Royal Gold

Fiscal 2018 Full Year and Fourth Quarter Conference Call

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CORPORATE PARTICIPANTS

Karli Anderson – *Vice President of Investor Relations*

Tony Jensen – *President and Chief Executive Officer*

Bill Heissenbuttel – *Vice President Strategy and Chief Financial Officer*

Mark Isto – *Vice President Operations*

PRESENTATION

Operator
Good day, everyone, and welcome to the Royal Gold 2018 Full Year and Fourth Quarter Earnings Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the star key followed by zero. After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press star then one on your touchtone phone. To withdraw your question, please press star then two. Please note that today's event is being recorded.

I would now like to turn the conference over to Karli Anderson, Vice President of Investor Relations. Please go ahead.

Karli Anderson
Thanks, William. Good morning, and welcome to our discussion of Royal Gold's fourth quarter and fiscal year 2018 results. This event is being webcast live, and you will be able to access a replay of this call on our website. Participating on the call today are Tony Jensen, President and CEO; Bill Heissenbuttel, CFO and Vice President Strategy; and Mark Isto, Vice President Operations.

This discussion falls under the safe harbor provision of the Private Securities Litigation Reform Act. A discussion of the company's current risks and uncertainties is included in our safe harbor and cautionary statement in today's press release and slide presentation and is presented in greater detail in our filings with the SEC.

Tony will give you an overview of the quarter followed by Bill with a financial update, and then we'll open the lines for a Q&A session. Now, I'll turn the call over to Tony.

Tony Jensen
Good morning, and thank you for joining the call. Since this is our fiscal year-end call, some of my comments today will be more global in nature, and I'll begin on slide 4.

Today we're pleased to report another year of record results for Royal Gold, record revenue of $459 million, was 4% higher versus last year, while the gold price was in line with the prior fiscal year. Record operating cash flow was $329 million up 23% versus last year reflecting continued strong performance from the portfolio of 40 operating properties. Our GEO volume was 354,000 ounces, which was slightly up from last year.

We've been guiding that we are allocating our strong cash flow to dividends, debt reduction, and new business. In fiscal 2018, that emphasis has not wavered. We've paid out a record $64.1 million in dividends. We paid off our revolving credit facility in June just as we planned, and we now have over $1.1 billion of total liquidity for new opportunities.

We took advantage of a relatively quiet year for industry drill to enhance our position in the Peak Gold joint venture through an agreement to acquire 13.2% of the equity of our joint venture partner, Contango ORE, and we look forward to sharing the results of our ongoing Peak Gold preliminary economic analysis with you later this fall. We also increased our interest in the Mara Rosa property in Brazil to the acquisition of a 1.75% royalty, which is in addition to our existing 1% royalty interest we hold on the property.

Our balance sheet was further improved with repayment of Golden Star's $20 million loan ahead of schedule. It's been impressive to watch Golden Star's operational and financial transformation from mine cost, open pit miner of complex refractory ores to an underground producer of high-quality and cost-attractive oxide ores. Royal Gold identified this potential and invested at an inflection point in Golden Star's history.

On slide 5, we've charted our operating cash flow over the last five years. Despite a flat gold price, Royal Gold delivered a 22% compounded annual growth rate in operating cash flow since 2014. I'd like to highlight that our share account has been essentially flat during this period making our cash flow numbers highly accretive.

This impressive growth is a function of our business development success and organic growth of our portfolio of 40 operating properties. And I note that we are not yet hitting on all cylinders at Mount Milligan and Rainy River. We expect better days for both of those assets ahead.

On slide 6, and turning to recent developments at some of our properties, at Rainy River, New Gold announced 55,000 ounces of gold production in the June quarter, only its third quarter of full operations. As New Gold is resolving some startup operating issues, it has reduced its full-year guidance at Rainy River to 210,000 to 250,000 ounces for calendar 2018.

We continue to be encouraged that the mine has demonstrated the ability to improve both throughput, which is expected to increase to 24,000 tons per day by the fourth calendar question, and recovery which increased by six points in the June quarter to 87%. New Gold's current mine plan for Rainy River compares favorably to the 2014 feasibility study, which was a starting point for our investment.

Overall, contained gold and silver is higher than the feasibility study. Slightly less gold rate is more than offset by higher reserve tonnage. The new production profile generally results in fewer ounces in the early years offset by higher production in later years.

At Wassa and Prestea, Golden Star's production of over 61,000 ounces of gold reflected continued strong performance from Wassa Underground where average grades were approximately five minutes [indiscernible] per ton, which was a 65% increase in grade from the same quarter a year ago. Much of the production is still from the open pit.

At Prestea, Golden Star reported that its average grade increased to 13.5 grams per ton from 8.2 grams per ton in the prior quarter due to improved [indiscernible] design and execution. Golden Star reiterated gold production guidance of 230,000 to 255,000 ounces for the year.

We were also pleased to learn of the La Mancha Holdings $125 million financing, which in our opinion, will further solidify Golden Star's balance sheet and position the company for the future if approved by shareholders. We believe Golden Star is rich with efficient opportunities such as the potential to expand the Wassa Underground mine to meet the Wassa Mill capacity, to identify further surface resources to supplement the Prestea underground feed, and to explore throughout their land position which is one of the largest holdings within the Ashanti Belt in Ghana.

At Mount Milligan, Centerra reported strong throughput topping 60,000 tons per day over a consecutive 30-day period. However, water supply remains the key focus for Mount Milligan in light of the temporary shutdown it experienced in early 2018 resulting from lower than normal water availability. Centerra is the permitting process to ensure future water supplies are adequate. But cautioned that fourth calendar quarter production could be impacted if they experience delays in receiving permits that will allow them to continue to draw water from nearby sources.

Turning our focus to some exciting catalysts for near-term growth on slide 7, and I should mention that these are all examples again of organic growth at no additional cost to Royal Gold. I'll start with Cortez Crossroads. We understand that initial ore has been placed on the leach pad. This represents the top of the ore deposit, and we continue to expect more steady-state heap leach production building in calendar 2019.

AT Penasquito, Goldcorp reported that construction of its Pyrite Leach circuit was completed with commissioning accelerated to the current quarter. Goldcorp expects first gold form this circuit later this year and anticipates that the project will add an incremental 100,000 to 140,000 ounces of gold and 4 million to 6 million ounces silver annually over the mine life.

Finally, at Pueblo Viejo, Barrick continues to advance the pre-feasibility study on the plan expansion to increase production substantially. This strategy includes a pre-oxidation heap leach pad and flotation concentrate. On a consolidated basis, Barrick states that the project has the potential to convert roughly 7 million ounces from resources to reserves, which would allow the mine to maintain an annual gold production of 800,000 ounces well into the next decade. Barrick reports that construction has been complete on the pilot leach pad and that civil works have begun on the pilot floatation concentrator.

I'll now turn the call over to Bill for our financial results.

Bill Heissenbuttel
Thanks, Tony. Turning to our fourth quarter results on slide 8 as compared to the prior year quarter, revenue of $116.2 million was up 7% while the gold price was up 4%. Volume increases at Andacollo and Pueblo Viejo during the quarter were sufficient to offset lower contributions from Mount Milligan and Golden Star.

Our GEO volume was up 3% for the quarter. Reported earnings of $0.41 per share included impacts of the US tax reform legislation and some other small non-cash items. Absent these items adjusted net income was $27.6 million or $0.43 per share up 39% from the prior year's quarter of $0.31 per share which was impacted by higher non-cash employee stock compensation expense and a higher effective tax rate.

Our cash from operations was up 17% due to volume price and positive working capital and other balance sheet changes. Our dividends paid increased 5% as a result of the increase in our common dividend to $1 per share in November 2017, and for the full-year dividends paid represented 19% of operating cash flow.

At the bottom of slide 8, I'd like to draw your attention to our liquidity. In the June quarter, we paid the final $75 million outstanding on our revolver, and together with working capital, we now have $1.1 billion in total liquidity. Not only is our liquidity strong, our leverage as expressed by net debt to EBITDA, is a conservative 0.8 times.

Turning to slide 9, fourth quarter ending inventory was comprised of 22,000 gold ounces and 573,000 silver ounces, which was a decrease from the prior quarter. We have started to see the effects of the Mount Milligan suspension of operations earlier this year in the number of ounces delivered. As such, we expect our first fiscal quarter 2019 sales related to our stream agreements to be in the range of 10% lower than the fourth quarter on a gold equivalent basis without having notable impact on inventory levels, although this will depend on the ultimate timing of the deliveries from all sources we see in the quarter.

Our only remaining indebtedness is the $370 million of convertible bonds, which mature in June 2019.

As we have the ability to repay the outstanding principal balance of the bonds with the proceeds from our long-term revolving credit, we did not reclassify the 2019 bonds as current on our balance sheet at June 30, 2018.

We expect to provide some guidance on depreciation and tax rates for fiscal 2019 after the first quarter. This will allow us to properly consider some key elements of US tax reform that took effect for us at the beginning of this new fiscal year.

I'll now turn the call back over to Tony.

Tony Jensen
Thanks, Bill. I'll conclude on slide 10. Looking back over fiscal 2018, Royal Gold navigated its business with a steady hand. We delivered solid, steady performance with total shareholder return during the fiscal year that beat the S&P 500, the price of gold, and the gold equity indices. We stayed true to our core objectives to provide optionality and leverage to the gold price.

Our fiscal 2018 revenue was 77% from gold or 86% stated in precious metal terms. Our cash flow will grow quickly now that our revolver is repaid, position us well for new opportunities. We are patient and disciplined regarding capital allocation and dusting at the cross when opportunities are often abundant and being patient during quiet times while rebuilding the balance sheet.

This organic growth strategy, utilizing our own cash flow, has been effective for Royal Gold over the last deployment and recapitalization cycle in that we have not issued a share for equity finance since 2012.

This is a very interesting market in which we can be relevant. Operators have limited access to equity markets, and few wish to issue equity today because of large market value discounts. We would not be surprised to see precious metal miners going private in this market, something I certainly haven't seen before in this sector.

At the same time, the cost debt is climbing. As we have said many times, debt and equity are our main competitors, so when miners intensify their efforts to develop and purchase additional properties or recapitalize the companies, we'll be there and ready.

We're still paying a growing, sustainable dividend. Royal Gold paid over $400 million in dividends since 2001 when the gold price traded at $263 per ounce. Our commitment to a growing return of capital has been unwavering in nearly two decades. We strive to be the most valuable company in our business.

A purchase of a share in Royal Gold at the beginning of fiscal 2001 would have yielded over a 30-fold increase in share price through the end of fiscal 2018 not including the benefit of 17 years of dividends. Looking forward, we will continue managing our company to pursue best-in-class total shareholder return.

Operator, that concludes our prepared remarks, and we'd be happy to open the lines for questions.

QUESTIONS AND ANSWERS

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press star then one on your touchtone phone. If you are using a speakerphone, please pick up your handset before pressing the keys. To withdraw your question, please press the star then two. At this time, we will pause momentarily to assemble our roster.

Our first questioner today will be Cosmos Chiu with CIBC. Please go ahead.

Cosmos Chiu
Hi. Thanks, Tony and Bill, and thanks for the call. Maybe a few questions from me here. First off, last week, Centerra's update on Mount Milligan and New Gold's update on Rainy River caused a bit of investor concern. Maybe we can tackle each of them separately first.

At Rainy River, I know you've talked about, Tony, potentially for the production to improve on a go-forward basis, but are you at all concerned about the liquidity position of New Gold?

Tony Jensen
Well, look, we are obviously are managing and monitoring that actively, but the issue is I think their first bonds don't come due—Bill, correct me if I'm wrong—until 2022

Bill Heissenbuttel
Yes.

Tony Jensen
So, we think there's plenty of time to get this operation up and running. I think it's a little early to be too concerned. Our focus is on the assets, and we see no reason why the asset can't perform at very successful levels.

Cosmos Chiu
Tony, on that front, could you remind us what kind of security you have on the stream?

Tony Jensen
Bill is our expert on that. Bill, could you speak to that?

Bill Heissenbuttel
Sure. Yes, Cosmos. So, the stream is unsecured relative to the assets of New Gold. The stream is an obligation of New Gold, the parent company, so we have all of the assets underlying it. We do have a collection account into which our share of proceeds is paid, and that's used to make deliveries. It is one of the stream agreements where we actually put a leverage test into the document, so we have a leverage test that's very similar to the bank's, but it's independent of the bank agreement. So, that's some background on where we stand.

Cosmos Chiu
Bill, so not saying it's going to happen, but in the case where something does happen to New Gold, what kind of protection to you have? Where would you rank?

Bill Heissenbuttel
We rank with the—the bonds and the bank facility are both unsecured.

Tony Jensen
We're pari passu at the top of the food chain right now.

Cosmos Chiu
Got you. Okay. Then, maybe again on Rainy River, could you remind us in terms of how much you paid for that stream, and how much cash flow has been returned so far?

Tony Jensen

Well, we're very early days in the cash flow return. I might stall a little bit and see if Karli can come up with that figure either now or a little later in the call. We purchased that $175 million, Cosmos.

Cosmos Chiu
Okay, so the bulk value today is still pretty close to $175 million.

Bill Heissenbuttel
Yes. I believe at the end of June, we had gotten about 4% of the advance payment back.

Cosmos Chiu
Okay. Then, the last question on Rainy River here is given the news item that happened last week, given the update coming from New Gold, again maybe it's still early days, but is there any potential that you need to test it for impairment, much like what you did with Pasqua last year?

Tony Jensen
You know, Cosmos, we have taken a look at that new technical report that came out, and we actually look at the contained gold being about 10% higher throughout the entire life of mine plan and what we actually did our work on back a few years ago. So, you do see a little bit less production in the first few years, and then the higher production later on in the portfolio, but we're not at all concerned on our carrying cost on the asset at this point.

Cosmos Chiu
Okay. Under accounting rules, what's a potential trigger for needing or leading to an impairment test? Is it if reserve resources come down, or is there some other trigger points as well?

Bill Heissenbuttel
There are a number of tests for impairment, but I think one of the key drivers is you look at the undiscounted revenue for cash flow that you expect to get from the asset. If that is below your carrying value, you then have to do a discounted analysis, and that's really what we did with Pasqua just a couple of quarters ago.

Tony Jensen
It's different than IFRS. We're able to take a look at the cumulative cash flow versus our carrying cost and then if that's below the carrying cost, then we look at the discounted rate.

Cosmos Chiu
So, I guess from that perspective, you've looked at the Rainy River technical report that came out two days ago. You've looked at projections in terms of cash flow at this point in time. You're very comfortable with your book value that you have in place.

Tony Jensen
We are.

Cosmos Chiu
Okay. Maybe switching gears a little bit here onto Mount Milligan, you know the water issue here, I was there myself five, six years ago and never could have thought that that was going to happen but, Tony or Bill, how close are you to the situation here? Have you been to the site recently, and sort of what's your perspective on this?

Tony Jensen

Well, Mark Isto is our VP of Ops, and he is very, very close to this. I think I'll just turn that question over to him because he knows what's going on there.

Mark Isto
Hi. It's probably been about a year since we've been to site, but we get a regular update as far as what's happening with the operation in general and specifically about the water situation, so I would say that we got enough details to feel comfortable. We understand the situation, and also feel comfortable that the message track that Centerra has put out we fully understand it, and the permitting in the near term is the key issue on water sources that they, in fact, are using or have used last winter. So, we think it's a very straightforward plan that they too have in the near term to continue with steady-state operations.

Cosmos Chiu
Again, on the question of security, could you remind us what kind of security you have on the Mount Milligan stream?

Bill Heissenbuttel
We are secure, we are subordinated, and I just can't remember the basket that sits in front of us.

Tony Jensen
I think it's like $230 million or something that sits in front of us. We can sure get that for you, Cosmos.

Cosmos Chiu
Okay. So, Tony, on Mount Milligan, you're secured on the asset.

Tony Jensen
We are.

Cosmos Chiu
Okay, so it's not a similar situation to Rainy River.

Tony Jensen
No.

Cosmos Chiu
Okay. I got it.

Tony Jensen
That's correct.

Cosmos Chiu
Then, in terms of book value here, for Mount Milligan, could you remind us how much you paid for it and how much you've received so far?

Bill Heissenbuttel
The total investment was $781.5 million. I'm just trying to think on the return of the asset. I think it's over—

Cosmos Chiu
Is it $400?

Bill Heissenbuttel

I want to confirm 40%, but I want to confirm that number for you.

Tony Jensen
You'll be able to see that in our financials, right?

Bill Heissenbuttel
You'd see it in the net book value.

Tony Jensen
The net book value in the financials.

Cosmos Chiu
Okay. Again, no concerns about impairment at Mount Milligan?

Tony Jensen
No.

Cosmos Chiu
Okay. Maybe on a half-year note on Golden Star, it sounds like they've received a large injection of cash from La Mancha. Certainly, Tony, you were fairly close to Golden Star previously on the board of directors, not so much anymore. But would you say that's a positive, and if they do look at expansion potential of Wassa, what they call Wassa Deeps, is that going to benefit Royal Gold?

Tony Jensen
Absolutely. So, let me speak specifically on Royal Gold's behalf, and I encourage you to talk directly to Golden Star for their comments, but we just view this a very good suite of assets. We're very pleased to be associated with it. It's just amazing the endowment of this area in the Ashanti Belt.

You know that the B Shute [indiscernible] continues to plunge, and they continue to intersect some pretty exciting grades there. It's probably plunged deep enough to think about some other access other than a ramp, and perhaps a shaft would be in place. What I get excited about is—Mark, you'll have to help me out with the throughput, but I think what is their underground ramp throughput—

Mark Isto
They're doing 2,500 tons a day.

Tony Jensen
Oh, 2,500. The mill has capacity for 7,500. So, is there another way that you could either increase the ramp production, or supplement that with a shaft production? It could be very, very exciting for that asset. It's already a large producer, but it could even be larger. As I said in my prepared remarks, Prestea is still ramping up, and they're still learning how to do things with the [indiscernible] raises, but we don't see any reason why that isn't going to be a very, very successful operation. To the extent that they could find some additional surface ores to supplement the high-grade underground, there's plenty of mill capacity there available.

So, that's just speaking about the two assets, but then beyond that, there has been and there continues to be all kinds of other targets and resources throughout their property package.

Cosmos Chiu
I think they've talked about Father Brown and some of the other satellite deposits.

Tony Jensen
Right. Father Brown was a very, very successful operation for them a few years back and an open pit scenario, so they're just looking at the underground now. But combined, those assets with liquidity to be able to do things, that's really good for Royal Gold.

By the way, to answer your other question, we have our interest on all of their entire property position.

Cosmos Chiu
Got you. Great. Thanks, Tony, team, and Bill and Karli, and thanks for answering my questions.

Tony Jensen
Thanks, Cosmos. Appreciate the questions.

Operator
As a reminder to everyone, it is star then one if you would like to ask a question today. Our next questioner today will be Lucas Pipes with B. Riley FBR. Please go ahead.

Lucas Pipes
Good afternoon, morning, everybody.

Tony Jensen
Hi, Lucas.

Lucas Pipes
Tony and team, I was intrigued by some of your comments in your prepared remarks about how the market fundamentals have impacted the way some miners are looking at financing. I think you even mentioned some companies are looking to go private. Can you elaborate on that, and would Royal Gold play a role in that, or could Royal Gold play a role in that?

Tony Jensen
I don't want to speak for companies and say that some companies are looking at that. What I said is I would not be surprised if when there's very high-quality companies, and you can look through your own portfolio there and see which ones might be in this basket, but when you're trading at 0.5 times NAV, it's awful tempting to capture that value internally. There are some good assets that are trading at that kind of level.

I wouldn't be surprised if that were to happen, and to the extent those kinds of companies want to continue to grow, their access to other capital is limited. So, what I really want to emphasize here is that this financing product that we have is very malleable. We can fit into a lot of different scenarios, market scenarios, and we've moved out of the scenario where we're restructuring balance sheets. Now, we've moved into another very unique, potentially unique, period of time where I think we can be relevant. So, those are the nature of my prepared remarks.

Lucas Pipes
Got it. Are you seeing increased imbalance given the change in the market over the past couple months?

Tony Jensen
Look, we think about things very creatively here. We don't really wait for imbalance to happen. We actually would consider strategies and then execute on the strategies. So, yes, we've seen a reasonable amount of traditional imbalance, but some of the more creative things we're acting more like an investment banker.

Lucas Pipes
Interesting. Okay. Then, there were a number of questions on impairments from the prior participant. Maybe you can just kind of remind us how you're reporting under US GAAP and how that would be different from companies reporting under IFRS. Maybe that's part of why we got so many questions on that.

Tony Jensen
Do you want me to take that, Bill, or do you want to take it? Okay, so look, IFRS, I think you have to look at the discounted cash flow for those assets and compare them to your carrying costs. Under GAAP we look at the cumulative cash flow and compare it to the carrying costs. Then, if the cumulative cash flow is less than the carrying costs, then we have to use discounted cash flow theory to determine what the impairment might be.

So, that's the nature of the difference, and then I guess the other, going down the road just a bit further with that, the other difference would be under IFRS I understand you can write down an asset and then later write it back up. We don't have that ability to write up later on under GAAP.

Lucas Pipes
So, if we apply this to Rainy River, for example, given that the cumulative amount of gold—I think you mentioned even increased 10%, and since you're not discounting that stream by any rate, just a cumulative amount of cash flow coming from this asset is unchanged or even higher than before, hence no impairment even if the timing of those cash flows have changed.

Tony Jensen
You know—I'm looking to Karli for this collaboration, but New Gold marks-to-market their liability to us on a quarterly basis, I believe. It's how they treat their accounting. We paid $175 million for that asset, as I mentioned, and I think they marked-to-market our interest debt about $280 million. So, as I said earlier, at this time, we have no concerns about our carrying costs on Rainy River.

Lucas Pipes
Got it. Okay. That's very hopeful. I appreciate that. Best of luck.

Tony Jensen
Thank you, Lucas.

CONCLUSION

Operator
This will conclude our question and answer session. I would like to turn the conference back over to Tony Jensen, President and CEO for any closing remarks.

Tony Jensen
Thank you, operator. We really appreciate all of you taking the time to join us today and appreciate your interest and continued support of Royal Gold. We look forward to a very exciting first fiscal quarter for Royal Gold, and we'll hopefully have some very interesting things to talk about at Peak Gold and others. We look forward to updating you as those news events come available. Thank you.

Operator
The conference has now concluded. Thank you for attending today's presentation. You may now disconnect your lines.