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Apathy in a panic

Running for their money as if for their lives, frightened depositors passed a small cohort of ambling pedestrians. These are the gold bugs, who, alone among the participants in the current monetary footrace, seem not to have broken a sweat.

Indifference to the first derivative of the world's legacy monetary asset either marks a large shift in generational preference or a commanding investment opportunity. While not absolutely ruling out the former possibility, *Grant's* favors the latter. This publication is—or, more accurately, remains—bullish on gold and gold-mining equities, including Agnico Eagle Mines Ltd. and Equinox Gold Corp. (AEM and EQX, respectively; both on the Big Board) and the Sprott Gold Equity Fund and First Eagle Gold Fund.

Gold, say we, is not so much an inflation hedge as an investment in monetary disorder. The rising CPI itself has proven a paradoxically mixed blessing. Yes, inflation is monetary disorder writ large, but it's a type of disorder that was accompanied by a strong dollar-exchange rate, rising interest rates and, for the gold miners, rising production costs. Bank runs, a weakening dollar-exchange rate and tumbling nominal yields go far to explaining the metal's almost (as we type) $2,000-per-ounce price.

As usual, someone does buy the stuff. Gold offtake jumped to 4,741 metric tons (or "tonnes") last year, an 18% increase over 2021, according to the World Gold Council, nearly matching the 2011 record demand. Central bank purchases reached 1,136 tonnes, the highest on record going back to at least 1950. Turkey and the People's Republic of China paced the buying.

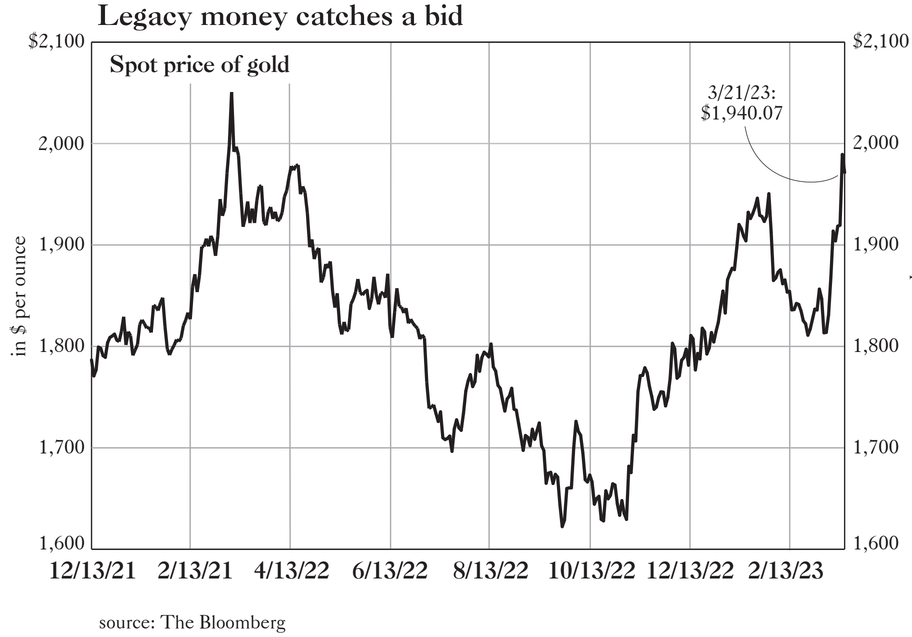
Even so, gold-mine equities have barely responded, as the ratio of the price of gold to the Philadelphia Gold and Silver Index sits at 0.06, one-third the post-1983 average and just 0.02 above the post-2015 record low.

John Hathaway, managing partner at Sprott, Inc., tells colleague James Robertson, Jr. that the industry trades at an enterprise value to forward Ebitda multiple of six to seven times, also near the recent low. At that, says Hathaway, it's a conservative estimate based on stale gold prices. If a sustained period of $2,000 gold is in the cards, "which I don't believe is a crazy thought," he goes on, "there's a huge amount of leverage in just about every name you can think of."

The miners and streamers themselves, at least, are paying attention. Triple Flag Precious Metals Corp., for instance, completed its takeover of Maverix Metals, Inc. in January (*Grant's* Nov. 25, 2022), paying 1.1 times net asset value, while, just last month, B2Gold Corp. agreed to buy Sabina Gold & Silver Corp. at a ratio of price to net asset value of 0.5, and Newmont Corp. has bid $17 billion for its former Australian subsidiary, Newcrest Mining Ltd.

The trouble with inflation is that the miners, too, are susceptible to it. As the costs of energy, chemicals and, most crucially, labor have soared, margins have reciprocally compressed, though

Legacy money catches a bid



source: The Bloomberg

Snapshot of indifference

source: The Bloomberg

relief may be in store. "The interesting thing that happened in the second half of the year going from Q3 to Q4," Greg Smith, CEO of Equinox, told conference-call listeners on Feb. 22, "is we actually did not see much by way of cost increases. In fact, cost stayed overall relatively flat. . . . It looks like costs have peaked sometime in Q3."

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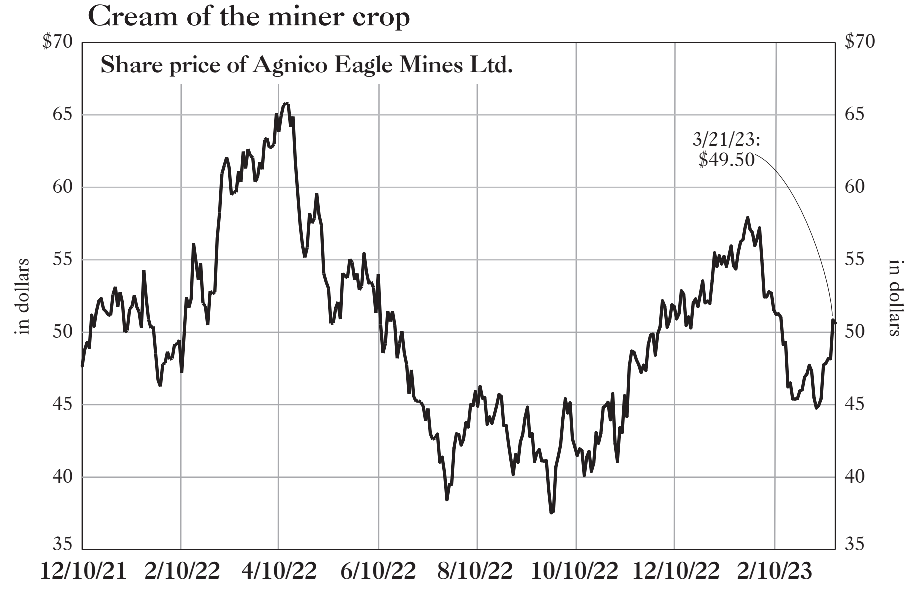
In 1957, Agnico Eagle christened itself Ag-Ni-Co, a mashup of the periodic table's designations for silver, nickel and cobalt, though Au alone would suffice today. AEM stands as both the world's third-largest investor-owned gold producer—many regard it as best-in-class among the majors—and an exemplar of the low estate of mining equities. As to the share price, suffice it to say that, since the January high, the gold price has gone up by 2% and AEM has declined by 12%, the latter being a direct result of a 5.6% rise in the company's all-in-sustaining costs, to $1,090 an ounce, in 2022.

Growth is the Agnico watchword. A player in the M&A wave, the company completed its merger with Kirkland Lake, Inc. last year, adding the largest Canadian gold mine, Detour Lake (*Grant's*, June 29, 2018), and Fosterville, the biggest gold mine in the Australian state of Victoria, to its portfolio in an all-stock deal.

On Nov. 4, 2022, Agnico, in partnership with Pan American Silver Corp., launched a successful bid for Yamana Gold, Inc. at an all-in valuation of $4.8 billion, a 23% premium over the prior day's closing Yamana share price. Agnico will pay $1 billion in cash and $1.5 billion in stock for Yamana's Canadian assets. Pan American will pay $2.3 billion in stock for Yamana's remaining mines, which are situated in Latin America. Agnico is set to receive exploration properties and full ownership of the Malartic mine, in Quebec, which produces 700,000-plus ounces a year and of which Agnico had previously owned half. The transaction is expected to close this month.

Cream of the miner crop



source: The Bloomberg

All but two of Agnico Eagle's mines are grounded in North America, and neither of these exceptions, in Finland and Australia, would seem to present inordinate political risk. However, as Thomas Kertsos, portfolio manager of First Eagle Gold Fund, tells Robertson, that's not to say they're riskless.

In Finland, regulators first approved an expansion permit for the Kittilä mine, then (by Agnico's telling) thought better of it, reducing production to 1.6 million tonnes from an expected 2 million tonnes until a higher Finnish court examines the case later this year. In Australia, regulatory authorities ordered a 25% cut in production in Agnico's Fosterville mine on account of "noisy" ventilation, even though, as Fred Hickey, of *High-Tech Strategist* fame, points out, the fans emit noise at a frequency below the level of human hearing. Perhaps some dingoes filed a complaint.

Despite those political speed bumps, Agnico Eagle "is the one major gold miner that's proven to be a consistent grower (in basically a non-growth group)," Hickey relates by email. "No. 1 Newmont has been stuck for some time around 6 million ounces of gold a year and No. 2 Barrick's 2022 production sunk to a 22-year low (note that I own all three of those stocks)."

With full ownership of the Malartic property, Agnico will have two mines projected to produce more than 700,000 ounces per annum until 2040. Yamana's Canadian assets are within spitting range of the five mines Agnico already operates in Quebec, including Detour Lake.

Agnico's gold production rose to 3.13 million ounces in 2022 from 2.1 million ounces in 2021 with the added production from Yamana's assets yet to come. The company's gold mineral reserves increased 9% to 48.7 million ounces last year and are expected to rise further when the Yamana acquisition closes.

Agnico has cut its debt by more than half, to $649 million from $1.5 billion at the start of 2020, putting its ratio of net debt to Ebitda at 0.29. And unlike Barrick Gold Corp. or Newmont, Agnico did not reduce its dividend last quarter, delivering a 3.2% yield for its shareholders. The shares trade at 9.5 times trailing 12-month Ebitda and at 1.1 times net asset value.

On Feb. 22, after reporting earnings, Agnico CEO Ammar Al-Joundi bought 8,200 shares at an average price of $62.17. Over the past six months, insiders have been net buyers of 56,267 shares. Analysts on Wall Street and Bay Street are likewise bullish with 15 buy recommendations, one hold and zero sells.

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For investors looking for a bit more leverage on the gold trade, there are mid-cap producers in the bargain bin. Equinox, for instance, operates seven mines in North America and Brazil. The stock has traded down 47% in the last 12 months and sells for 5.5 times trailing Ebitda and 0.68 times NAV.

Equinox is a mid-cap miner with a big backlog of organic expansions that would rank it foremost among intermediate producers if development proceeds as planned—rarely a given in the mining business. The company drew 532,319 ounces of gold from the ground last year at an all-in sustaining cost of $1,622 per ounce. Projected to produce an additional 400,000 ounces a year, the Greenstone mine in Ontario, Canada, is 70% complete and largely on budget, according to management.

Equinox shares Agnico's problems, but in spades. Its costs are higher, its political landscape riskier and its production delays more prevalent. Just last year, nearly every mine met some trouble that reduced output—too much rain, a strike at an explosives supplier, permitting delays, production ramping-up more slowly than expected, leaching issues. Altogether, production missed guidance by 20%.

Will Thomson, managing partner and portfolio manager of Massif Capital, LLC, who owns a position in Equinox, says he doesn't fault management for last year's string of operational mishaps, but rather blames the vicissitudes of the mining industry.

"You've got a fantastic management team," Thomson sums up the case for Equinox, "and great ownership with plenty of experience and background in building mines. And over the next couple of years as they turn on Greenstone and they finish up some additional brownfield expansion at some of their existing assets, they will move from 600,000 ounces a year to a million, maybe a million plus with declining all-in sustaining costs. They will be as they have been for the last couple of years, basically the fastest-growing gold miner in the world in terms of production. . . . We view it as a $12 stock [compared with $4.35 on Tuesday]."

Equinox, another position in the Sprott Gold Equity Fund, is, according to Hathaway, an "ultra-cheap mid-cap that is highly leveraged to a better gold price and price environment."

Insiders, too, are bullish, having bought a net 386,381 shares over the past six months, though the Street is of many minds, with three buys, four holds and two sells. Ross Beaty, founder and chairman of Pan American Silver and chairman of Equinox, bought 262,500 shares on Nov. 4, 2022 at an average price of $4.06.

Expanding its Castle Mountain mine in California, Equinox expects to add 218,000 ounces a year to a complex that pulled only 23,227 ounces out of the ground in 2022. After completion of the project, management expects company-wide AISC costs to drop to less than $950 per ounce from $1,699. The difference between expectations and results may explain why the stock trades at a 32% discount to net asset value.

"The royalty and streaming segment of the gold industry offers a safer haven for those who think costs will only continue to rise," Robertson points out. "With shoestring operating budgets and low headcounts, the coupon-clippers of the gold market provide some insulation against production delays and rising operational costs. The market leader, Franco-Nevada Corp., operates without an ounce of debt on its balance sheet. While royalty and streamers offer a margin of safety, it's the miners themselves that boast operating leverage to the gold price.

"Investors who wish to take a portfolio approach have a few options," Robertson continues. "They may consider the Sprott Gold Equity Fund, which invests 65% of its $838 million assets under management in gold stocks. Top positions include i-80 Gold Corp. (5.35%), Osisko Mining, Inc. (4.79%) and Agnico Eagle (4.72%). Other than a 14% position in gold bullion itself, the fund holds smaller miners of other species, including a 6% stake in MAG Silver Corp. Retail investors pay 1.41% in management fees while institutional investors pay 1.12%; there are no sales charges. Since inception in June 1998, the investor class has returned 8% annualized net of expenses, including reinvested dividends.

"Another option is the $2.1 billion First Eagle Gold Fund, which allocates 80% of its AUM in gold equities. Major positions include the streamer Wheaton Precious Metals Corp. (12.73%), Newmont (9.88%) and Barrick (7.06%). The First Eagle fund charges a 1.2% management fee and a sales load for investments under $1 million of between 5% (less than $25,000) and 1.5% ($500,000 to $1 million). The fund delivered a 5.2% annualized total return net of expenses and sales load since its inception in 1993."

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