Mali, Guinea, Burkina Faso, Benin, Cote d'Ivoire, Ghana, Gambia, etc. These ASMs have been moving to Kedougou, Bantaco, Tinkoto and other areas. Small-scale mining as of the previous ten years has increased dramatically. Today, up to 70,000 to 100,000 people are working in the ASM industry. Senegal still trails some of the other countries in small-scale mining and gold production (Mali, Ghana, Sierra Leon and Nigeria) but is rapidly gaining ground. The three regions, Kharakhena, Tinkoto and Bantaco, have possibly 8,000 to 10,000 people involved in artisanal mining.

Strict travel restrictions have limited progress in Senegal and continue to be a con

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cern, but we do believe 2022 will be a more positive year in terms of news in regards to this project. Do not expect an operating mill within the year, but the potential for Senegal to add diversification in 2023 as restrictions in the country are lifted over 2022 and construction potentially begins is real.

Broad Expansion Roadmap:

- 3 new mills are planned in next 3-5 years.
- Target locations: within Peru (North), Other Latin American Countries, West Africa (not including Senegal).

RISK UPDATE

New Peruvian Government

The election of Castillo, a member of a Marxist-Leninist party, as president in June spooked investors, with Peru's Sol currency falling to a fresh record low against the U.S. dollar. There have been promises of new or increased taxes on miner operators but the government is working to regain investor confidence. While increased social spending is expected, the administration is committed to maintaining fiscal discipline and plans to reduce the deficit in 2022 by 1 percentage point compared with 2021. Spending ceiling rules will also be reinstated after they were lifted due to the pandemic. Logically, Dynacor's business helps local Peruvians make a solid living and should be a company that is encouraged by the new regime. But without a track record, the new government is a wildcard and adds a level of risk.

Potential Tax Assessment

On October 26, 2021, Dynacor's Peruvian subsidiary received a notice of assessment from the local tax authorities for the fiscal year 2015 in the amount of \$6.4 million (25.6 million Soles) including \$4.1 million (16.3 million Soles) in penalties and interests. The main item of the assessment relates to the ore purchased from certain suppliers, qualified as non-genuine transactions by the local tax authorities and therefore considered by the authorities as non-deductible expenses. Dynacor and its legal tax

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counsel are currently reviewing this notice of assessment and strongly believe that ore purchases are genuine transactions. Therefore, the company will contest this claim. As of September 30, 2021, no provision has been recorded. Any provision would be recognized in Dynacor's consolidated financial statements if an unfavorable outcome becomes probable. Even if a \$6.4 million total fee was imposed, while not good for the business, with \$17.8 million in cash on hand, the company would be able to easily digest the payment.

VALUATION

Based on the mid-range of Dynacor's 2022 guidance (\$0.39 per share) the company trades with a forward price-to-earnings (PE) multiple of 8.72. Based on a justified multiple of 10 times and after adding back the net cash of approximately 0.55 per share, we arrive at a fair value in the range of \$4.45, up from \$4.00 in our latest update. The multiple endeavours to take into account are the additional geopolitical risk in Peru as well as the risk of a lower gold pricing environment. If the geopolitical environment stabilizes and the price of gold moves higher, and the company executes on growth ambitions outside Peru, there is an upside to the current fair value estimate.

CONCLUSION

While not nearly the growth level realized in 2021 (93% revenue growth), Dynacor's 2022 financial guidance once again calls for growth which is a positive. Revenues are expected to be in the range of US\$200 - \$220 million (C\$254 - \$279 million) representing growth of 8-16% over the 2021 September revised guidance and 4-14% over 2021 final production sales. We note that Dynacor significantly exceeded its initial 2021 guidance released on February 18, 2021, of US\$150 million and revised guidance (released on September 22, 2021) of US\$185-190 million. In 2021, Dynacor also achieved a new record gold production of over 100,000 ounces for the first time in the company's history. If the company executes on expansion plans at the existing mill, grades improve as the year progresses, and the gold price remains elevated there is upside once again to this year's guidance.

Call-outs from the 2022 guidance include Dynacor's 2022 capital budget ranging from US\$5 - \$8 million which includes additional capacity expansion to follow the 25% increase in 2021. We expect the company's existing Veta Dorada plant to see a further upgrade in 2022 which sets the stage for further growth in the second half of 2022.

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We do note that Q1 2022 faces a number of variables that make for tough potential comparisons to start 2022 compared to 2021 including the volatile rainy season, a pull forward of sales from Q4 2022 into Q1 2021 and lower grades realized over the first part of Q1 2022. This could cause some near-term weakness in the first quarter of 2022.

Based on the mid-range of Dynacor's 2022 guidance (\$0.39 per share) the company trades with a forward price-to-earnings (PE) multiple of 8.87 and 6.64 times ex cash. By applying a justified multiple of 10 times and after adding back the net cash of approximately \$0.87 per share, we arrive at fair value in the range of \$4.75, up from \$4.45 in our latest update. Dynacor operates in a high-risk environment geopolitically and is appropriate for risk-tolerant clients. **We maintain our SPEC BUY recommendation and the company's place in our Focus Buy Portfolio.**

Update

On March 31, 2022, Dynacor released its 2021 audited annual consolidated financial statements which bested revised estimates. The company completed 2021 with both production and financial historical high performances on its way to its eleventh consecutive year of profit. Dynacor achieved a production record of 106,862 AuEq ounces powering total sales to \$196 million a significant 93% increase compared to 2020, and a net income of \$11.8 million.

Notes:

- **Strong cash position:** Cash on hand of \$27.1 million or \$0.87 per share at year-end 2021 compared to \$11.9 million in 2020,
- **Guidance:** For 2022, Dynacor is forecasting sales in the range of \$200-220 million representing growth of 4-14% over 2021 final production sales. This would result in a net income in the range of \$11-13 million (\$0.28-0.33 per share) (CA\$0.36-0.42 per share).
- **Expand Veta Dorada plant:** Dynacor's 2022 capital budget ranging between \$5-8 million includes sustainable capital at the Veta Dorada plant. Management intends to increase the mill capacity later this year.
- **New Potential Mills:** Dynacor is continuing to assess other opportunities of growth in Peru as well as in other jurisdictions.

Fair Value: Based on a justified multiple of 10 times and after adding back the net cash of approximately 0.87 per share, we arrive at a fair value in the range of \$4.75, up from \$4.45 in our latest update.