Thanks for inviting me to speak

Intro

- I'll talk a little bit my views on the conference theme "Is Bigger Better"
- Then I will talk about stock market prices for gold shares, and components of stock market multiples, including size

Background

- By way of background, I have been fortunate to work with both large and small firms
    - The first half of my career was with Climax Moly and AMAX,
    - And I have been with Royal Gold now for more than 25 years, as it has grown from a small producer to a world class gold royalty company

Royal Gold

- For those of you who do not know about Royal Gold
    - It is one of the largest royalty companies in the world
    - We earn our revenue almost entirely from top line based royalties which shield us from much of the operating and capital costs of a mine.
    - We acquire properties and earn our revenue from purchase of existing royalties (usually prospector royalties), the creation of royalties by financing new mines or expansions, and through M&A activity.
    - We have grown from 5 royalty properties to 191 properties today **(Slide 9)**

    - The royalty model is highly profitable since most of our revenue ends up as cash flow. The table on the left of this slide showing market cap per employee makes the point **(Slide 3)**

General observations on size

- My Climax/AMAX years convinced me that size does make an enormous difference in mining
    - AMAX had first class people. They were the very best at what they did. And the outside consultants were the best that could be obtained
    - AMAX had the money to do things right. I would observe that mining operations are not forgiving of poor practices. You simply cannot cut corners on any aspect of an operation.
    - The major negative that I observed in the big company setting is that they can become bureaucratic and petty corporate politics sometimes interfere with decision making

- My experience at Royal Gold supports the view that it is possible to start a mining firm from scratch, but that it is very hard to get started as an operator
    - Royal got started as a miner, with operations in California and Colorado – mines like the Camp Bird mine here in Colorado
    - We had some good properties and good people, but we kept running out of money. We had trouble putting together reserves, and doing the kind of metallurgical work we needed to do to get the best metallurgical response from our ores. Likewise, environmental costs were a killer. And we were not prepared to cut corners on safety.

    - We supported our operating “habit” by doing some deal making that kept us in cash. We were better at buying and flipping mines than we were at operating.
    - We also got lucky and made a major discovery in Nevada, and managed to keep a royalty on the property when we sold out to a major (**Slide 6)**
    - Our discovery of South Pipeline gave us a cornerstone property for converting ourselves into a royalty company (**Slide 7)**
    - We finally decided to get out of operations, and to put our deal making skills to work buying and managing royalties **(Slide 8)**
    - I will observe that one of the joys of small companies is the ability to make things happen fast, and the lack of corporate politics. Even though Royal Gold is now a large company with a market cap of about $4 billion, we still has only 21 employees.
- Summing up, I have tried it both ways, and bigger is better

The rest of my talk deals with valuation of gold shares, and in particular, the premium that the market assigns to such shares

- My colleague Bill Heisenbuttel, who is Royal Gold’s corporate development VP, gave a talk last month at the National Western Mining Conference in Denver. As part of that talk he commented on the premium, and I will quote “It is important to understand gold equity valuations. I attended a good business school with a strong finance focus and I thought I knew how to calculate a cost of equity and a cost of capital. Upon joining this industry, I was faced with the gold space where companies trade at high cash flow multiples and actually receive a share price premium to the discounted cash flow of the company's assets. I would ask myself 'What do you mean you discount the cash flows and then multiply that by 1.5X or 1.75X?'. That was not in any of the textbooks I still have at my desk. But these premiums are real and have been for a long time. One of the keys to receiving the premium is having enough revenue from gold. We believe that to be considered a "gold share" you need about 70% of your revenue to come from gold."

- (**Slide 13)** CIBC prepared the charts on the right. The red bars in the charts are the NAV and cash flow multiples for royalty companies. The yellow bars are the valuation metrics for gold senior and intermediate companies. The green bars are those same measurements for senior and intermediate base metal companies.
- **(Slide 14)** As just pointed out, royalty companies trade at higher premiums than other in the gold space. This chart was taken from work done by Merrill Lynch. You might not be able to see all of the names in this chart, but those green bars at the right high end are Royal Gold and Franco Nevada. The high valuation reflects the view of the market that we provide exposure to the metal without the direct exposure to operating costs, capital expenditures, site management, political risk, and environmental liabilities. And these multiples have, again, been consistent over time.
- (**Slide 15)** One more chart deals with price earnings multiple. Again, Royal Gold ranks at the top of the list. Although we do not typically use P/E ratios in our industry, it is very common in the rest of the market place, so I thought you might like to see how our P/E compares to some other industry and mining sector titans. Our 45X multiple is more than twice anybody else/s on the list!

Observations on gold share premiums

- There are a lot of theories about premiums. I tend to follow our cash flow multiple. As I said earlier, P/E ratio's don't get much attention in the gold space. Earnings seem to be completely in the control of the accountant, and are subject to all kinds of charges and additions that seem not very related to the cash generating abilities of a company.
- I like to think of the cash flow multiple in terms of objective and subjective factors. When I talk about objective factors, I am thinking of things you can measure, like revenue. Subjective factors are issues like quality of management and political risk. Many subjective matters may be capable of being made more objective by enough research, but few analysts are going to put in the time to measure rather than intuit or guess.
- Here are some of the factors that I think go into awarding premiums for gold equities
    - As I said earlier, most analysts will tell you that exposure to gold revenue is critical to earning a premium. Presumably investors want exposure to the optionality of gold. Many gold mining firms operate mines where gold is a co-product or by product of base metal mining. The market seems to have trouble awarding gold stock multiples to firms who violate the 70% rule. Barrick ran into some flack recently when it did a copper acquisition.
    - The royalty business model itself commands the attention of investors. Within the model, the special features of various royalties make them more or less valuable. For example, a sliding scale gross or net smelter return royalty provides incredible leverage in a rising gold price environment. And the exposure to

exploration upside in many royalty situations cannot be ignored.

  - Likewise, there is an issue of “what is a precious metal”. Can you get the gold multiple for silver revenue, or platinum and palladium, or diamonds?
  - I believe that investors do pay attention to the quality of management. Reputation is important. Good deal makers deserve a premium
  - The company’s financial condition is an issue to take into account. Is the debt structure apropriate. Does the company have the cash firepower to keep buying more and more royalties and metal streams?
  - Stock ownership. Who owns it? Big, smart institutions? Gold mutual funds? Retail. Insider positions and behavior.
  - Dividend policy. Does continued increase in the dividend command a bigger premium. As a firm that has raised its dividend every year for ten years, we think so.

There are a number of interesting aspects of the gold share premium to consider, but I will leave them for another talk

- The current erosion of the premium for gold miners
  - Is the GLD cannibalizing the gold space
  - Are we at the end of the long bull market in gold.
  - ETC