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Central-bank vaccine

While the world awaits a cure for the new coronavirus, you can self-inoculate against the plague of novel monetary policy whenever the market's open. International Tower Hill Mines, Ltd. (ITH on the Toronto Stock Exchange and THM on the American wing of the New York Stock Exchange) is one such prophylactic.

ITH is an embryonic gold mine in Alaska. Years away from production, if, indeed, it ever does reach production, it's a geologically highly leveraged option on a much higher gold price. In preview, *Grant's* is bullish on it.

If it turns out that the Fed was the monetary solution all along and not, as you perhaps have read in these pages, the monetary problem, we will have written in vain. More, the three full-time employees of International Tower Hill, along with the lead investor, Paulson & Co., Inc., will have wasted their time and money.

No matter how promising the geological indications of the ITH deposit or how thoughtfully management goes about exploiting it, the "largest independent gold-only resource in North America" won't pay unless the ongoing experiment in quantitative easing, ultra-low interest rates, limitless fiscal stimulus and the rest somehow comes to grief.

International Tower Hill is an intentionally undiversified business. Its one and only product is gold. It controls a single property, the 75-square-mile Livengood gold project, situated 70 miles northwest of Fairbanks, Alaska. At the southwest corner of this sprawling asset lies the Money Knob gold deposit. Money is the right word, assuming success in the long, drawn-out work of study and permitting and construction and operations, and—of course—in the raising up of a gold price high enough to justify those efforts.

For reasons best known to himself, the Almighty buried gold where electricity, roads and the rule of law frequently are not. Happily for ITH, Livengood can count on all three, though that's not to say that successful development is a foregone conclusion even in a world of $2,000-plus gold.

A geologist, friendly to gold in general and speaking in his trade's shorthand, advises a friend about some of the technical risks that the ITH investor currently faces or must encounter:

> The combination of low-grade (0.7 g/t), complex ore body with multiple rock types with variable (kind of crappy) recovery, 2–3 year pre-strip and multi-billion-dollar capex requirement are prohibitive. The 2017 study uses aggressive cost assumptions and still has a base case NPV5 of minus $552 million with a payback period of 22 years at $1,250/oz Au price. Even at today's prices, it's probably still a single-digit IRR (especially allowing for capex creep).

In other words, it's going to take time and money to prepare the ground for mining, to update a now three-year-old pre-feasibility study, to procure federal and state permits, to complete the necessary engineering work and to build what must be built to operate what the consultants project to be a 23-year mine life.

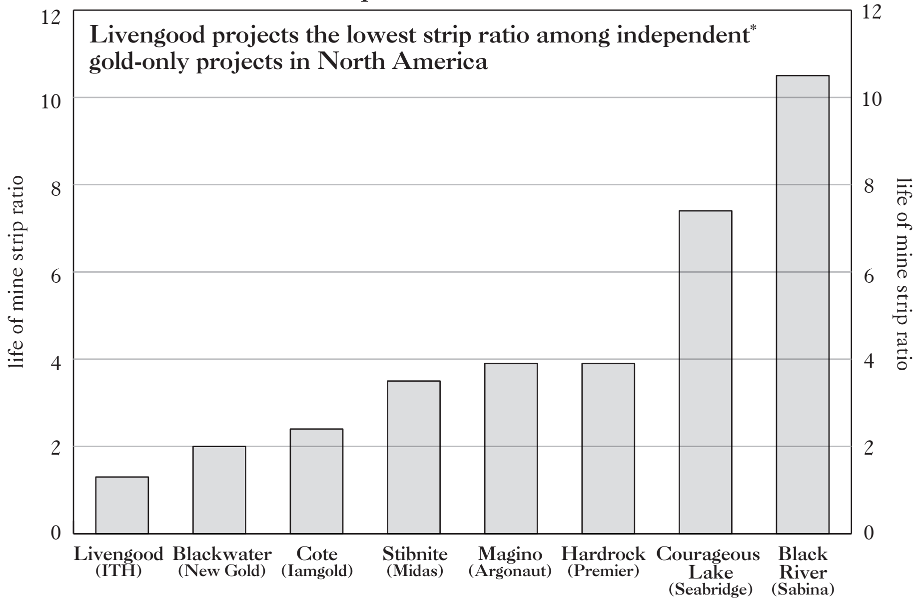
With gold occurring at only 0.7 grams per metric ton of that Alaskan rock and soil, it's no wonder that, in 2017, when the metal was priced at $1,250 an ounce, the net present value of the property, using a 5% discount rate, was negative. Today, with gold at $1,700 an ounce, ITH is a 66-cent stock. It commands a $124 million market cap, which represents 17% of the estimated $715 million net asset value (also calculated with a 5% discount rate).

We bulls may quibble, but our unnamed geologist has also described the opportunity. It's because of what a move in the gold price to $2,000 or $2,500 would mean for the ITH net asset value that Paulson & Co., owner of 31.8% of ITH's 190 million fully diluted shares, got heavily involved in 2016.

John Paulson, founder and eponym of the Paulson firm, came to the phone last week to explain why. "We own a lot of gold companies," said Paulson, paid-up subscriber, *Grant's* conference speaker and, of course, table-sweeping money-maker in the big short of 2007–09. "We own Seabridge," Paulson went on. "We own Barrick. We own Novagold. It depends on what your focus is."

For the safest, least leveraged hedge against (or—another way to say it—investment in) money printing and interest-rate suppression, one buys gold itself, he observed: "If you want a little more leverage, you buy Barrick or Newmont. If you want even more leverage, you can buy an intermediate producer like Seabridge. If you want to go for the maximum return, you

Fewer bulldozers required



* Defined as not more than 50% owned by a major.

source: International Tower Hill Mines, Ltd.'s May 2020 corporate presentation

start off with an undeveloped mine that needs to go through the process, but then you get the valuation at the lowest level.

"These," Paulson continued, referring to start-up mines like ITH, "are prospects. They don't produce any cash. You need to raise cash to do the feasibility study, then for the permitting, then the mine construction. But as you move the project along, as you complete each one of these steps, the valuation should rise, and then, at the higher valuation, you issue a limited amount of equity to fund the next portion."

The beauty of ITH and its kind is the aforementioned potential for an explosive lift in NAV in a fast-rising gold market. As Marcelo Kim, a Paulson & Co. partner and chairman of ITH, and his boss do the arithmetic, a rally in the gold price to $2,500 from $1,700 would boost ITH's net asset value to $2.7 billion from $715 million (again using a 5% discount rate).

"So the gold price goes up 50%, and the NAV goes up 500%," Paulson went on. "Why does that happen? There are two reasons. One, this is a low-grade mine. So it is a high-cost mine. The cost of producing gold is probably around $1,200 to $1,300 an ounce. At $1,500 there is very modest net present value. When gold was $1,200, this mine had no value, and that was when we bought the stake. As gold prices rise, they don't have to rise that much before this becomes economic. And if it goes to $2,500, it becomes extremely economic."

Of course, there's no confusing the building of a new gold mine with drawing a paycheck from home during lockdown. It's physically, analytically and politically complex, and it's never problem-free: "The permitting is always an issue, but we're in a good jurisdiction. The metallurgy is an issue. Building the mine is an issue. But every mine has an issue."

Paulson, whose formative Wall Street experience was in risk arbitrage, got an education in mine development with his 2009–10 investment in Detour Gold Corp., another low-grade North American property that recently fetched $4 billion in a sale to Kirkland Lake Gold, Ltd.

Quite apart from the 2018 boardroom battle over whether or not Detour should remain independent (Paulson led the fight to install the slate of directors that would ultimately decide to sell), the company had to struggle against natural impediments. Situated in the Abitibi gold belt of northeastern Ontario, the mine lacked amenities.

"It had no access to roads or electricity," Paulson said. "You had to build a road to get there. You had to build a camp for the people to stay over and then move around in shifts. You could lock into a grid, but I think it was a 150-mile extension through rather remote corridors. Here, it is only 50 miles, and it is along the Alaska pipelines, so it is just a matter of stringing the grid.

"The biggest thing was the strip ratio," Paulson went on. "What that means is you have to remove a certain amount of tons [of earth] for each ton of ore-bearing soil. For Detour, it was 3.7:1. It becomes a dirt-moving operation, and so you have to have more trucks, and those trucks cost $6 million apiece plus the fuel cost of moving unproductive dirt. Then you have to have the retaining facilities to store all of the overburden. All of that dramatically adds to the cost. Even then this turned out to be a dramatically profitable mine once gold prices got to about $1,250. At $1,700, it is like printing money. The beauty of ITH is that the strip ratio is very low, 1.3:1."

"As at March 9, 2020," the new International Tower Hill 10-K report states, "management believes that the company has sufficient financial resources to maintain its operations for the next 12 months." But cash in the grand total of $6.9 million doesn't sound like much, and we asked Paulson how the company intended to keep the lights on.

By issuing stock as the work progresses and as the valuation, presumably, rises in turn, he replied. One step forward provides the valuation impetus to raise the capital that leads to the next step: "Once you get the permitting, you enter a new valuation range which should be similar to where Novagold is today. They have a permitted project, but they haven't started construction. Even then, just as a permitted project, 50% of Novagold has a $3.8 billion value." Electrum Group, LLC, an investment-advisory firm chaired by Thomas Kaplan (who is also the chairman, and largest owner, of Novagold), is the third-largest holder of ITH.

In view of the half-decade or more to production and the tribulations that come with the territory of any new mine, we asked Paulson if it wouldn't be better to apply leverage to a safe full of gold ingots. It would be riskier, he answered. Leverage to the gold price—operational leverage—is one thing, debt something very different.

"It is such a volatile area," he said. "You can get wiped out pretty quickly if you use leverage in gold. Buying the equity—and the company has no debt—you will have volatility, but you won't take the risk of being wiped out because of financial leverage. The ultimate return could be much higher than you can possibly get by leveraging a stack of gold."

All you need is a big, fat gold price. Carry on, Jerome Powell.

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