18 Thoughts on the Seniors

Dr John Wolstencroft
for Frisby's Bulls and Bears

1. We are lucky

- The Seniors – the big gold miners like Newmont, Goldcorp, Barrick, are now valued as ordinary businesses
- (By Juniors I mean the smaller single-mine producers, 100k or 200k ounces, Mom-and-Pop miners, and the explorers)
- First time in a generation; the Seniors used to not make money or be on p/es of 25 to 60 plus

2. Optionality

- Gold miners used to not make money
- Analysts and Promoters had to think of a way to value them:
  - Gold in the ground
  - Next to a producing mine
  - Optionality on higher gold prices cf. options / futures markets
  - The Junior miners CEOs loved this! They didn't have to do anything and their company had value!
  - People would buy on the basis of "Jam Tomorrow"
- This is history, not just in Golds but the market generally (people no longer believe even in Apple's or Facebook's optionality)

3. We can treat Gold Seniors as normal companies

- Start with the price / earnings ratio
- Look at enterprise value (market cap plus debt) and EBITDA
- Look at the dividend yield
- Brightly coloured graphs and drill hole results – forget them
- OK you still have to value Juniors somehow, but this means less and less especially with the Seniors – it's cash flow that counts now

4. Balance Sheet

- Cash in the bank
- Ability to raise debt
- Genuine cash flow with long-term cash generative assets
- Asset-backing by owning existing assets
- Ability to pay dividends
- (Rules out most Juniors)
- High capex mines often only make sense if you have the cash or can raise debt – dilution destroys shareholder value

5. Margin

- Investors look forward
- Industry trashed on static gold price and rising costs
- But there are some low cost miners out there, trashed also
- Buy margin (low cash cost as sales price is fixed industry-wide)
- www.kitco.com has a nice list every few weeks from Scarsdale Equities of the Seniors and Juniors to start looking
- Juniors of course don’t need to worry about margin because they often don’t produce anything

6. Growth

- Many gold miners, even the biggest, have good growth plans
- Maybe worth paying a little bit more in terms of valuation
- GARP – growth at a reasonable price
- As I pointed with Mining Ruin, most Juniors are GAUP (growth at an unreasonable price) or NGAUP (no growth at an unreasonable price)

7. Barriers to Entry

- Normally applies to business with strong customer relationships, brands, intellectual property
- Also High-capex entry businesses
- Juniors are basically shut out from mine building as costs have risen so much
- The best assets are very high-capex high-impact very long-life and commensurately low cash-cost low sustaining-capex – the Seniors love these; the Juniors just cannot do them

8. Diversity

- Multiple revenue streams
  - Multiple mines
  - Polymetallic
- In the dot-com boom there were massive single-product companies that simply went bust when the market changed (cf. mobile phones today look at Nokia, HTC share prices)
- Resource nationalism, or something similar to the nickel price crash will kill a single-country single-metal single-asset Junior

9. Negotiating Strength

- Seniors can now walk away – the commodities bull market has changed
- They have multiple assets in multiple locations and can decide which to develop
- They can negotiate fiscal terms
- They can expand existing mines or build new one
- They have options

10. Replacement cost

- A Junior might have a 100m market cap
- They might be able to get into production for 200m to produce 100k ounces p.a.
- That's 300m of cost/value
- Barrick, on a replacement costs basis, on these numbers is worth 20bln (7m ounces p.a.)
- You can buy Seniors for not much more than replacement cost and take no development risk
- Replacement cost of a Junior is a nice suit, a flashy watch and a $20,000 option over some land in the Yukon.

11. Boring is Fun

- People overvalue risk and undervalue safety
- We buy gold because we want to preserve wealth
- ....and then take unbelievable risk in the Juniors
- We had to when no-one made any money (Newmont p/e of circa 70 in 2003, didn't make money in the several years before that)
- We have choices now

12. Forget arbitrary valuations

- Many of the measures used to value Gold companies were INVENTED (cf dot-com boom) in order to value companies that had no profits, and in many case no sales
  - Gold in the ground
  - Trenching and drill results
  - $ per ounce of Proven and Probable, Measured, Indicated and Inferred
  - $00000 per licence area
  - "On trend" locations
  - Old mines that went bust in the past to be revitalised
- We are using old measures in a new era
- Cash generating and dividend paying ability is the best way to value any company

13. Special: Royalty Companies

- Some companies simply buy royalty streams (e.g. 3% of sales, 100% of price above $10 per silver ounce) from other miners and so are not exposed to cost inflation, only commodity price changes
- Some have negative costs because they are polymetallic and the primary metal (e.g. Silver) is free as the sales from the secondary metals (Zinc, Lead) cover all costs
- Worth looking at; they have been trashed too

14. Strength in Weakness

- In a crisis
  - The poor weak companies go bust
  - The good weak companies get bought
  - The strong companies buy them at distressed prices
- I would rather be a shareholder of a strong company on the buy side for the longer term benefits than be on the sell side seeing my shares get bought out at a low price

15. Nothing replaces gold

- A gold miner is not gold
- They are different asset classes

16. Seniors are not Juniors

- They are different assets classes as well
- Juniors are speculative ventures
- You cannot replace the features of a Senior with a basket of Juniors because in aggregate the Juniors will not have the balance sheet strength and they will be involved in more risky ventures, they also won’t walk away from a bad asset because often its their only asset

17. When to sell

- Never?
- Never sell Shell
- If you believe that well run long term sustainable Seniors
  - Can benefit in bad times by buying assets on the cheap
  - Wont go bust because of their lower cash cost base and strong balance sheet
- ...maybe just hold them until we are back to really crazy valuations

18. Seignorage

- Gold is a financial asset
- Seignorage is the benefit that accrues to the minter of money – the difference between the value of money (face value) and cost of creating it (printing a note, minting a coin, and in some cases extending credit)
- Gold miners get this benefit and hopefully eventually the shareholders
- Gold is different to most products
  – Very high value in a small space
  – Global market and pricing
  – Very Liquid
  – Doesn't degrade with time
  – Nominally appreciating not depreciating in storage
  – Generally transportable world wide with no taxes
  – Seen as a store of wealth
- …and currently producers of this have no premium attached