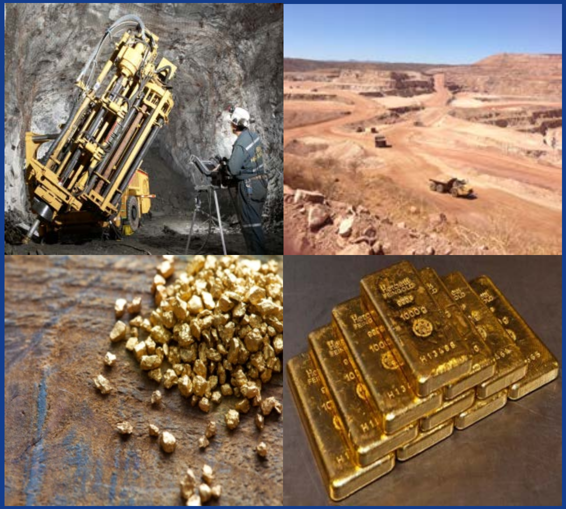
Gold: Escape from the Matrix

Grant's Conference
October 20, 2015



John Hathaway

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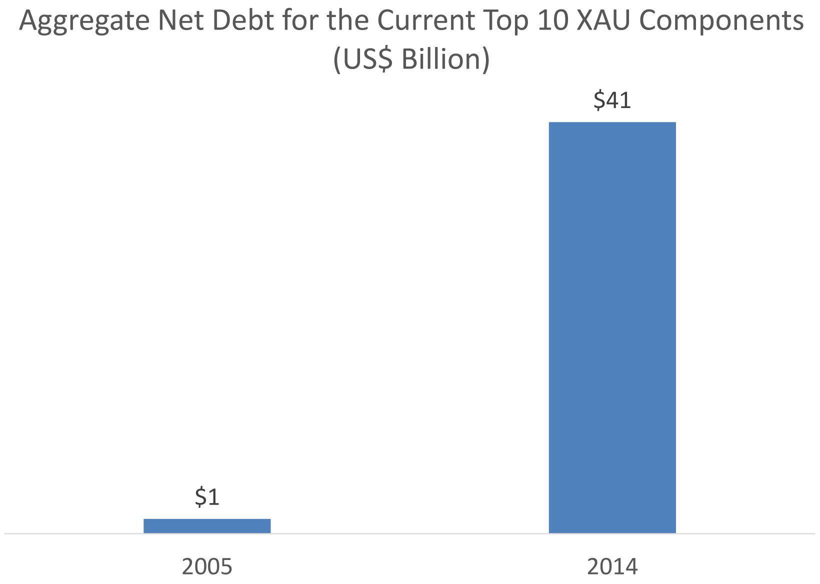
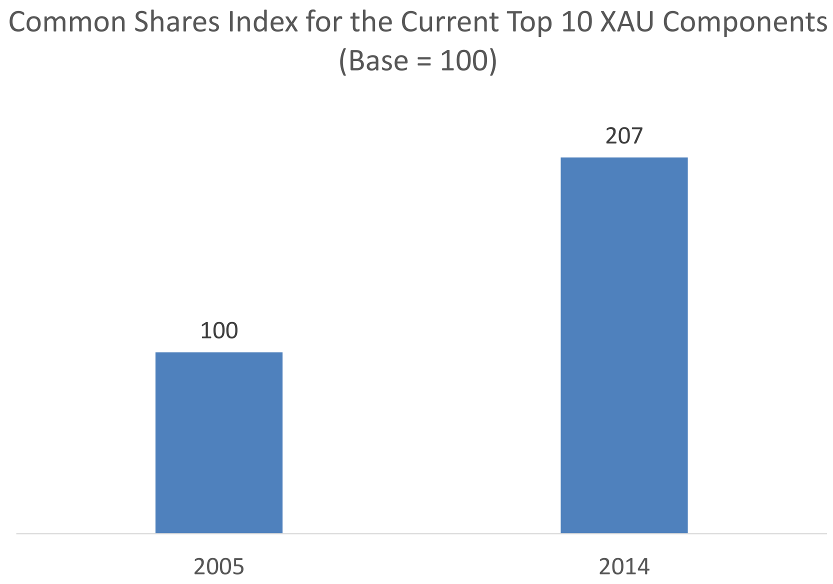
(I) The Business of Gold Mining: Coping with Nuclear Winter

Gold Mining Industry has Carpet Bombed Investors with Paper

- Aggregate debt increased from $1 billion in 2005 to $41 billion at year end 2014
- Common shares outstanding more than doubled (2.07x)
- Estimated gold production rose from 38 Moz to 43 Moz (+13%)
- Gold production per share declined from .38 oz to .21 oz (-45%)

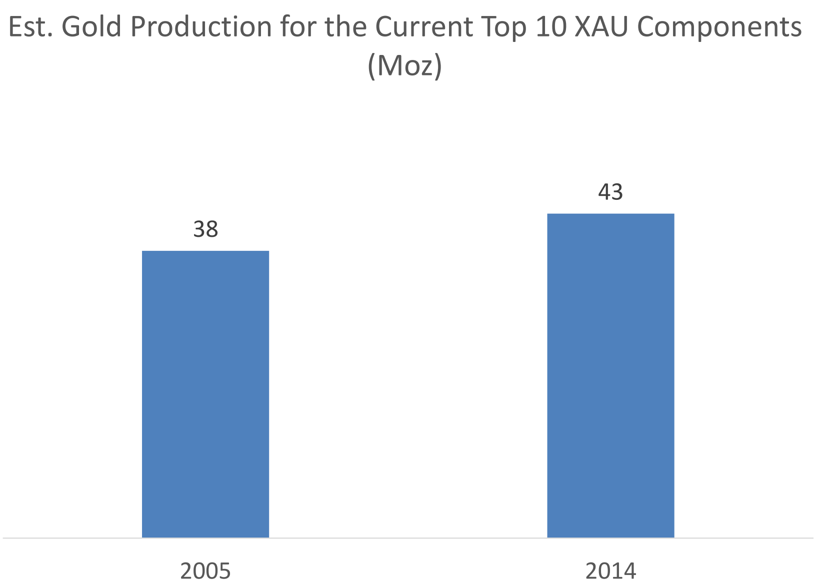


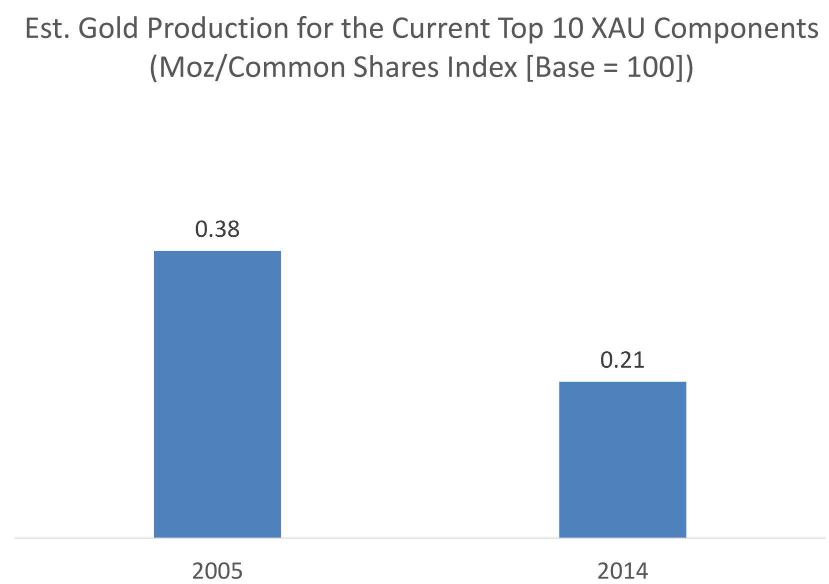


Source: Bloomberg, FactSet

Industry Estimated Gold Production

- Significant increases in capital have spurred little production growth
- Share issuance has severely diluted equity holders

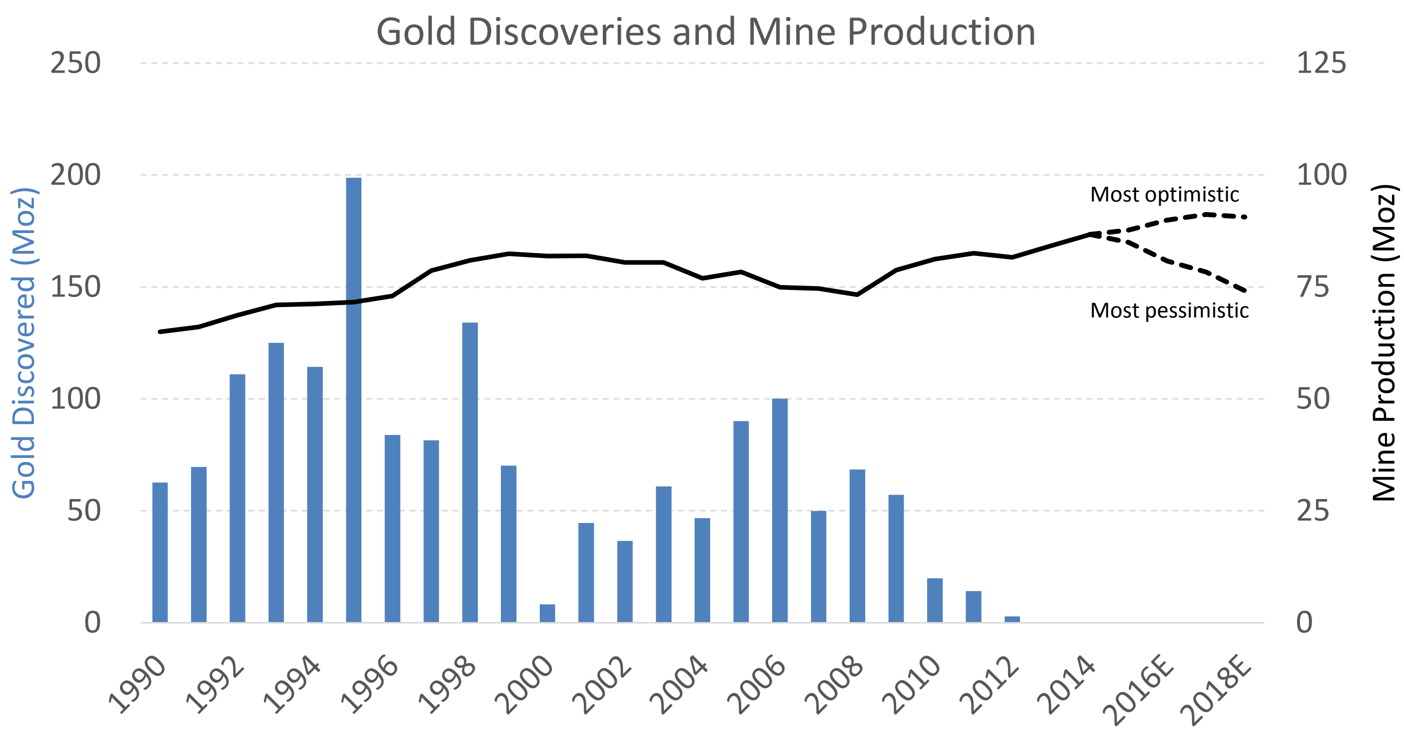




Note: Estimated gold production = revenue divided by average gold price
Source: Bloomberg, FactSet

Gold Discovery Rates

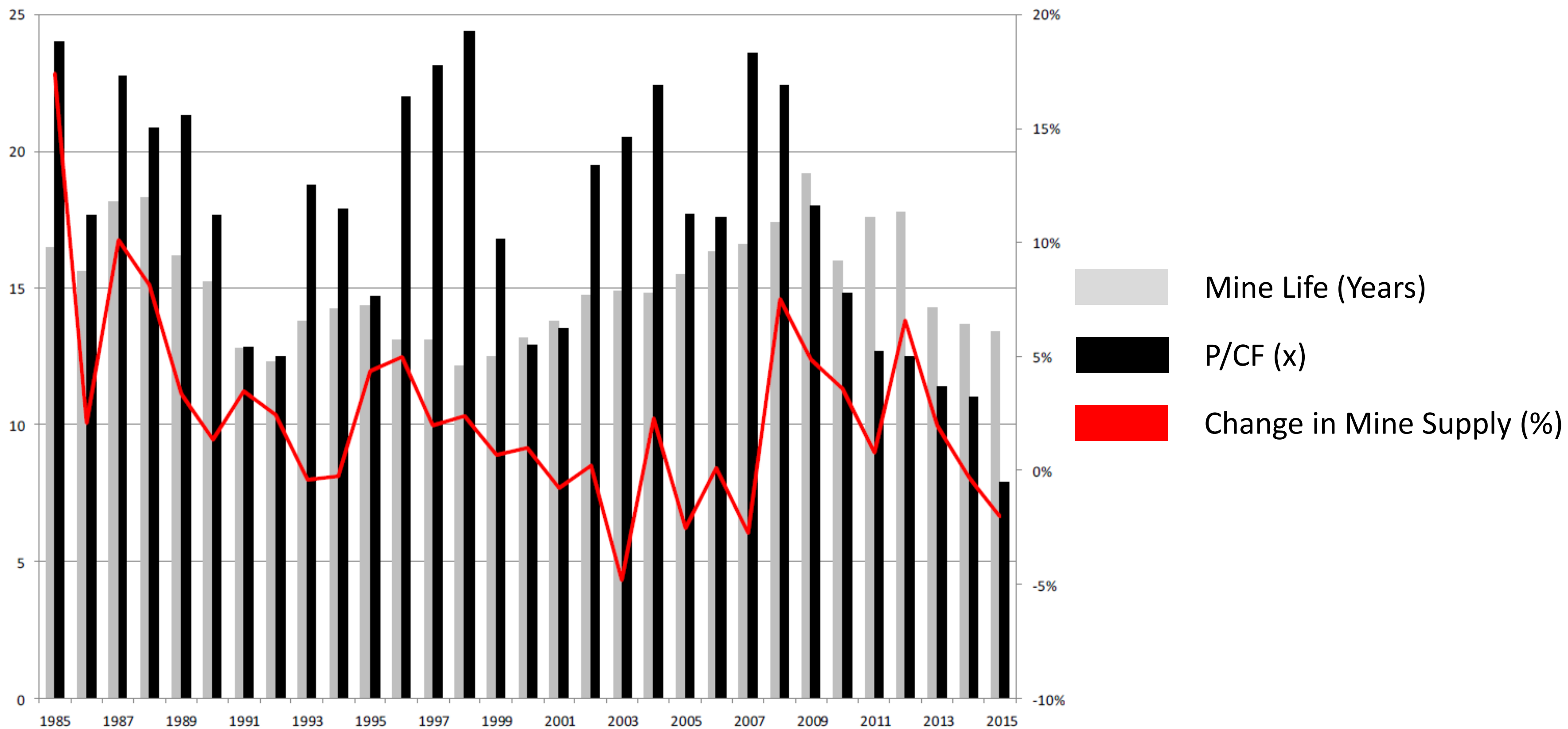
- Gold discovery rates will likely remain low without a positive change in the gold price or a change in exploration methodology/technology



Note: Gold discovered is based on deposits containing >2 Moz
Source: BMO Capital Markets, Credit Suisse, SNL Financial

Mine Life

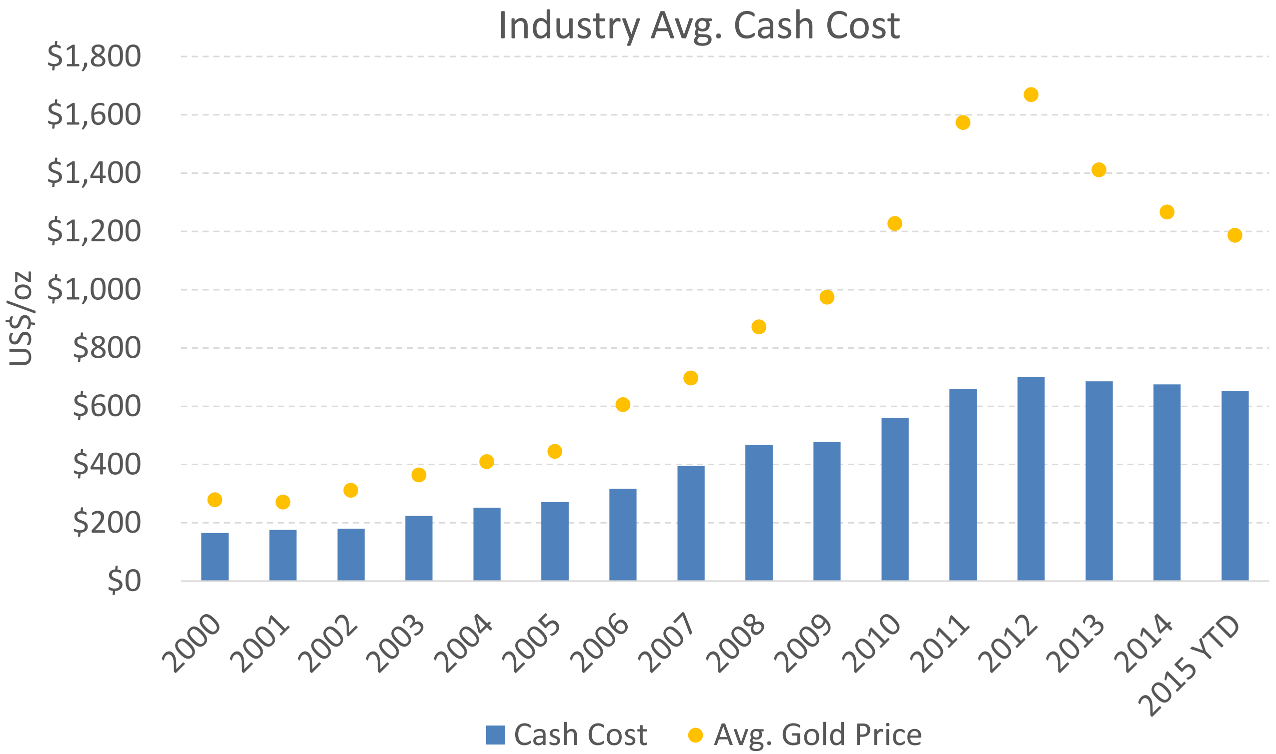
- Mine life in the gold industry is currently 13 years, which is one of the lowest levels over the past 30 years



Source: Scotiabank

Mine Operating Costs

- Cash costs have been declining recently due to beneficial foreign exchange rate movements, lower input costs, and increased productivity



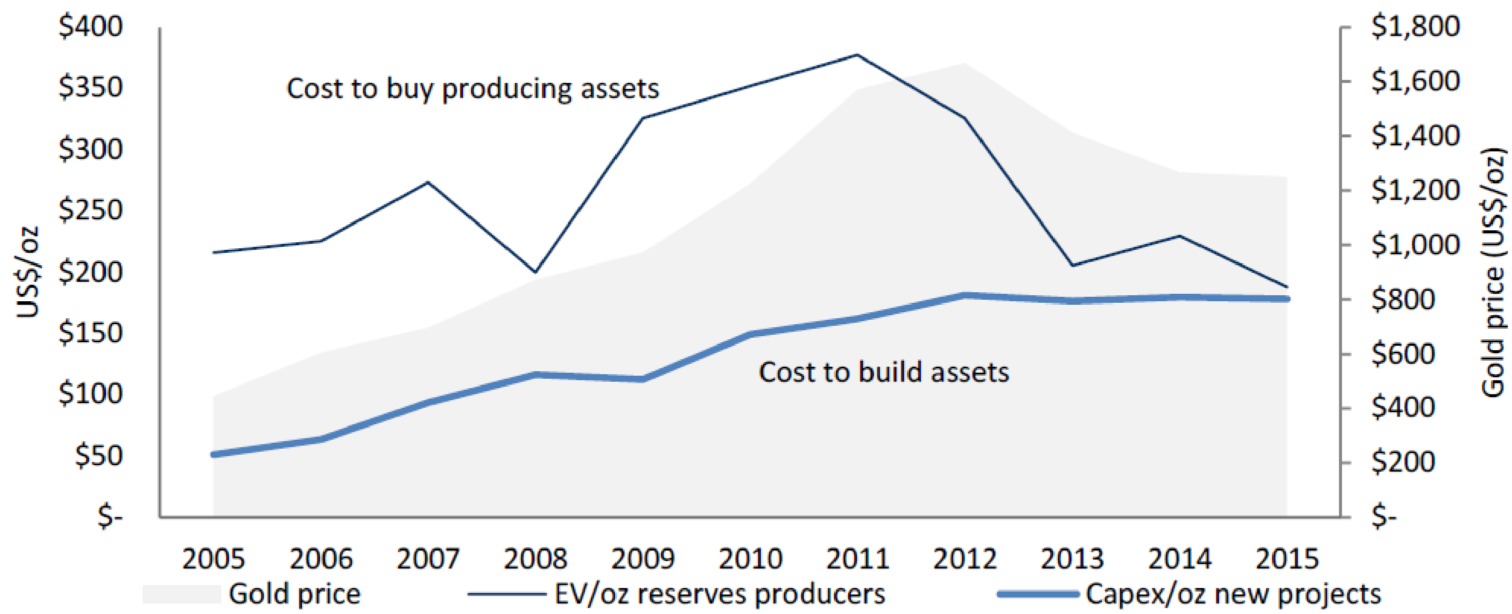
Source: Scotiabank

Cost per Ounce to Buy vs. Build

- It makes little sense to develop new gold mines today because you can now buy producing ones at a similar cost
- Industry is retrenching; M&A, asset divestitures on the increase

Cost to buy producing assets converging with cost to build assets

LHS: EV/oz reserves for producing companies vs. capex/oz to build new projects



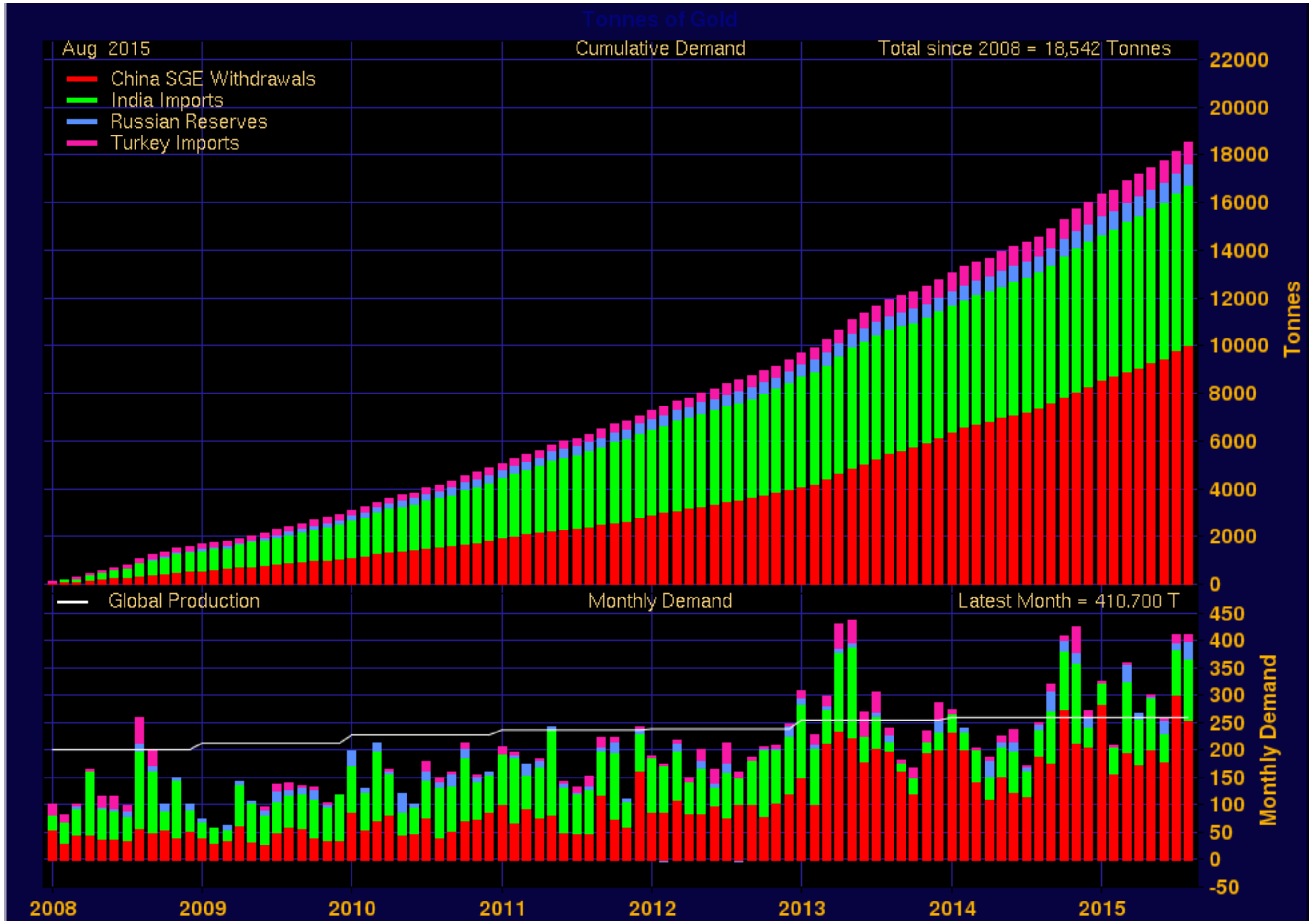
Source: RBC Capital Markets

Silver Linings

- Industry is not monolithic; it is possible to identify value creators
- Renewed focus on balance sheet and capital allocation discipline
- Current environment allows accretive deal making

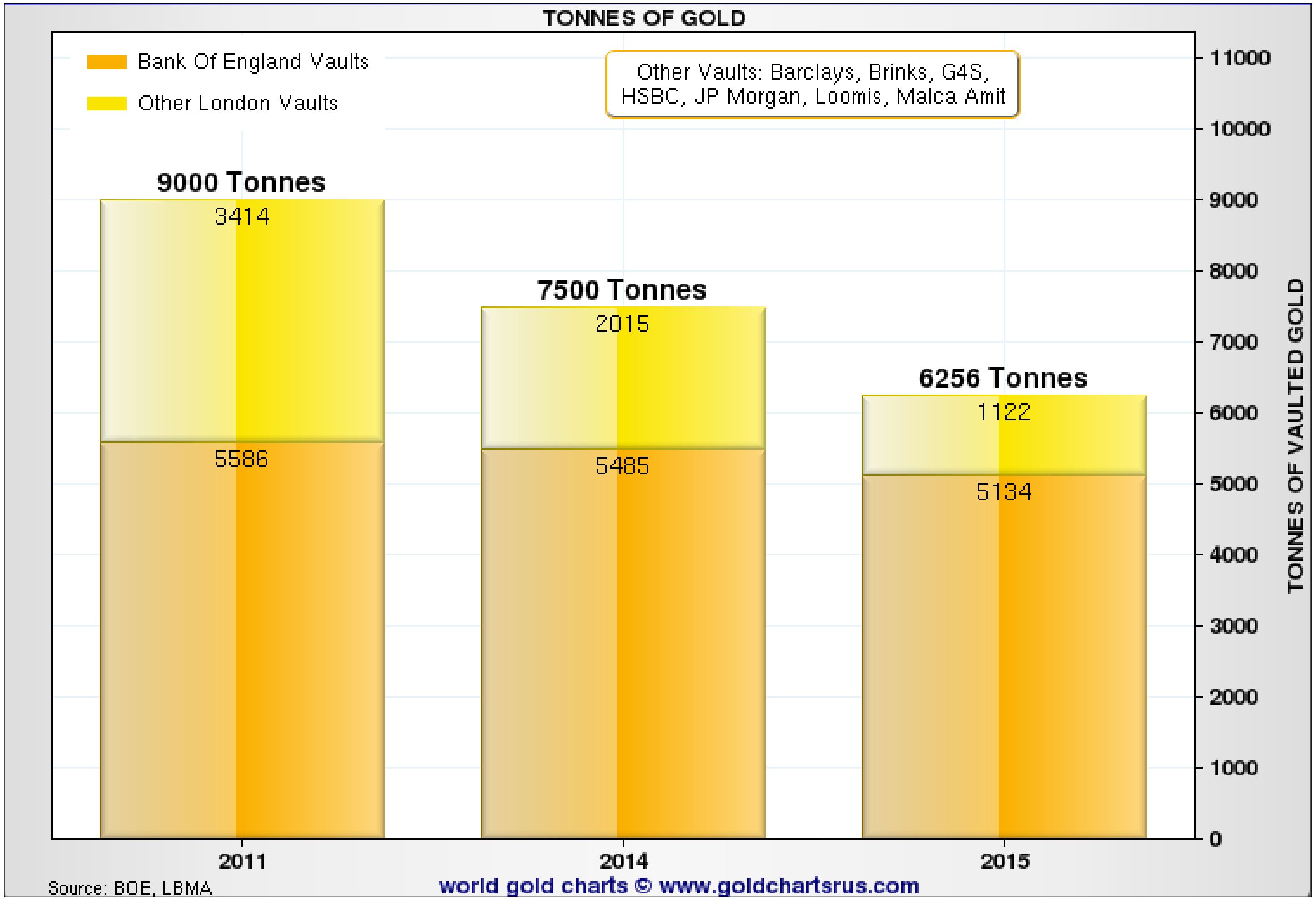
(II) Synthetic Gold: Utopia for Alchemists

Silk Road Gold Demand

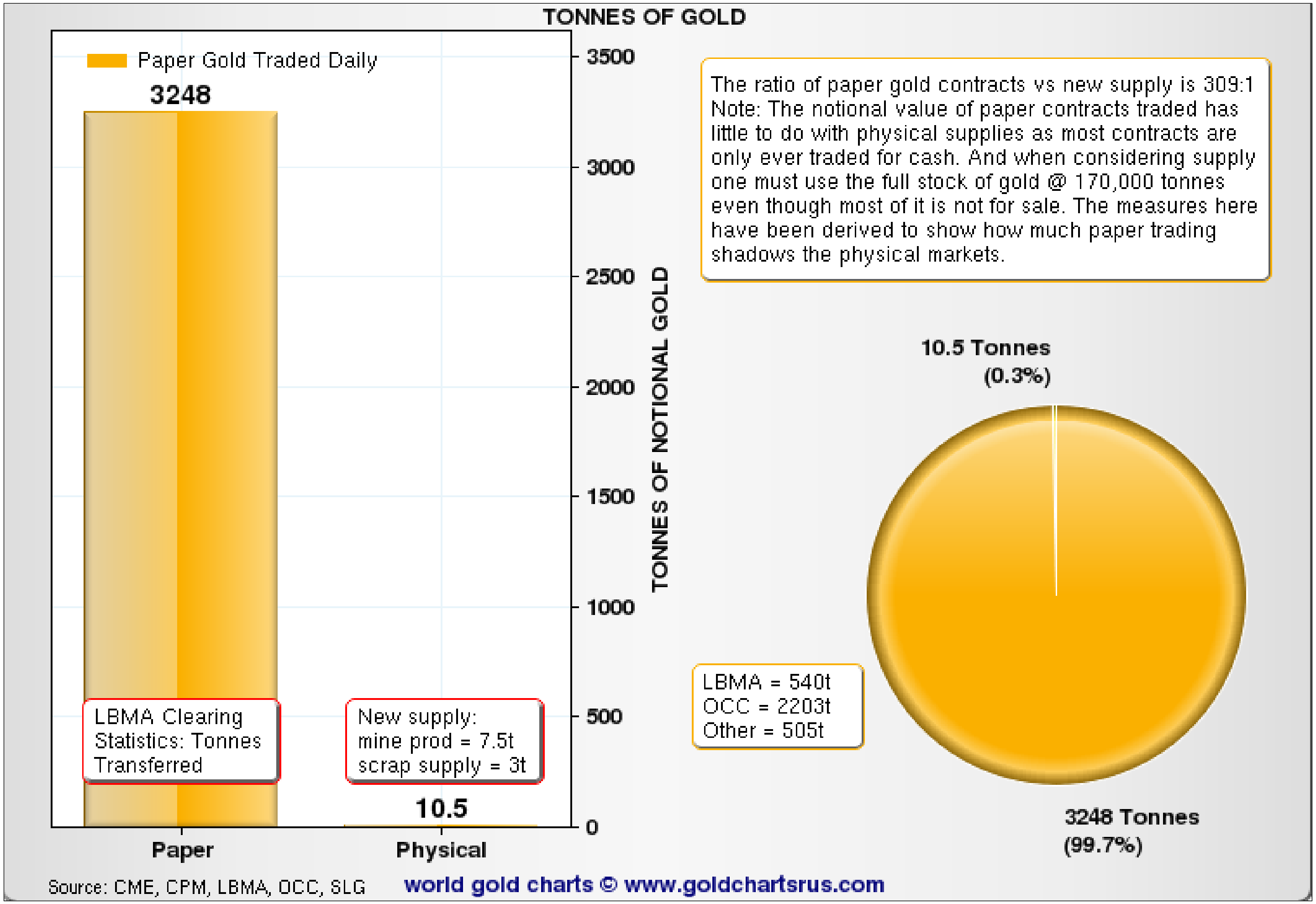


Source: Sharelynx

LBMA Vaulted Gold in London



Notional Gold Paper Trading – Daily Average



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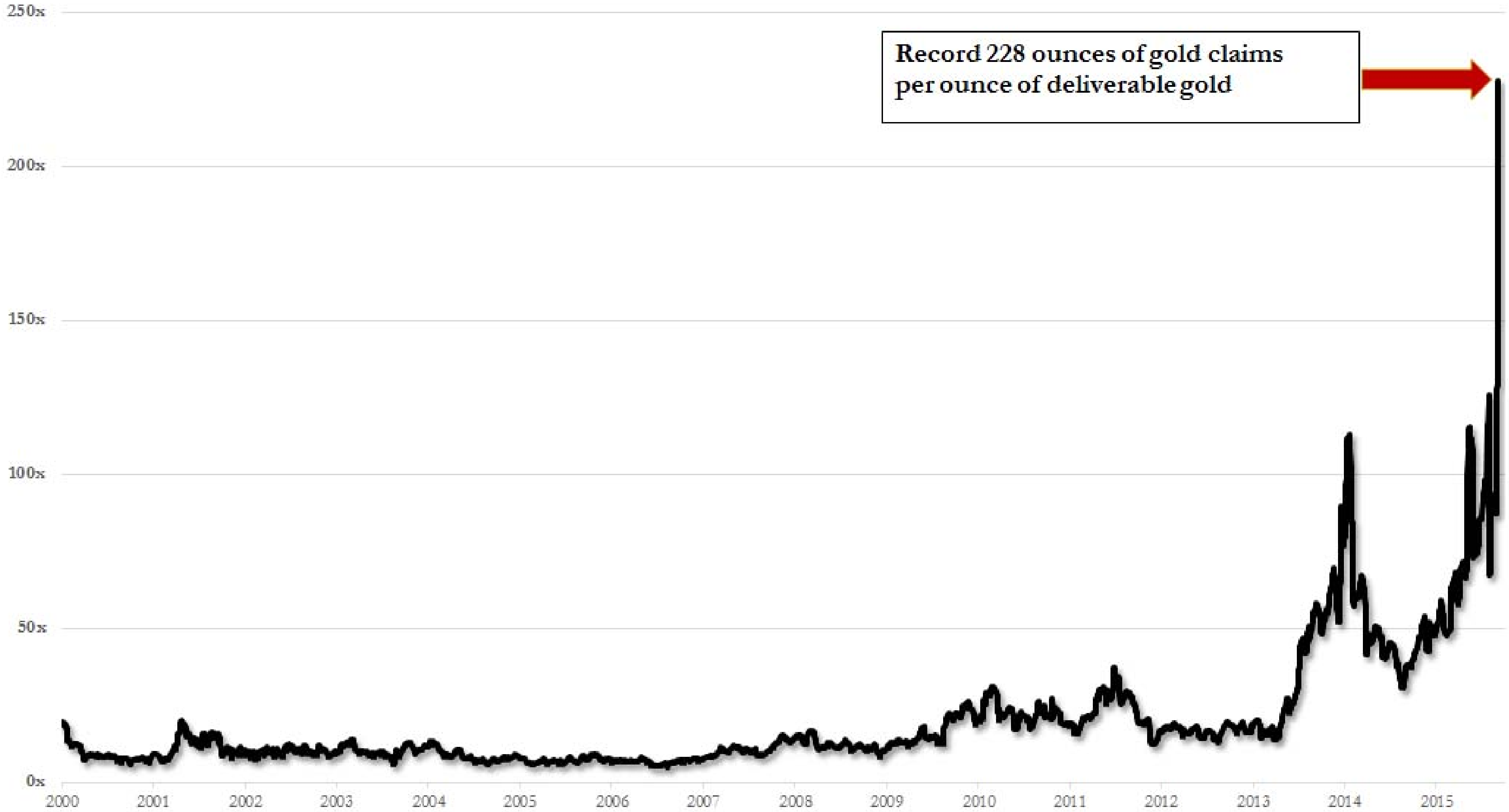
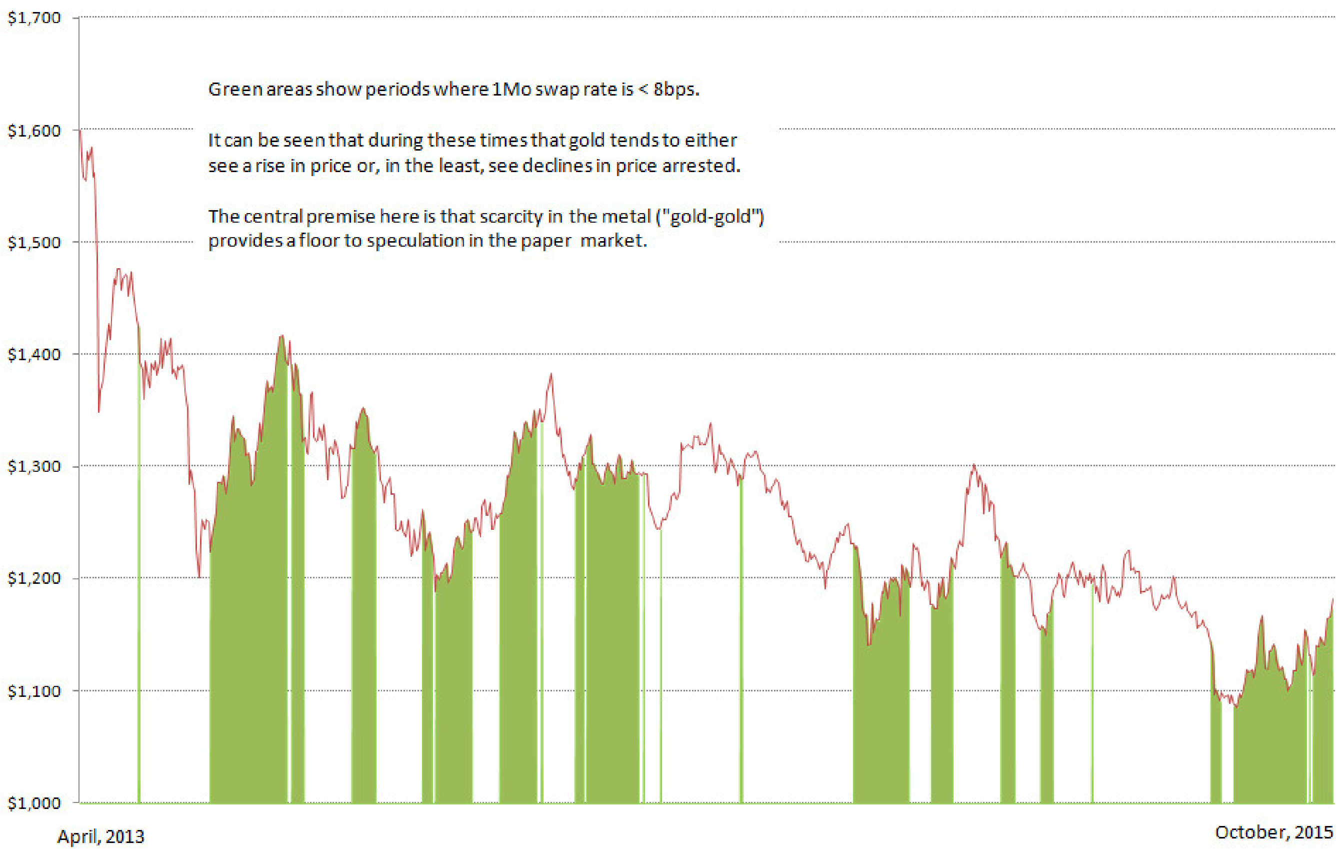
Comex Gold Cover Ratio
(Open Interest/Registered Gold)



Source: COMEX, Zero Hedge

Indication of Possible Stress

- Gold swap rates indicate tightness in supply of physical gold



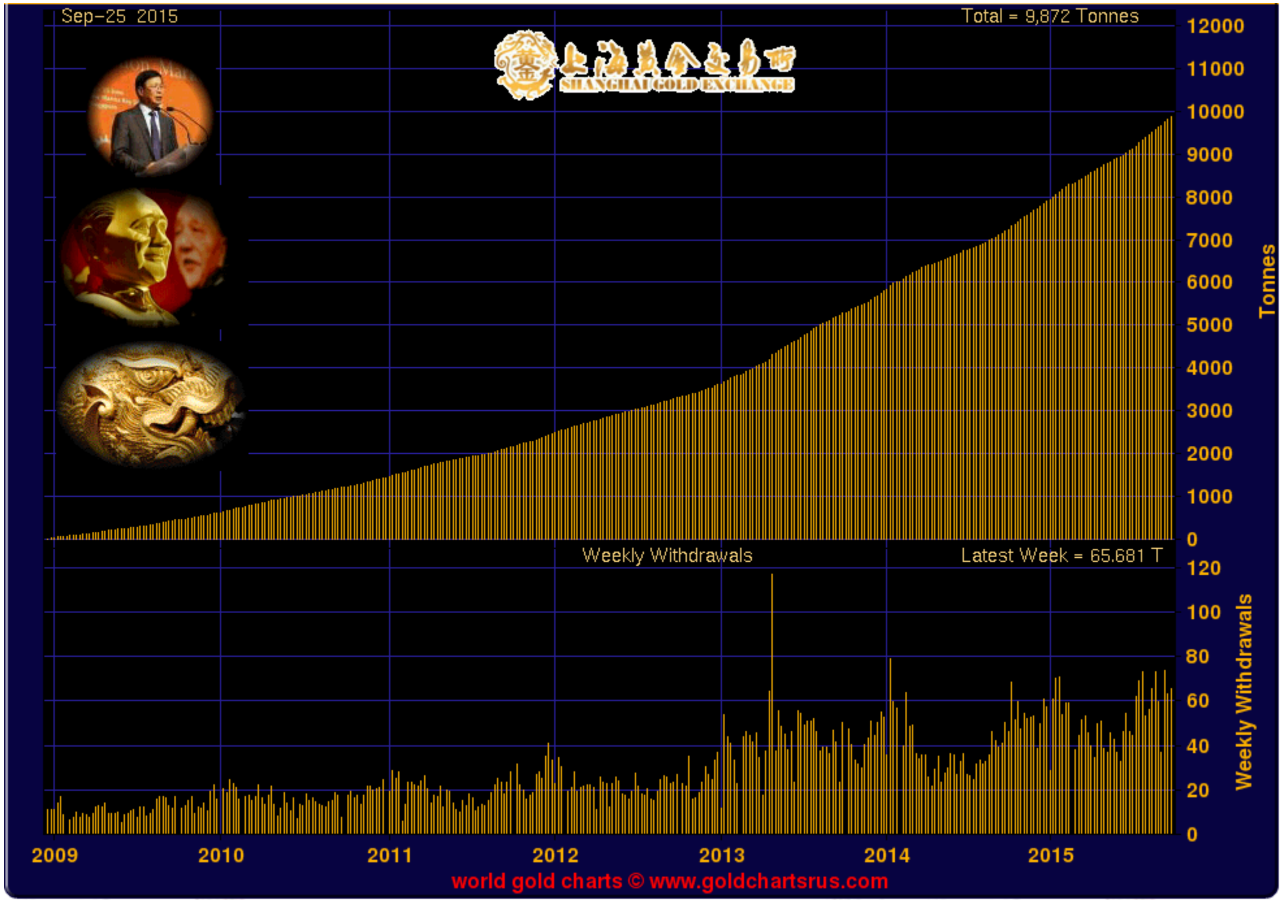
Source: Pollitt & Co. Inc.

(III) The Gold Market: A Worm That Must Turn

- Fed credibility
- Gold mine supply drought
- Gold drain from West to East
- China ??? SGE withdrawals
- ETF AUM ramp
- Market psyche

Shanghai Gold Exchange Gold Withdrawals

- Cumulative 10,000 tonnes over 7 years, about 50% of global production



(IV) Ideas

Option Value –
NovaGold Resources Inc. (NG - $3.76)

- Exploration projects in a safe jurisdiction with a large in situ gold resource can provide long-term and low cost option value to the gold price
  - NovaGold's primary asset is a 50% interest in the Donlin project located in Alaska, which could produce 550,000 oz/yr of gold (attributable) for 27 years if developed
  - Also owns 50% of the Galore Creek project
- A 10-year call option to purchase 100,000 oz of gold with a US$1,340/oz strike would cost US$394/oz today
  - This contract is illiquid and potentially unattainable in the market

	NovaGold Resources Inc.		10-yr. Call Option for 100,000 oz	
Option cost	EV/oz	US$70	Option cost/oz	US$394
Strike price	Initial capex/oz	$214	Strike price/oz	$1,340
	Oper. cost/oz	$584		
	Sust. capex/oz	$115		
	Total cost/oz	US$983	Total cost/oz	US$1,734

Source: Morgan Stanley, NovaGold Resources, Tocqueville

Value Added –
Torex Gold Resources Inc. (TXG - C$1.39)

- Torex is adding value by exploring for and developing gold projects in Mexico
  - Production at El Limon/Guajes will begin in Q4 2015 and is expected to realize 360,000 oz/yr Au @ US$530/oz Au (or US$637/oz AISC) over its 10 year life
  - Its second potential mine (Media Luna) has a significant resource adjacent to El Limon/Guajes and could share the infrastructure
    - Development is likely to take ~4 years and cost US$482M to achieve production of 313,000 oz/yr AuEq @ US$572/oz AuEq (or US$636/oz AISC) over its 13 year life
  - Potential exists for further organic growth through exploration
- Gold companies typically experience a re-rating as they transition from development to production
- Market cap. = US$800M; cash = US$143M; debt = US$228M; 2017E P/CF = 5.8x

Note: AISC = all-in sustaining cost
Source: FactSet, Torex Gold Resources

Managed Value – Goldcorp Inc. (GG - $14.35)

- Goldcorp is a low cost gold producer engaged in the acquisition, exploration, development and operation of gold properties in Canada and Latin America
- 2015 Gold production is expected to be 3.45 Moz @ US$875/oz AISC
  - Production will be sourced from Canada (38%), Mexico (29%), Argentina (15%), Dominican Republic (13%), and Guatemala (5%)
- Has a good mix of production, development, and exploration assets
- One of the few large gold producers with a reasonable balance sheet
- Market cap. = US$11.1B; cash = US$0.9B; debt = US$3.5B; 2016E P/CF = 6.9x

Summary

- Gold is cheap because risk is mispriced
- Supply of physical is constrained
- Paper market is a potent flywheel in either direction
- Fed cannot normalize interest rates
- Catalyst for directional change will be a bear market and concurrent, widespread loss of confidence in central banking
- Gold mining equities offer dynamic exposure

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