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Long Shots, Inc.

Last week, President Trump told *The Wall Street Journal* that the dollar "is getting too strong." As for monetary policy, said the former New York leveraged real estate speculator, "I do like a low interest rate policy, I must be honest with you." And he said (we paraphrase) that Janet Yellen is a good egg.

We now incorporate by reference 34 years of *Grant's* monetary analysis (and comment and lamentation), reiterating only that gold is a kind of derivative. It derives its value from public policy more than from its own physical properties. It will appreciate, from here, against government money—or it won't. If it does appreciate—all the way, say, to $1,800 or $2,000 an ounce at some date not given to your editor—the share prices of certain currently loss-making mining businesses stand to excel. The miners would excel all the more if they managed to remain solvent until the future day of monetary truth.

Following is a survey of a handful of these geological long shots. They include: Novagold Resources, Inc. (NG on the NYSE MKT and Toronto Stock Exchange), Midas Gold Corp. (MAX on the TSX) and International Tower Hill Mines Ltd. (THM on the NYSE MKT; ITH in Toronto).

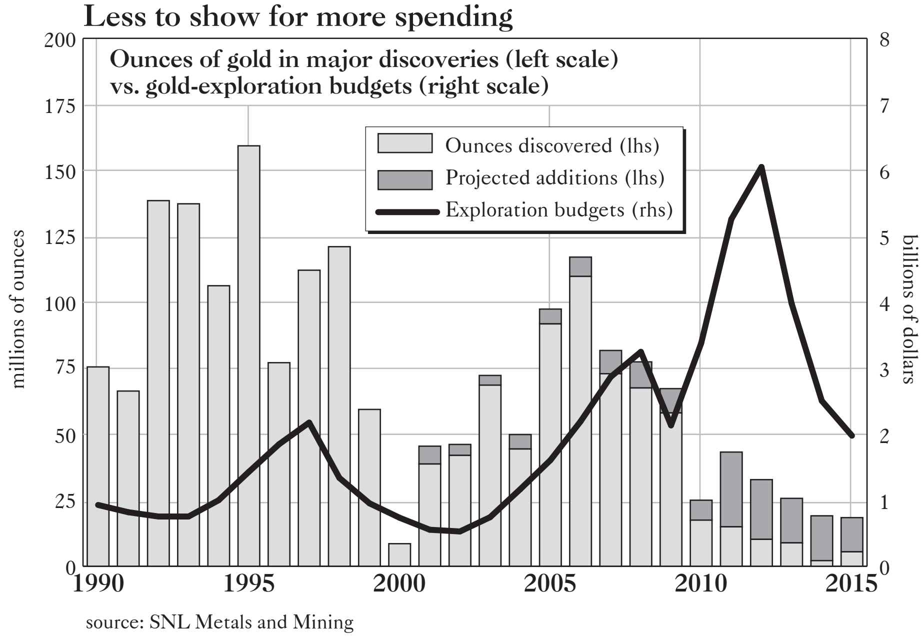
Gold is hard to find and hard to mine, but those facts hardly affect its price. So small is a given year's production in relation to above-ground hoards that, for gold, unlike the average non-monetary commodity, the supply-demand situation is almost extraneous. What is entirely relevant is the need of the gold-mining majors to replenish depleted reserves.

At year-end, the sum total of AngloGold Ashanti Ltd., Barrick Gold Corp., Goldcorp, Inc., Gold Fields Ltd. and Newmont Mining Corp. showed 298 million ounces in reserves, down 32% from 440 million in 2012. They've spent less looking for it. According to figures from SNL Metals & Mining, exploration outlays totaled $1.98 billion in 2015, the latest year available, down from a 2012 high of $6.05 billion. Not that the treasure is getting any easier to find. In the 1990s, prospectors turned up an average of 105 million ounces per year; they discovered an average of 60 million ounces a year in the aughts and have found fewer than an average of 10 million ounces a year since 2010. Even accounting for possible future gold finds at the more recent major discoveries, the return-on-exploration effort is falling.

"Companies are taking whatever cash flow they can generate and getting their debt levels down. They're getting their balance sheets [in order]," says Joseph Wickwire, portfolio manager for the Fidelity Select Gold Portfolio and Fidelity Global Commodity Stock Fund. "So the fact that exploration spend is still tight is not surprising given the still significant debt levels that you've seen in the industry and the fact that most of these companies still aren't generating significant amounts of profitability that enables them to generate maintenance and growth capex."

All of which frames the bull case for junior gold miners. As one privacy-seeking mining investor tells colleague Alex Hess: "Under circumstances [where] gold prices go up a few hundred bucks, all these other

Less to show for more spending



source: SNL Metals and Mining

companies don't have a pipeline to invest in, and the only [projects] available that they're going to want are the ones that have a lot of ounces defined, but also have economical parameters and ultimately are in places where they can do business."

Gold investment is no closer to the heavenly ideal of Graham and Dodd than tech-stock investing is. There are golden unicorns and golden ETFs, including the Direxion Daily Junior Gold Miners Index Bull 3X Shares (JNUG on the NYSE Arca), which uses futures and total-return swaps to produce a leveraged one-day return three times that of its underlying index. There is "index hugging," too—in the case at hand, the hugging of the MVIS Global Junior Gold Miners Index. From this scrum of speculation somehow emerges a gold price that reflects (so we like to think) the world's shifting, unwarranted faith in the institution of 21st-century central banking. Just where in the scrum the magic happens is sometimes an enigma.

On, then, to Novagold Resources (*Grant's*, May 17, 2013), 50% owner of the Donlin Gold project in Alaska alongside Barrick. To listen to the Novagold chairman, Thomas Kaplan, NG is a grand-slam home run just waiting for its big, fat monetary pitch. Donlin, relates Kaplan, is a 39 million ounce resource with an average grade of 2.24 grams per metric ton ("tonne") versus a global average of 1.12 grams. "[That's] only three kilometers of an eight-kilometer strike line. Our real belief is we're dealing with double that. . . . [T]hose eight kilometers and potential for 80 million ounces are on only 5% of the land package."

There is a problem, as Kaplan acknowledges: "[Barrick's] shareholders are not looking for multi-billion-dollar expenditures"—and neither, by the sound of recent executive utterances, is the Barrick front office. To push development forward, a March 1 Novagold presentation proposes more than $1 billion in cost cuts. "It's very clear that, even if we built it to feasibility study size, the number is going to go down significantly from $6.7 billion," the chairman goes on. "Besides that, we look at this and say 'Can this be done in phases?' The ore body is going to have the longest life of any major gold mine in the world. Why not do a phase-one and fund the rest out of cash flow?"

To be clear, Donlin is viable (assuming that it can be financed) at a much higher gold price. Using $1,200 an ounce, Novagold's 2011 technical report determined that building the mine would require capital of $6.7 billion to generate an internal rate of return of 6% per year for 27 years. At today's market cap, the project boasts an imputed value above $2.9 billion if no value is assigned to Novagold's up-for-sale copper project, Galore Creek. That math works using a 10% discount rate, a $1,550 gold price and a project start date around 2019.

Up next are International Tower Hill and Midas Gold Corp. Neither is big enough to meet the market-cap or liquidity requirements for inclusion in the MVIS index. Each is developing a high-potential, high-risk project. Since each has a higher all-in cost per ounce than Novagold, each represents a more leveraged speculation on large movements in the price of gold than does Kaplan's pride and joy (see table nearby).

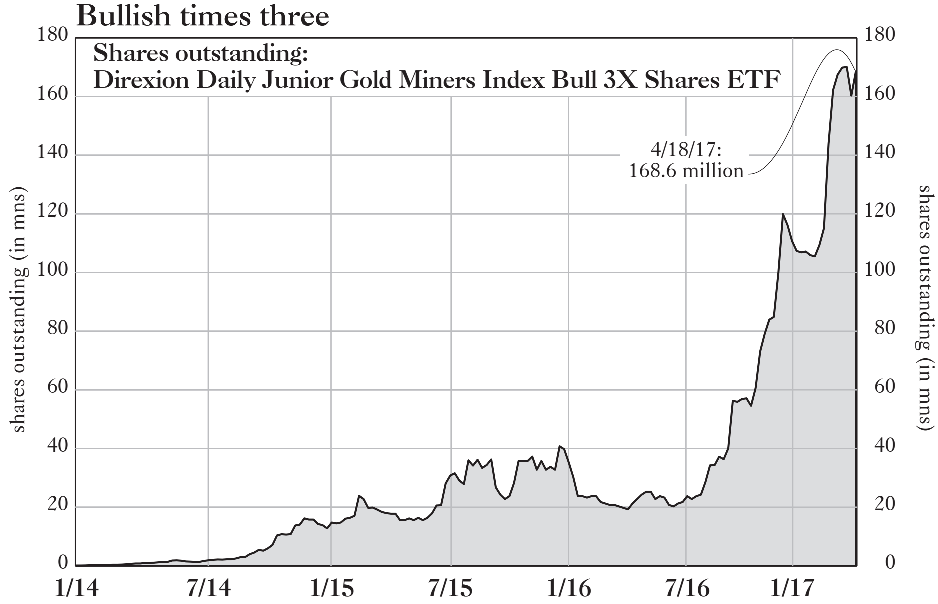
International Tower Hill—with a market cap amounting to just $92 million at a share price of but 57 cents—may look like a unicorn. The board-approved budget for 2017 is $6.3 million. As of January, cash on hand totaled $7.5 million. Supra-unicorn, however, is the ownership of the company. Three shareholders—Paulson & Co., Tocqueville Asset Management LP and AngloGold Ashanti Ltd.—own 58% of the shares.

Livengood, the centerpiece of ITH, resembles a small-scale, lower-grade Donlin: It's an open-pit mine situated in Alaska that is bluntly unworkable at the present gold price. At $1,250 an ounce, the project would generate an internal rate of return of 0.5% on $1.8 billion in initial capital. Doug Groh, co-portfolio manager at the Tocqueville Gold Fund, which is long both Novagold and International Tower Hill, also draws the connection: "[Both] companies probably need a gold price over $1,600 per ounce, at least, to attract capital to build their mines and operate profitably. But the valuation move for those companies as gold prices rise from $1,290 to $1,500 is significant, as their asset values would likely increase in value by 50% to 100% if not much more."

While Barrick and Novagold might be able to start mining within the next few years at a higher gold price, Livengood is nowhere near ready. Nor does it boast high-grade deposits or promise a healthy recovery rate of the gold present in its ore bodies. Metallurgical testing will feature in this year's work agenda, as prescribed by an October preliminary feasibility study.

"ITH shares provide high-leverage exposure to the price of gold," Hess points out. "At the present gold price, you are far out-of-the-money. Using a 5% discount rate, the company's preliminary feasibility study determined the Livengood project is worth negative $552 million, and so would not be built at the present gold price or even a moderately higher one. Yet, at a gold price of $2,000—and using a more realistic 10% discount rate—the project might be worth in excess of $800 million, or more than eight times the value of the company today. With 9 million ounces in reserves, International Tower Hill would move the needle for most of the gold majors."

Bullish times three



source: The Bloomberg

Comparing costs
Plain vanilla over-the-counter call option vs. three junior gold miners

5-year OTC call option	
Option cost/oz	$99
Strike price/oz	1,800
Total cost/oz	$1,899

	International Tower Hill Mines Ltd.	Midas Gold Corp.	Novagold Resources, Inc.
Enterprise value/oz	$11	$44	$98
Initial capex/oz	271	242	220
Sustaining capex/oz	99	32	49
Operating costs/oz	877	597	584
Total cost/oz	$1,258	$915	$951

Note: All project-cost figures are from NI 43-101 technical reports.

sources: The Bloomberg, company reports

Vancouver-based Midas Gold, longshot No. 3, owns the 6.5 million-ounce Stibnite project in Idaho. It's already economically viable. At a gold price of $1,350 per ounce, it would fully repay its capital in 3.4 years, according to a Dec. 2014 prefeasibility study, as well as yield a 19.3% internal rate of return. Top backers include Teck Resources Ltd., Paulson & Co. (through a series of 0.05% senior unsecured convertible notes due 2023) and Franco-Nevada Corp. (through a series of warrants and a 1.7% net smelter return royalty).

Naturally, Midas is risk-fraught—so is every junior miner. Tocqueville's Groh comments: "We are not in Midas and [have] nothing really against them, per se, but the ore chemistry (metallurgy) and location in Idaho (despite [being] a mining state) have caused us to pause, but some day, at higher [gold] prices, it is appealing." Then, too, in the past 12 months insiders have net sold 404,000 shares for C$356,820, including 45,000 shares by CEO Stephen Quin, who elected not to accept any cash bonus payments in any of the past three years and who in 2014 skipped his annual option grant "due to limited capacity for the Company to grant options . . . [and] in order to provide a greater allocation to other employees." Midas did not return an email seeking elucidation.

"Midas makes no bones about the fact it wants to be taken over," Hess observes. "A March investor presentation shows three model takeover transactions, all involving smaller mines: New Gold's acquisition of Rainy River at C$77 (approximately $58) per ounce of reserves in May 2013, OceanaGold's acquisition of Romarco at C$293 per ounce in July 2015 and Goldcorp's acquisition of Kaminak for C$218 per ounce in 2016. One might be conservative and use Rainy River as a model for what a company would pay for a project with several years to production and as-of-yet unrealized flaws (*Grant's*, Feb. 10). And, since this publication has no staff geologist, we simply assume there are flaws. With 4.6 million ounces of gold reserves at C$77 per ounce, the company might be worth C$353 million, or C$1.03 per diluted share, a 24% premium to today's price. Would the company hold out for more? Using a 10% discount rate and based on the prefeasibility study, the Stibnite project has a net present value of $418 million at just above today's gold price. At a higher gold price of $1,650, the project might be worth over $800 million."

Where else might one look for value among smaller gold miners? Hess asked Groh, who replied: "I like Nulegacy Gold Corp. (NUG on the TSX Venture Exchange), which is a pretty small market cap name, which has potential regarding exploration—given their property location in Nevada, while Osisko Mining, Inc. (OSK in Toronto) is making a notable discovery in Canada." Nulegacy has a market cap of C$79 million, and Osisko a market cap of C$957 million.

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