Golden Income Streams

*The Precious-Metal Industry’s Best-Kept Secret*

*By Jeff D. Opdyke, Executive Editor*
Golden Income Streams: The Precious-Metal Industry’s Best-Kept Secret

Gold has captivated the imagination of the human race for millennia, spanning cultures, history and geography. From ancient Rome to ancient Egypt, to Africa, Asia and Central America, gold has symbolized wealth and prosperity.

Wars have been waged and alliances forged because of it. Kings and queens wore it upon their heads as a symbol of their sovereignty. The search for the yellow metal has even toppled civilizations.

So it makes sense that investors would single out gold as a great way to profit. It’s a safe haven, plain and simple.

And, while I recommend buying gold bars and coins, there are other ways to profit from gold.

For example, many investors try to gain exposure to gold by buying shares of mining companies. Gold miners normally give investors a leveraged way to invest in precious metals, offering the potential for outsized gains.

The Hidden Risk of Gold Miners

You see, when gold prices jump, a gold producer normally sees its earnings accelerate at a faster pace than the price of the actual metal.

Let’s say you own a mine that produces gold at $1,100 an ounce, but gold is trading at $1,200. You’re making a profit of $100 an ounce.

If the price of gold jumps from $1,200 to $1,500, that’s a price increase of $300, or 25%. For the gold miner, however, profits have jumped from $100 to $300. That’s a 200% gain.

For that reason, stocks of miners have tended to outperform underlying precious metals while the price of gold rises. In other words, higher prices of precious metals have normally resulted in even higher earnings and higher share prices.

But the recent performance of miners has shown that’s not always the case. While gold is up 50% since 2008, the AMEX Gold Bugs Index (HUI), which tracks the performance of gold miners, is down 50%.

Gold Miners Have Been Underperforming the Metal

The truth is that the potential for higher returns offered by miners comes with a much higher risk.

The performance of miners depends on several factors, not just on the price of the precious metals they dig out of the
ground. You have to consider, for example, the company’s balance sheet, management team and mining capability.

Rising mining costs, for instance, are one of the biggest risks. In fact, these are the factors that have led to some very poor performance of miners in recent years.

But what if you could get the leverage that miners offer without the risk of rising exploration costs?

**A Better Way to Invest in Gold**

Well, there’s a special niche of the gold market that allows you to do just that. It gives you the opportunity to grab outsized gains while avoiding all the normal risks of mining.

I’m talking about companies that collect streams of income from owning royalties on the world’s preeminent precious-metal mines.

These are known as royalty companies.

And investing in gold-royalty companies is one of the easiest and safest ways to turn a small investment into incredible wealth over the next few years.

The reason? Well, they don’t get their hands dirty.

They don’t dig the gold out of the ground. Instead, they provide financing to mining companies in exchange for future payments. As long as these drilling or mining operations are producing, the royalties roll in year after year.

This is a safer way to invest in gold miners because the company is not exposed to risks such as exploration costs. They have zero exposure to the capital, operating and environmental costs inherent in running a mine. And when gold prices are rising year after year, it’s a fantastic business.

The production cost of an ounce of gold or silver has gone up dramatically in recent years. For example, back in 2000 the average cost of production for an ounce of gold was around $200 an ounce. Last year, the average cost to produce an ounce of gold was close to $650.

Royalty companies are not exposed to these rising costs of production. They don’t have to spend time or money investing in pricy drilling equipment, land, permitting and licensing fees, labor and all the other costs associated with mining exploration.

And that’s why these royalty companies buy up royalty stakes in as many of the world’s best mining assets as they can. These royalties give them the right to a portion of the mineral resources for the life of a mine.

The best royalty companies make hundreds of small investments to spread out their risk and even out future payments. This is another factor that makes them a safe investment. Since they collect royalties from multiple mines, they provide diversification. So if something goes wrong in one of the mines, it doesn’t have a big impact on the royalty company.

Because of these advantages, royalty companies have performed much better than gold miners.

I expect this outperformance to continue. And with the companies featured below, you’ll be investing in the three royalty companies with the greatest potential.

**Royal Gold**

Consider Royal Gold, Inc. (Nasdaq: RGLD). It used to be a penny stock with a market cap of less than $50 million when it entered the markets quietly in 1992. Research giants like Merrill Lynch and Goldman Sachs didn’t know the company existed. Most mutual funds steered clear of it, too.

But after securing a portfolio of rich royalty deals, Royal Gold’s shares ascended from a penny stock to more than $60
a share. The company has generated returns of more than 100,000% since 1992. That's not a typo!

Royal Gold is a model royalty and streaming company. Worth nearly $3 billion and collecting royalty and streaming revenues from over 200 properties, the company offers many features you won't find in gold.

The company receives 75% of revenue in gold production from one asset — the Andacollo project, where there are more than 60,000 ounces of gold being produced each year. Another project, Mt. Milligan, in North British Columbia, is set to begin its first commercial production this year. Royal Gold will receive over 50% of the payable gold from the project, with the estimated production for the first year around 260 thousand ounces.

The Mt. Milligan project by itself will boost volume for the company by 50%. The company runs an earnings-before-interest-and-tax margin at 90%, which is one of the highest in the industry. It runs with such efficiency because of its low overhead costs and its ability to run a company with just 21 employees.

That allows it to allocate more and more to its shareholders as dividends and to make new strategic agreements.

Speaking of dividends, the company generates a 1.7% yield currently, but it has a strong history of increasing them. In fact, the company has increased its dividend for the past 10-plus years. When was the last time gold sent you a check each quarter? On top of paying out a quarterly dividend, the company has increased the amount it pays out by threefold since 2007.

Even with the strength of increasing dividends, the stock has just a 1.5 times price-to-book ratio; the five-year average is 2.5. This means the shares are deeply undervalued. The drop in the price of gold clearly plays into this, but this stock will turn around in quick fashion as the price of gold stops bleeding.

**Action to take: Buy Royal Gold, Inc. (Nasdaq: RGLD) shares up to $54 per share. Use a 33% trailing stop.**

If shares are trading above our buy price, be patient and wait for them to come back into range before establishing a position.

**Franco-Nevada Corporation**

**Franco-Nevada Corporation (NYSE: FNV)** is a $6.4 billion mining royalty company set up just like Royal Gold. It collects royalties and a stream of revenue from a basket of companies and owns the rights to more than 349 assets — even though most are in the exploration phase. Since 2011, FNV has added 23 new assets.

Here is an example of how royalties can boost a company's bottom line: One of Franco-Nevada’s flagship projects, Goldstrike, has generated more than $700 million for the company — even though it only paid $3 million for the royalties to it. That’s a 20,000%-plus return on investment.

The company is also running lean. With zero debt and a stockpile of cash, it is free to add additional assets whenever a promising opportunity exposes itself. The company also uses its cash pile for growing dividends. The current yield is 1.6%, but the company has increased payments each year since its initial public offering (IPO) in late 2007. Dividends have grown 200% over that time.

If you are looking for a company that’s better than gold, what’s a better indicator than stock performance?

Since the company’s IPO, shares have soared 300%. Gold is up a modest 160% and the S&P 500/TSX Global Gold index is up just 70%. I don't know about you, but I would go with FNV every time if I had my choice.

If you are holding a company that outperforms the precious metal when it's going higher, and that's ultimately where gold is headed, then you want to own a stock like Franco-Nevada.

**Action to take: Buy Franco-Nevada Corporation (NYSE: FNV) shares up to $48 per share. Use a 33% trailing stop.**

If shares are trading above our buy price, be patient and wait for them to come back into range before establishing a position.
Sandstorm Gold Ltd.

Last but not least is another royalty and streaming company, **Sandstorm Gold Ltd. (NYSE: SAND)**. It holds nine gold streams and 25 royalties. Sandstorm Gold focuses on acquiring gold and other precious-metal purchase agreements from companies that have development projects or are operating mines in the advanced stages.

Sandstorm also offers upfront financing for gold-mining companies looking for capital. In return, it receives a gold-streaming agreement, which gives it the right to purchase a percentage of the gold produced at a fixed price.

The company is tiny compared with Royal Gold and Franco-Nevada, with just more than $500 million in market cap. This comes with its advantages, though. For smaller projects, the company faces less competition. It tends to focus on mines that are below the industry average and only bids on projects with a major exploration upside.

With the biggest dogs on the street refusing to expend the time or effort on competing for the smaller projects, Sandstorm can afford to be meticulous.

On an enterprise-value basis, even with its small size, it’s one of the most undervalued companies of the bunch. The ratio of its enterprise value to its cash value is under 10 for the first time in several years. With the new streams of revenue it’s bringing in, it expects the ratio to fall under eight. Compare that to an average of 15 times for Royal Gold and Franco-Nevada.

Sitting with zero debt and over $100 million in cash, Sandstorm is poised to continue adding streamline and royalty opportunities.

Currently, 84% of revenues come from four sources – Luna Gold Corp., SilverCrest Mines Inc., Brigus Gold Corp. and recently added Premier Royalty Inc. Over the next three years, revenue is projected to increase more than 65%, or more than 20% a year, based on an average price of gold at $1,350. The company also plans to reduce its general and administrative expenses by 35% next year.

All told, the company is in a prime spot for investors. Despite a troubling year, the stock has still outperformed gold and the S&P 500 by more than double over the past five years.

**Action to take:** **Buy Sandstorm Gold Ltd. (NYSE: SAND) shares up to $6 per share. Use a 50% trailing stop.**

If shares are trading above our buy price, be patient and wait for them to come back into range before establishing a position.

**A Unique Investment**

Securing a core position in royalty companies is simply a smart play if you are looking for a nice reward in gold without the major risks. Royalty companies are not subject to the risks involved in mining.

With all of their advantages – no exposure to the capital, operating and environmental costs of running a mine – I anticipate these companies will continue to outpace gold miners. So, if you’re looking for a great way to profit from higher gold prices, Franco-Nevada, Royal Gold and Sandstorm are the places to be.

For any comments or questions, you can always send us an email at cs@sovereignsociety.com, visit our website at www.sovereignsociety.com or call 1-866-584-4096.

Until next time, stay Sovereign …

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