ALIGNMENT OF INTERESTS – ROYALTY FINANCE

Royal Gold, Inc. is a Denver-based, precious metals royalty company focused on two primary business objectives: the purchase of existing royalty positions on precious metal mines and projects; and development of royalty interests through financing activities – royalty financing.

Royalty financing provides companies with an additional potential source of funds for exploration, project development and other financing needs. The basic concept of royalty finance enables a company to fund its activities today by exchanging, for cash, a portion of its future revenue stream on a particular project or projects. It can be employed as an alternative to, or in conjunction with conventional debt and equity financing vehicles. The following discussion outlines characteristics of royalty finance, with comparisons with debt and equity financing approaches.

Royalty Structures

A wide variety of royalty structures are employed in the natural resource sector. Some are more commonly employed in specific segments of the sector, such as coal mining, or sand, gravel and aggregate operations. Others, such as net smelter return royalties and net profits interests, are common to metal mining operations. Listed below are a number of the common variants in royalty structure and terminology, with relevant comments.

- Gross Smelter and Net Smelter Returns Royalty – a percentage of gross revenues or gross revenues adjusted for transport, refining and insurance costs, respectively, received by the mine operator from the smelter or refiner of concentrates or dore shipped from the mine. These royalty structures are common in metal mining. These are preferred structures for Royal Gold in that there is no need for the royalty holder to become strongly involved with the operator in auditing mining and processing costs.
- Net Profits Interest – a percentage of the net profits of the mining operation, with net profits determined by deducting all cash costs of the operation from revenue. This royalty structure is also common in metal mining, but may require the royalty holder to be concerned with the efficiency of the operation/operator.
- Net Value Royalty – a royalty structure intermediate to Net Profits and Net Smelter Return Royalties; whereby certain costs, but not all, are deducted from revenues to determine the value subject to the royalty percentage.
- Dollar per Ton Royalty – a fixed rate royalty whereby the royalty holder receives payment on a per ton (or tonne) mined, or per ton (tonne) processed. This type of royalty offers the royalty holder exposure only to production rate, with payments totally independent of commodity or metal price.
- Dollar per Ounce Royalty – a fixed rate royalty whereby the royalty holder receives payment on a per ounce produced basis. Payments are independent of metal price.

- Fixed Rate or Sliding Scale Royalty – while the most common structure for any of the above royalties is as a fixed percentage or dollar amount; certain of the royalty types, and especially Net Smelter/Gross Smelter Return Royalties, may be structured with a sliding scale of percentages linked to metal price (increasing percentage with increasing metal price). The Sliding Scale Net (Gross) Smelter Return Royalty structure provides superior leverage to the royalty holder with increasing metal prices, while offering protection to the operator via lower royalty rates in low metal price environments.

Royalty Financing

Royalty financing can be employed in a wide variety of situations including the following:

- Early stage exploration projects.
- Late stage exploration projects seeking financing for pre-feasibility and feasibility studies.
- Mine development and construction financing.
- Mine or plant expansion projects.
- Reclamation bonding.
- Project or company acquisition financing.
- Financing to restructure debt and balance sheets of projects and companies.

Comparative Financing – Debt/Equity/Royalty

The following list provides the attributes of royalty financing as compared to conventional debt and equity financing.

- In its simplest form, royalty financing repayment is not an obligation, as in debt/bond financing.
- Royalty financing does not result in direct dilution of shareholders as with a substantial equity financing.
- Royalty financing carries fewer restrictive covenants than conventional debt or bond agreements. Most notably, royalty financing does not typically impose a hedging requirement on the company or the operation, as is more standard with debt financing vehicles.
- Royalty financing does not necessarily require extra-project collateralization.
- Royalty financing preserves debt capacity for future or additional opportunities.
- The royalty financing concept stretches payments over the life of the reserve or mine, rather than front-loading the project with interest and principal payments as with conventional debt. If analyzed from a financial viewpoint, this characteristic of royalty financing enables an operator to enjoy higher cash flows in the near-term – the net present value of cash flows in a royalty-financed project may exceed those of a debt financed operation.

- Costs of conventional debt and bond issues, and equity financings are commonly much higher than realized when all fees and costs are included.
- Royalty financing transfers the payment and repayment obligations of conventional debt and bonds in dollars or other currency; to product-denominated payments, thereby eliminating price risk and production/operational risk as it relates to more rigid debt service structures. The provider of royalty finance, therefore, assumes a share of the various risks involved in the operation; and is equally rewarded with the operator/owner for positive developments; and suffers with the operator in down markets or with negative developments.
- Royalty financing applies only to the project(s) of interest. Debt financing may require a security interest be extended to other assets of the company; bonds extend a claim to all assets of the company; and equity financing, by definition, provides an ownership interest to new shareholders and sponsors in all assets of the company, current and future.
- Royalty financing is not permanent. If the project(s) subject to the royalty financing ceases operation; the royalty payment also ceases. Equity financing permanently alters the ownership of the company, and applies to all assets, present and future, even if the project financed by the equity financing is terminated. Debt and bond financing may remain corporate obligations regardless of operational status of mining operations.

There are no hard formulas employed to calculate the royalty percentage for a certain financing amount. Each project requires consideration of stage of development, and the risks associated with that project; technical, political, social, permitting and environmental. For a project in production, or with all permits in place, and with reasonable other risks, Royal Gold would typically value a royalty stream using a competitive discount rate on pro forma production from the proven and probable reserves. The application of the royalty beyond the life of proven and probable reserves is attractive to the party providing the royalty financing. Significant upside potential may lead to a lower rate financing structure.

Royalty financing provides the opportunity to an operator to enjoy greater cash flow in the early years of an operation; to denominate the royalty payments in product, and to share the metal price and production risks with the provider of royalty financing. In this manner, the interests of the operator and the financing party are much more strongly aligned than in most conventional financing vehicles.

Royal Gold, Inc. is listed on the Nasdaq (RGLD) and TSE (RGL); has a website at www.royalgold.com; and can be contacted for additional royalty financing details and discussion (303-573-1660).