

## Precious Metal Royalties : follow the yellow brick road

It's difficult to tire of a business model that requires so few staff, zero capex outlays, high operating leverage and 50% net margins. You can buy one, create one, generate one or incubate a whole group of them. Dust off some maps while you identify developers and operators with a talent for production. Then it's just a short hop to the beach without the hassle of all day digging. Royalty etiquette can get quite nuanced – deal making and structuring will require some knowledge of small print and a good grasp of acronyms. It's also a business where the economics that intertwine promoters and performers can be quite finely balanced. Investors should probably separate the precious metals group and everyone else. The second grouping, a diversified set of metals and coal targets, should be viewed as minor royals.

mkt	ticker	issuer	key persons	Oct 7th price	mkt cap \$mm	segment	key points	revenues \$mm	GEs in 2020
NYSE	FNV	<b>Franco-Nevada</b>	Paul Brink	134.91	27,299	precious metals	The Newmont spinout in 2007 : 300 mines 70% gold, debt free. But keep tabs on the 14% energy exposure	850	500,000
NYSE	WPM	<b>Wheaton Precious Metals</b>	Randy Smallwood	47.34	22,548	precious metals	2004 origins as Silver Wheaton. London listing soon, already NYSE/TSX listed. Variable div formula.	980	680,000
NYSE	RGLD	<b>Royal Gold Inc</b>	Bill Heissenbuttel	122.64	8,161	precious metals	187 property interests, 9 years of inc divs. Khoemacau in Botswana and Mount Milligan are key projects	490	310,000
NYSE	OR	<b>Osisko Gold Royalties</b>	Sean Roosen	11.99	2,113	precious metals	Still at NAV, lags behind others: royalties plus an accelerator (incubation) model.	275	65,000
TSX	SSL	<b>Sandstorm Gold</b>	Nolan Watson	11.03	1,675	precious metals	Hod Maden is the key (copper gold) project. Strong balance sheet. Expensive but good quality	68	52,000
TSX	MMX	<b>Maverix Metals Inc</b>	Daniel O'Flaherty	6.62	686	precious metals	2016 start with the Pan American Silver : 11 Royalties acquired from Newmont	40	28,500
TSX	NSR	<b>Nomad Royalty</b>	Vincent Metcalfe	1.42	631	precious metals	Orion Mine Finance assets, 11 assets. Bought Coral Gold in August for \$45.8mm	18	18,000
NYSE	MTA	<b>Metalla Royalty &amp; Strmg</b>	Brett Heath	7.42	313	precious metals	portfolio of 50 royalties and streams, earlier stage, 3 assets production	4	nmf
TSX	RZZ	<b>Abitibi Royalties Inc</b>	Ian Ball	25.64	238	precious metals	IPO 2011, spun out from Golden Valley. \$70mm cash, key 3% nsr on the Malartic mine. 12.5mm shares only	5	nmf
NYSE	EMX	<b>EMX Royalty</b>	David Cole	3.63	233	precious metals	TSX/NYSE : Generative model : constant deal flow; jurisdiction agnostic. Successful strategic asset program.	10	nmf
TSX	ELY	<b>Ely Gold Royalties Inc</b>	Trey Wasser	1.22	127	precious metals	Nevada focus : production royalties only : most deals come from 3rd parties.	4	nmf
TSX	VOX	<b>Vox Royalty</b>	Kyle Floyd	2.98	73	precious metals	Raised c\$14mm in ipo: 41 royalties and streams, 75% Australian assets. 50% precious metals	<1	nmf
TSX	FISH	<b>Salfish Royalty</b>	Akiba Leisman	1.35	66	precious metals	7 asset portfolio - Wexford Trading controlled; gold and silver only. 10 shareholders have 70%	<1	nmf
TSX	ELE	<b>Elemental Royalties</b>	Frederick Bell	1.53	52	precious metals	26% owned by mgmt: Raised c\$24mm, oversubscribed ipo. 6 royalties, 4 in production.	<1	nmf

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TSX	LIF	<b>Labrador Iron Ore Ryty</b>	John Tuer	26.26	1,298.48	diversified materials	LIORC 15% holding in 18,200 hectares of ore producer IOC	180	nmf
TSX	ALS	<b>Altius Minerals</b>	Brian Dalton	10.28	327.10	diversified materials	Shermitt coal and potash royalties in 2014. 15 assets today. Base metals 37%. \$100mm into renewables.	55	nmf
ISE	APF	<b>Anglo Pacific</b>	Julian Treger	123.00	291.20	diversified materials	Less than 10% in precious metals : 15 assets, 5 continents	40	nmf
ISE	ALS	<b>Altus Strategies</b>	Stephen Poulton	60.50	55.13	diversified materials	17 projects in six African countries - project and Royalty generator model £12.3mm in shareholders' equity	<1	nmf
ISE	TRR	<b>Trident Royalties</b>	Adam Davidson	30.00	40.37	diversified materials	PE equity board culture; raised £16mm in ipo; Backers inc Tamesis, Azore, Ashanti. Lake Rebecca deal.	<1	nmf
TSX	GMX	<b>Globex Mining Inc</b>	Jack Stoch	0.76	30.82	diversified materials	189 properties, mainly early stage, 95 precious metals, 34 targets are less common minerals. 68 royalties.	<1	nmf
TSX	ELEC	<b>Electric Royalties</b>	Brendan Yurik	0.20	7.28	diversified materials	The drive to electrification and storage : 11 cobalt/graphite/lithium etc battery metals portfolio underway.	<1	nmf
TSX	MOX	<b>Morien Resources</b>	Dawson Brisco	0.15	5.33	diversified materials	royalty interest in the Donkin coalmine, Cape Breton. Black Point aggregates quarry in Nova Scotia. Cut its div	<1	nmf

Once you have a grasp of the NSR, the ORR, the GR and the FH, it should be plain sailing. You may want to understand what's different about streams and streaming. You might have become an expert already through streaming on Spotify. The £9.99 a month however does not entitle you to demand delivery of the real thing behind the agreement. Beyoncé and Kylie will not themselves show up, no matter how carefully you negotiated your subscription. In royalty metals world however, there can be a long term purchase agreement negotiated after an initial sign up. For a bite sized summary to demystify some of the jargon, take a look at Elemental's guide.

<https://www.elementalroyalties.com/investors/understanding-royalties/>

\*'GEO's' - gold equivalent ounces about 1.7mm ounces for those top seven royalty names.

## Other sectors ?

No need to dwell on these but, just for a bit of context, here's a small cross section of what's out there.

The royalty patch for upstream US energy names was once a much more prosperous corner. Many of them have had to cut dividends and now languish in the 90% club. BP Prudhoe Bay sums up the risk/reward history of a once mighty cash machine, now felled having depleted its only asset. The last five year slowdown in North American upstream is a reminder of how the 'capex light' model can suffer badly when demand, investment and pricing fall.

mkt	ticker	issuer	key persons	last local quote	mkt cap \$mm	segment	key points	revenues \$mm
usa	RPRX	Royalty Pharma	Pablo Legorreta	44.20	25,000.13	bio-pharma	NYSE IPO raised \$1.68bn at \$28 in June 2020 : 45 therapies, only 3 early stage products. But .... \$4.4bn debt.	1900
usa	LGND	Ligand Pharma	John Higgins	103.57	1,540.00	bio-pharma	\$800mm in cash following a major sale to Royalty Pharma. Captisol is the winner.	160
usa	XOMA	Xoma Corp	James Neal	20.20	195.00	bio-pharma	90% down over a decade having torched \$1.2bn of capital - enjoy the new royalty aggregation strategy .....	3
tsx	PSK	Prairiesky Royalty	Andrew Phillips	8.43	1,520.78	energy	May 2014 ipo : No long term debt, 7.8mm acres of fee lands. Production 22,000 boe per day, Overall 77% liquids.	150
usa	KRP	Kimbell Rylty Pnrs LLP	Robert Ravnas	6.01	364.00	energy	interest in 94,000 wells, 144,000 royalty acres. 12,000 boe/d. Cut dividend - debt levels need watching	100
tsx	FRU	Freehold Royalties	Tom Mullane	3.48	348.45	energy	Canada focus, 44,000 wells and 9884 royalty barrels boe/d : cut its dividend, \$96mm in net debt	70
usa	SBR	Sabine Royalty Trust	Clarke Futch	29.79	434.20	energy	50% assets in Texas : NPV based on existing reserves is below \$300mm	52
usa	NRT	North European Oil Trust	John van Kirk	3.07	27.41	energy	Gas in Oldenberg, Shell and Exxon as operators. NYSE Listed for 45 years. No debt. Very cheap but no growth	4.4
aus	FZR	Fitzroy River	Malcolm McComas	0.14	7.61	energy	Canning Basin and Lennard Shelf oil royalties in far north Western Australia	<1
tsx	URC	Uranium Royalty Corp	Scott Melbye	1.16	64.63	uranium	Backed and supported by Uranium Energy Corp which owns 20%. URC Owns 9% of Yellow Cake.	<1
lse	YCA	Yellow Cake	Andre Liebenberg	196.20	218.40	uranium	Owens 9.6mm lbs of u308 and has a purchase agreement with Kazatomprom. Streaming / royalties deals likely.	<1
tsx	AD.UN	Alaris Equity Partners	Steve King	11.38	317.43	diversified commercial	8 ipo at \$12.00 : 81% of loan book in US based SME's. Now an income trust. Dividend cut in 2020. Undercapitalis	102
lse	DUKE	Duke Royalty	Neil Johnson	23.15	74.54	diversified commercial	SME focus with 11 royalty partners and £80mm equity raised to date : royalty loan advances of £20mm in 2019	7

There is little to cheer onlookers in this subsection but PrairieSky could soon be attracting believers in Canada's onshore recovery prospects. Royalty Pharma is beyond our remit but its IPO got our attention. The uranium price revival and SMR (small modular reactors) development is a legitimate discussion though liquidity constraints limit the choices. Lastly, diversified commercial 'revenue loans', a variation of trade finance and factoring, never really seems to have worked out.

## Analysis and selection

S&P Global data is showing gold production at 107mm ounces in 2018 and slightly more in 2019. With an unknown degree of disruption this year, 2020 production will likely be nearer the 105mm ounce mark. That's around 3375 tonnes if we've clipped off the data correctly from the Gold Council. Silver production will be nearer 820mm ounces (~25,500 tonnes) this year.

Recycling rates from both the jewelry industry (accounting for 50% of the 200,000 tonnes of all gold held above ground) and individuals feeling the pinch are unlikely to induce the annual 1100 tonnes thought needed to balance the market deficit by 2025. Rising debt levels might push total *secondary supply* up to 1200 tonnes this year but the main levers of supply and demand would seem to limit any sustained fall in gold prices. Central Banks and western retail investors remain better buyers than sellers and thematically, we can point to gold miners struggling to replace reserves. The m&a train wreck that followed the 2011 peak imposed much needed capital discipline and only more recently has the decade's funding drought begun to ease. In a world used to instant results, the lifecycle of a mine, key to reserve replacement stats, remains between 10 and 20 years.

One key decision for investors is to decide how far these royalty precious metals names can scale-up their portfolios. In spite of that very rich multiple to 'sales', there's a good case for this cumulative valuation to rise a long way in the next five years. Capital gains on partner companies' shares interest are a less visible but significant element to future values. This is not to pretend that a dizzy growth story multiple is now appropriate across the group, simply that a sufficient number of conditions are lining up to allow an already pricey group to inflate exponentially as gold interest improves. Gold price gains do not have to mirror crypto-hype for a bubble to take hold here. Mainstream asset allocation supremos will find it easier to reset a normalized gold weighting – client confidence in the custodial arrangements for crypto currencies and blockchain remain in their infancy.

It's a challenge that the three largest gold royalty plays are 85% of the sub group's entire valuation. But their large target market should diminish the perception of crowded trades and concentration risk. The top ten mines produced 425 tonnes in 2018 (13.6mm ounces). That's only 15% of annual demand – there are umpteen emerging operators jostling to develop a similar type of giant. It would be fairer to show the dominance of the 10 ten operators – see below right - they produced 28.74 mm ounces in 2018, still only a modest percentage of the whole. And now we have a new top 10 player being formed with the proposed friendly merger of Northern Star and Saracen. M&A activity has been busy at the junior and mid-tier levels already but now we have a new tier one deal with 1.5mm ounces of production, a combined \$11.5bn market cap.

	mine	location	operator	ounces 2018
1	Grasberg	Papua, New Guinea	Freeport	2,700,000
2	Muruntau	Uzbekistan	Navoi	2,400,000
3	Goldstrike	Nevada, US	Barrick	2,100,000
4	Olimpiada	Russia	Polyus	1,300,000
5	Lihir	Aniolam, Papua New Guinea	Newcrest	976,000
6	Pueblo Viejo	Dominican Republic	Barrick/Newmont jv	969,000
7	Carlin	Nevada, US	Newmont Goldcorp	927,000
8	Kibali	Doko, DRC	AngloGold Ashanti/Barrick	807,000
9	Cadia East	NSW Australia	Newcrest	752,000
10	Boddington	Western Australia	Newmont Goldcorp	709,000

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COMPANY	COUNTRY	PRODUCTION (Moz) 2018	CHANGE Y/Y (%)	AISC (\$/OZ) 2018	CHANGE Y/Y (%)
1 Newmont Goldcorp	USA	5.10	-3	\$909	2
2 Barrick Gold	Canada	4.53	-15	\$806	7
3 AngloGold Ashanti	South Africa	3.40	-9	\$976	-7
4 Kinross Gold	Canada	2.45	-8	\$965	1
5 Freeport McMoran	USA	2.44	55	n/a	n/a
6 Polyus	Russia	2.44	13	\$607	-1
7 Newcrest Mining	Australia	2.41	6	\$779	-7
8 Goldcorp	Canada	2.30	-12	\$851	3
9 Gold Fields	South Africa	2.04	-6	\$981	3
10 Agnico Eagle	Canada	1.63	-5	\$877	9

Production = Attributable ounces based on % ownership for 2018 calendar year. All-in sustaining cost per ounce (AISC) excludes byproduct credits. Graph: MINING.COM Data: Mining Intelligence

mining.com

## CONCLUSION

Model portfolio performance which works so brilliantly in the lab is quickly diluted in the real world. Much of this is driven by the fallacy of diversification, usually a jumbled collection of misleading pie charts showing niche product ideas with built-in underperformance. Portfolios of more than 20 individual names should be strongly discouraged and offenders banished to work on index trackers. The 21<sup>st</sup> stock choice and its co-successors offer all the disadvantages of portfolio dilution and no marginal diversification benefit.

Conviction ideas include observing a creative energy which can supersede the influence of many corporate kpi's. The performance needs to be fed by showmanship, substance, and the consistency of narrative. It may also be about believing in the superior mindset and culture of some organizations. The common thread may be that some leaders are just a bit more confident, just a bit more committed, and are proportionately connected as shareholders themselves.

We have modeled most of the royalty group portfolios in more detail and, in spite of our short term timing reservations, have reached a view on three names, none of which we own as of now. So we are looking for some sort of pre-Christmas rout to let us get involved on better absolute terms. Whether or not we get that chance, we are minded to focus on three names : Wheaton Precious, EMX Royalty and Osisko Royalties. We are led by a judgment on management style as much as by any great NPV guesswork but as always, we confess to knowing nothing and trigger happy readers should accept the risk of all three of them halving in value during a proper rout. There is plenty to review amongst several other capably managed names shown here. We'll review the group's progress again in Q1.

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