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For monetary disorder

"The whole point of gold is insurance," a well-informed Canadian observer reminds colleague James Robertson, Jr. "It's peace of mind. The irony is a gold mine is one of the riskiest things on the planet."

The yawning gulf between the bullion price and the XAU, or the Philadelphia Gold and Silver Index of 30 mining-company stocks, is the business at hand. Constant readers will not be surprised to learn that *Grant's* is bullish on the metal and stocks alike.

We favor gold as the incorruptible legacy monetary asset and mining shares as a low-cost monetary derivative. Make no mistake: This is a play on—an investment in—monetary disorder. Wesdome Gold Mines Ltd. (WDO on the Toronto Stock Exchange), Triple Flag Precious Metals Corp. (TFPM on the New York Stock Exchange) and Sprott Gold Equity Fund (SGDLX on NYSE Arca) are the particular equities under the *Grant's* lens.

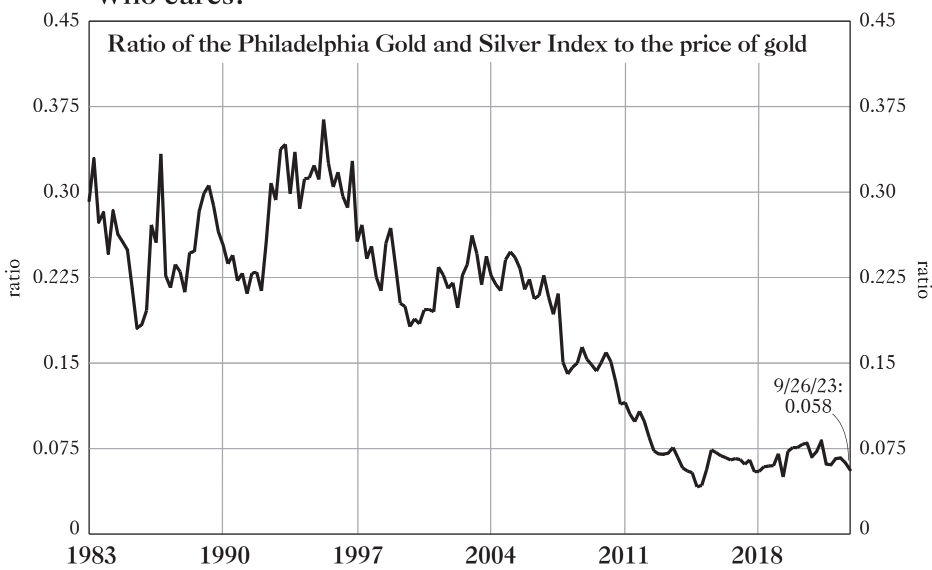
Imagine the moated, predictable, high-margin business that finds its place in the Berkshire Hathaway portfolio. Gold mining is not that business. It is capital-intensive, complex, dangerous, precarious, volatile. There are permitting risks, capex-blowout risks, technical risks, environmental risks, reserve replacement risks and, of course, the overarching risk of the gold price itself. There are idiosyncratic Canadian risks, too, including caribou migrations, forest fires and wolverine infestations, though Canada is esteemed one of the world's safest mining jurisdictions. Elsewhere, with the exceptions of Australia and the United States ex-California, there is the ever-present risk of confiscation and nationalization.

On the bright side, you wouldn't call the gold miners a crowded trade. Since 1983, the ratio of the XAU to the price of gold has averaged 0.19, but today it slumps at 0.06. And while the price of gold has risen by 5% this year—despite rising real yields and the firmer dollar exchange rate—the XAU has fallen by 6.5%. No surprise, then, that analyst coverage of the miners is scant and investor interest in those names is scanter. Our friend Bill Fleckenstein, money manager, commentator and former lead director of Pan American Silver, ruefully wonders if Mr. Market has got it into his head that gold mines actually mine bonds.

Many wish that they mined lithium, uranium or copper—really, anything except the yellow metal, which is neither a hot cryptocurrency nor a buzzy play on the Western world's forced march to net zero. "We've seen multiple erosion in the gold industry specifically because we don't invest in exploration," Mark Bristow, CEO of Barrick Gold Corp., complained to the Gold Forum Americas conference two Tuesdays ago, "so we don't have optionality. The copper industry has a multiple in it."

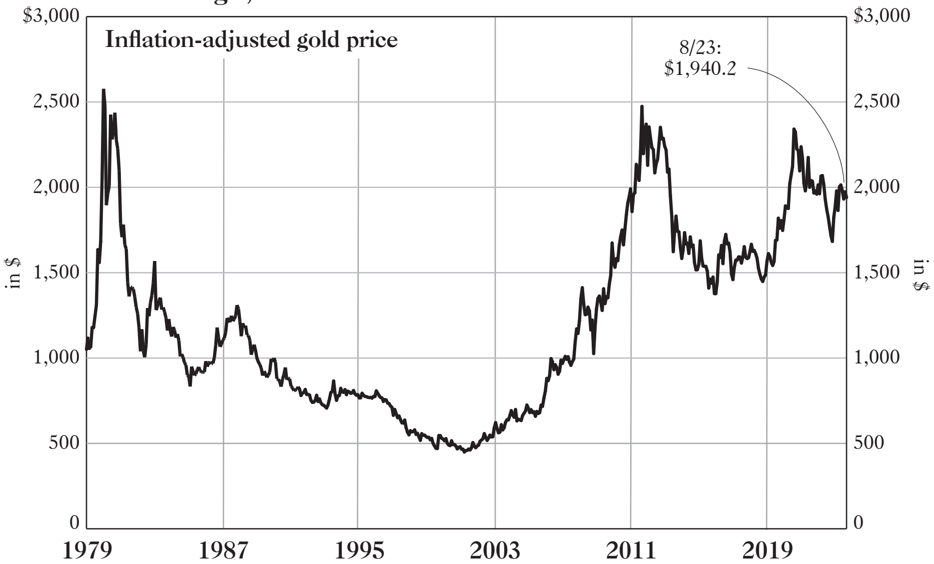
Newmont Corp., the world's biggest gold miner, boasts that, following its takeover of Newcrest Mining Ltd., copper will constitute 30% of its reserves. Harmony Gold Mining Ltd., South Africa's top gold miner, announced in December the beginning of a strategic shift into "a future-facing metal."

Who cares?



source: The Bloomberg

Not so high, after all



sources: Federal Reserve Bank of St. Louis; the Bloomberg

Robertson speaks for the management of this publication when he says that 2,500 years of faithful monetary service creates a positive presumption about the next 2,500 years. And with due respect to Barrick, the vagaries of the Ph.D. standard of monetary management are creating more optionality for the gold-mining industry than Mark Bristow could shake a stick at.

In fairness to the nonbelievers, it isn't just a paucity of exploration activity that's punished the XAU. Gold-mine managements have worn out their shareholders with dilutive equity issuance. They themselves have been victimized by rising costs, predatory governments and the ever-lengthening interval between the identification of a new mining project and the production therein of ounce No. 1.

However, if we know our behavioral economics, a new updraft in the gold price would draw the veil of forgetfulness over the disappointments of the past. The great question is when and, indeed, whether such a new thrust will occur. The CPI-deflated gold price was much higher in 1980 (at $2,577 an ounce) and 2011 ($2,472) than today's nominal price of $1,900. Interestingly enough, in the March–June quarter, gold holdings of central banks and other official institutions climbed to 38,764 metric tons, breaking the 1965 record, according to data from the International Monetary Fund and estimates by Jan Nieuwenhuijs, analyst at Gainesville Coins. At the margin, therefore, the central bankers are choosing to pass up interest-bearing Treasurys for non-yielding, credit-risk-free gold ingots.

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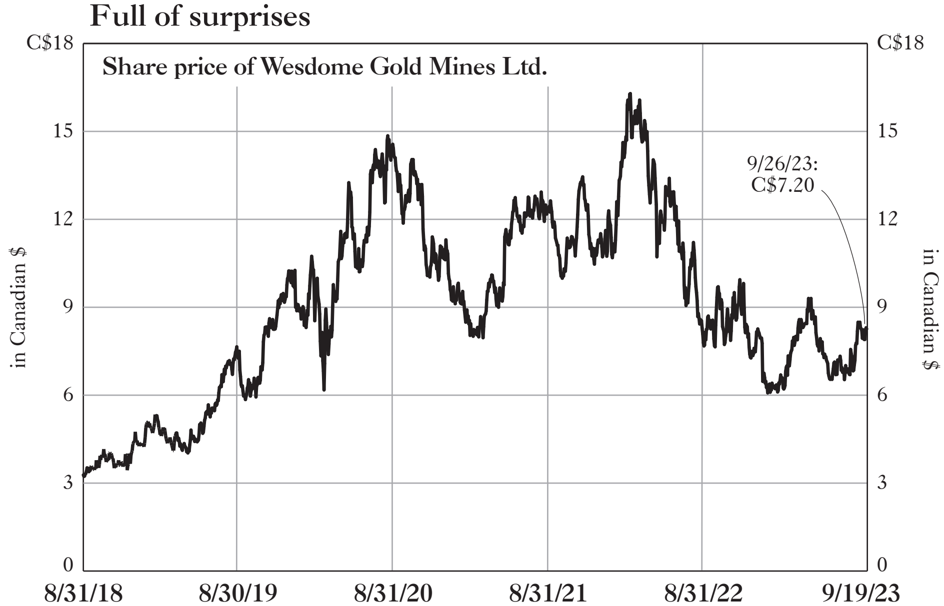
Wesdome Gold Mines is an asset-rich, midsize, two-mine company in Canada. Mining mishaps will happen, and concentrated assets present the risk of an operational problem that is capable of scuttling the share price, if not the company behind the share price. Mitigating that risk, in Wesdome's case, is the happy overlay of high-grade deposits, relatively low costs, lots of exploration potential and the rule of law that runs in Ontario and Quebec, where Wesdome does its underground business. Eagle River, in Ontario, is the mine whose ample cash flow financed most of the development of Kiena; situated in Quebec, 471 miles to the west, Kiena resumed commercial production last December after nine years in the mothballs that miners call "care and maintenance."

Last year was one to forget for Wesdome, with leaching tank failures and late equipment deliveries contributing to a company-wide 31% production shortfall. Worse, management instituted an at-the-money equity-issuance program, which, while it did raise a little money, knocked $200 million off the Wesdome market cap. Anthea Bath, appointed CEO in June (she was formerly chief operating officer of Eros Copper Corp.), immediately stopped that "ATM," to the cheers of the shareholders and the benefit of the share price. Meanwhile, development of the Kiena project proceeds apace.

"Lightning can strike twice in the gold industry, especially in the prolific Abitibi region of Quebec," Robertson observes. "The Kiena mine had been in production, off and on, since the late 1930s. Wesdome acquired ownership in 2003, but—facing decreasing recovery grades, persistent industry

Full of surprises



source: The Bloomberg

cost pressures and uncertainty in the Canadian dollar gold price—suspended production in 2013. Lightning, in this case, took the form of a 2016 discovery of the Kiena Deep A Zone, a big new area of high-grade deposits."

Doug Pollitt, analyst at the family firm of Pollitt & Co., an investment-banking business in Ontario, is the son of the late Murray Pollitt, the "visionary," as the *Canadian Mining Journal* described him, who assembled the Kiena land package. It took him 30 years. The son came to the phone the other day to brief Robertson.

What's captured the market's attention, says Pollitt, is the combination of "grade and thickness." Those attributes were present in 2016 drilling results and continue to impress with new exploration. "You've got these four-to-six-meter-wide zones, and they run 12, 14, 16 grams," i.e., grams of gold per ton of rock, an unusually rich grade, even for the Abitibi region. "People love the grade.... Grade is margins. As an old geo on the project would say, you go underground at Kiena, and you see the honey dripping from the walls."

"The philosophy of this company from way back," Pollitt goes on, "has been, Get good land. Don't die in the heat bath of [equity] issuance. The results will come. The gold price will come. But be there, have the assets and be in a position to capitalize on it when these things do come." Pollitt holds a position in Wesdome.

At last report, proven and probable reserves of Eagle River summed to 400,000 ounces at a grade of 16.3 gold ounces per metric ton of rock. Kiena showed proven and probable reserves of 606,000 ounces at a grade of 11.4 g/t. Rather more conventional are the metrics of such open-pit mines as Agnico Eagle's Detour Lake property, which boasts reserves of 20.7 million ounces at a grade of 0.76 g/t. "You mine rock, not grade," as Pollitt observes. "You don't mine gold, you mine the rock that contains the gold."

"High-grade mines cover up a multitude of potential sins," Fleckenstein tells Robertson, "like when your costs went up more than you expected. I want high-grade gold mines." Fleckenstein is also long the stock.

Wesdome is full of surprises, so a definitive judgment on mine life and terminal value is little more than a guessing game. What can be said is that the drilling results in and around Kiena are enticingly bullish. Notable is the Presqu'île zone, which conveniently connects to existing mining infrastructure. As it is, the Kiena mill is operating at around 559 metric tons a day. Management and the stockholders will raise a cheer if and when the mill reaches its capacity of 2,000 metric tons a day.

It speaks to the serendipity of the mining business that Kiena continues to serve up surprises more than a century after its gold-bearing possibilities first came to light. Kiena sits between two of Agnico Eagle's mines, including one of Canada's largest, Malartic. In fact, Agnico Eagle, after its acquisition of Kirkland Lake Gold, Inc., has five operating mines in the Abitibi region. "Whether or not another acquisition is in the cards," as Robertson observes, "Wesdome is in good company and in the right neighborhood."

Wesdome trades at an enterprise value of 14 times trailing 12-month Ebitda. Assets, in the sum of C$601 million, include C$22 million of cash against which is set C$44.9 million of debt. Net debt stands at 0.31 times trailing Ebitda. Out of 10 analysts on the case, five say buy and five say hold. In the past year, insiders, who collectively hold 486,750 shares, were net sellers of 43,429 shares.

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The Sprott Gold Equity Fund, born the Tocqueville Gold Fund in June 1998, is the fifth-largest mutual fund of the precious-metals type. In the toppy gold year of 2011, the fund managed $3 billion but today looks after only $825 million. It holds 63.4% of those assets in gold producers and 5.9% in silver producers. Of its 53 equity positions, 68.4% are mid-tier and smaller gold enterprises, which happen to be Mr. Market's least favorites within an industry group that he broadly scorns.

The Sprott fund, under the leadership of John Hathaway and Douglas Groh, makes a specialty of treading where others wouldn't be caught dead. Take the launch date, June 1998. The gold price was slipping below $300 an ounce, the dot-com bubble was still inflating and the Bank of England was preparing to sell off half of its gold reserves. On the authority of the Dec. 13, 1997 edition of the *Financial Times*, gold was "dead."

Fast-forwarding to today, BMO Capital Markets observes that the junior segment changed hands at a 72.4% discount to its estimated net asset value, whereas the favored seniors traded at a discount of a mere 47.1% to their estimated NAV. A reversion to the inflation-adjusted gold price of 2011, the Sprott managers estimated, would lift the GDX miners index by more than 110% but would instigate a rally of 300% in the GDXJ (the "J" signifying "junior"). Well, we'll see.

The fund's largest portfolio weightings include Agnico Eagle Mines Ltd. (AEM: NYSE), Alamos Gold, Inc. (AGI: NYSE) and Osisko Mining, Inc. (OSK: Toronto), each at about 4½% of assets. Wesdome weighs in at 1.9%, and Triple Flag at 3%.

Management fees and expenses for the gold fund run to 1.45% for the "investor" class and 1.16% for institutional clientele. Minimum investment is $1,000 and $1 million, respectively.

In the year through August, investor-class shares earned a negative 2% total return net of fees while the institutional class bore a minus 1.8% total return, also net of fees. This compared with a loss of 1.26% for the Philadelphia Gold and Silver total return index. Since inception in 1998, Sprott and its predecessor have returned 8% annually versus 3% for the index.

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An alternative approach to gold investing is to skip the bottom line and buy into the top line instead. Employing this approach, royalty and streaming companies buy entitlements to appreciating metals prices and to successful exploration and expansion efforts but without the operational risks of pushing around large rocks. Since we first had our say on Triple Flag, an exemplar of the type, the company's shares have returned 30% in U.S. dollar terms even as the XAU has tumbled by 8% (*Grant's*, Dec. 10, 2021).

On January 19, Triple Flag bought Maverix Metals, Inc., another royalty and streaming outfit, in a cash-and-stock deal valued at $606 million. The transaction, 18 months in the making, boosted the Triple Flag portfolio to 231 royalty and streaming investments, up from 80 before the acquisition; the tally includes 31 assets currently in production.

Post-acquisition, 78% of the Triple Flag portfolio is harbored in the Americas and Australia, though the Maverix portfolio did add exposure to politically exotic jurisdictions, including Burkina Faso and Russia. By no means were all toxic, but the Russian asset is carried at zero.

The Maverix purchase likewise improved the liquidity of the Triple Flag shares, which had previously traded as if every day of the week were Saturday. Average daily shares traded across the American and Canadian exchanges rose to 559,000 this year from 50,218 shares in 2022. In January, TFPM entered the GDXJ index.

Post-closing, net debt to Ebitda rose to 0.29 from -0.69 at year-end 2022, though management says it expects the company to be debt-free by year end, such is the strength of its cash flows. In the second quarter, Triple Flag paid off $15 million of borrowings.

A window into the operational leverage of a well-managed streaming and royalty company is the post-closing employment situation. Although the bigger and better Triple Flag more than doubled its streaming and royalty agreements, the headcount grew only to 17 from 13 in 2022. (Only one Maverix employee made the transition.) CEO Shaun Usmar says that the acquisition has delivered $7 million in annual synergies in the context of $60.8 million in trailing profits.

Triple Flag trades at an enterprise value of 21.6 times trailing Ebitda, which compares to multiples of 14.8 and 18.4 for Sandstorm Gold Ltd. and Osisko Gold Royalties Ltd. The streaming and royalty eminences Franco-Nevada and Wheaton trade at 24 and 28, respectively.

Another post-merger highlight is the Triple Flag dividend, which was boosted by 5%, to $0.21, delivering a 1.6% dividend yield; it was the second raise since the 2021 listing. "And you know," as Usmar does not fail to remind Robertson, "we pay the highest dividend yield in the space." Second-quarter production amounted to 26,616 gold-equivalent ounces, with the company guiding for 110,000–115,000 gold-equivalent ounces for the year versus 84,571 ounces in 2022.

Elliott Management L.P., the original financier, owns 66% of Triple Flag, down from 83% last year as a result of the Maverix purchase. Insiders hold 3.57% of the company. Over the past 12 months, Elliott purchased 4.68 million shares at a cost of $77 million while other insiders net sold just 610,513 shares for proceeds of $8.6 million. Of the 10 analysts who rate the stock, each and every one says buy.

"Most management teams have little to no equity," Usmar says of the royalty and streaming industry. "We are substantial equity owners in our own right, both on the board as well as the management team. So we don't have to think to act like owners. We are meaningful owners. I'm a top-10 shareholder in this company, as are a lot of my teammates."

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