Interview with Tony Jensen, CEO of Royal Gold

When You Invest $780 Million in a Royalty, You Need to Get it Right

Royal Gold is one of the three largest royalty and streaming companies in the world, alongside Franco-Nevada and Silver Wheaton. Its market cap sits at over $4 billion.[1]

While much of the sector has been decimated, these three leading royalty and streaming companies have suffered far less.

As of January 6, 2015, Royal Gold is also the sixth largest holding of Sprott's Gold Miners ETF (NYSE: SGDM), at 4.20%. For more information and disclosures, please visit www.SprottETFs.com.

How did you first become interested in the royalty and streaming business?

I spent about 20 years on the operational side of the business with Placer Dome. I was operating mines in North and South America. My last 'posting' was at the Cortez mine. At that project, I was paying substantial royalty from our revenues to Royal Gold.

I became more and more familiar with the royalty business model during those days. As I looked at the simplicity and robustness of the royalty business model and compared that to the complexity of operating mines, it became obvious to me that it was a business segment that could grow.

At that time I joined Royal Gold, in around 2003, the mining royalty business was still in its infancy. Franco-Nevada had become part of Newmont Mining. It was a bit of a gamble for me, but one that has played out extremely well. Since then, the royalty and streaming model has changed dramatically. We never would have envisioned that it would become an important element of financing new projects.

It was the prospect of providing lower-risk returns to shareholders that attracted me to the business model.

What are some weaknesses of the royalty and streaming model?

You have got to get the projects right, and have the right size of a commitment to a project. It's easy to do business in this environment. There is substantial opportunity. Selecting the quality projects that will be in business at this price point and in the future, whatever that might bring, will be the real important part of the business.

Where you're investing hundreds of millions of dollars, for example at Mount Milligan where we invested $780 million, you really need to have confidence that the project is going to perform as expected, or better. Not picking the right projects is what can really get in the way of success in this platform.

The other side is picking the right size for the deal. You just can't take too much of the revenue so that there is a lack of incentive for the mining operator to produce. We spend a lot of times making sure that the transaction is not only good for Royal Gold, but good for our counterparty – the ones who will pay us a royalty – as well.

[1] http://www.marketwatch.com/investing/stock/rgld

Should investors heed your approach of investing in projects with 10, 20, or 30-year time horizons?

When one invests in short-term in equities, it's really just a leveraged play to gold price because the company doesn't have the time to realize on its business plan. So you might buy a high-cost producer because you feel that the gold is going to move, and you want to have leverage. We're in the business every day and we're going to be in it for decades to come. Most of our value is going to be realized over long periods of time. A great amount of value comes where we're able to turns resources into reserves. It's then that a small investment can just keep on delivering and delivering. It's where we get the reward for identifying the right projects and the right types of assets. The payoff lasts a tremendous period of time after the initial reserves are exhausted. It is not captured, contemplated or valued on a short-term basis. We are long on all our assets. We are a buyer of assets, not a seller. We generally want to own more of what we already have, so I don't know how you could be more long-term.

What is the 'value-add' of royalty and streaming companies, if they do not operate mines or explore for metals?

There are great examples of value creation all the way through the development cycle from exploration and discovery, to production and implementation, all the way through to financial arrangements made with royalty and streaming companies. I think there are good, honest, profits to be made in each step. The trick is that we need to make sound business decisions, and have sound business results.

The problem that we face in the gold mining industry is the utilization of capital in an efficient manner. We need to invest in assets that can deliver over various price cycles, and we need to be able to use those facilities for decades, not just a 5 or 7-year mine life. We don't have very large costs in the royalty business and we're able to invest capital in a prudent fashion. We give our investors a rather stable investment portfolio. It is easy to model our cash flows and you can see what returns we are likely to see in this gold price environment and others. There's just less uncertainty in our business model than in other parts of the gold mining business.

Of course, we can't control the revenue side because we're fixed in at the gold price like anyone else. But in price cycles like this lie the opportunity to layer in to good pieces of business at the lower end of the cycle and harvest returns as the price moves up. That's a good position to be in.

So the value-add for investors comes from minimizing uncertainty?

In this environment, people are looking for quality go-to names that offer diversification. If you can build a company that has all the upside of a mining company – meaning you benefit from reserves increasing – but you leave the risks like operating and capital costs for someone else to deal with, it makes for an attractive proposition to shareholders. Royalty companies are dividend-paying companies that also have good growth associated with them. If you combine those three aspects – yield, growth and a low risk profile – that is the value proposition.

What 'red flags' would you tell investors to watch out for in any royalty and streaming stock?

What really makes this business go forward is having an asset that gives you a powerful engine. For us, it was the Cortez mine.

The second important thing would be the management team. The capital that is received from your growth engine is then going to be deployed in more assets that will hopefully provide additional growth in the future. That is where the decision-making ability of the management team is crucial. The royalty business is a simple business from a financial perspective. But it still takes a tremendous amount of intellectual discipline to identify these properties and use that capital wisely. It's a lot like every other business in that regard.

As Mr. Jensen points out, royalty and streaming companies have minimal costs compared to mining companies; they are therefore unlikely to run out of money or face closure if metals remain low, or go lower. Investors are often told never to 'buy and hold' in the resource sector – companies and circumstance simply change too much. However, investors who want exposure to metals prices without the need to follow specific and highly-technical exploration or development stories may be interested in the royalty and streaming model. While these stocks may underperform a 'hot' junior exploration stocks in a raging bull market, their business model may allow them to weather severe bear markets in the metals while still benefitting from increases in metals prices.

This interview was originally published in *Sprott's Thoughts* on December 23, 2014 and has been excerpted.