Royal Gold

Fiscal 2018 Second Quarter Conference Call

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CORPORATE PARTICIPANTS

Tony Jensen - *President and Chief Executive Officer*

Bill Heissenbuttel - *Vice President, Corporate Development*

Stefan Wenger - *CFO and Treasurer*

Mark Isto - *Vice President, Operations*

Karli Anderson - *Vice President, Investor Relations*

PRESENTATION

Operator
Good afternoon and welcome to the Royal Gold Fiscal 2018 Second Quarter Conference Call. All participants will be in listen-only mode. Should you need assistance, please signal a conference specialist by pressing the "*" key followed by "0." After today's presentation, there will be an opportunity to ask questions. To ask a question, you may press "*" then "1" on your touchtone phone. To withdraw your question, please press "*" then "2." Please note this 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
Thank you. Good morning and welcome to our discussion of Royal Gold's second quarter fiscal year 2018 results. This event is being webcast live, and you'll 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, Vice President, Corporate Development, Stefan Wenger, CFO and Treasurer, Mark Isto, Vice President of Operations, and Bruce Kirchhoff, Vice President, General Counsel and Secretary.

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 the 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.

Now, I'll turn the call over to Tony.

Tony Jensen
Thanks, Karli, and good morning. I'm not able to be with the team in Denver, so I just have a few brief opening remarks. Bill is going to give you an update and overview of the quarter followed by Stefan with a financial update, and then we'll open the lines for a Q&A session.

But, before we do that, let me just emphasize a few points. First, today, we're reporting another solid and steady quarter of good operating results, driven by volume and price. Second, our financials are reflective of the tax reform recently passed in the United States, and we have adjusted our financial statements accordingly. While this resulted in higher effective tax rates for the quarter, we welcome the long term benefits of the reduced corporate taxes going forward.

Third, we are pleased that Mt. Milligan is operating again, albeit at reduced capacity. We expect lower deliveries from Mt. Milligan principally in the September quarter due to the current water restrictions at the site. And finally, fourth, we continue to generate strong cash flows, which we are using to strengthen our balance sheet for future acquisition opportunities.

I'll turn the call to Bill.

Bill Heissenbuttel
Good morning and thank you for joining the call. I'll begin on slide four. We delivered continued strong operating performance in our second fiscal quarter. We recorded high single digit

increases in revenue, cash flow and GEL volume from the year ago quarter, driven by a higher gold price, which was up 4% from a year ago, increased gold production at Andacollo and Wassa and Prestea and our newest operating property Rainy River.

Like all other US companies, we were required to recognize the impact of the new US tax legislation in the quarter in which it was enacted. Our reported loss of $0.23 per share reflects the impact of US tax reform and also the effect of a currency election at one of our Canadian subsidiaries that should help reduce volatility in our tax rate but which also had a non-cash impact to our reported earnings per share. Stefan will provide more details on that in a moment.

In such a noisy quarter, I'll highlight that our adjusted earnings of $0.41 per share was right in line with consensus and consistent with our performance over the last few periods.

Our cash flow is dedicated to the pursuit of new opportunities, the payment of dividends and debt reduction. We paid out $16 million in dividends in the second quarter, which is equivalent to a 21% cash flow yield.

We reduced $50 million of debt in the second quarter, the fourth straight quarter in which we've paid down debt, and the outstanding balance under our revolving credit is now $150 million. And our balance sheet is strong, and we have about $975 million of total liquidity.

Onto slide five - we've provided some updates on our producing properties. I'll start with Rainy River, which is our newest producing property. Rainy River began production just a few months ago. Commercial production was achieved in mid-October and New Gold announced that the milling rate for December averaged 21,000 tons per day, which is the nameplate capacity for the facility. In total, the mine produced approximately 37,000 ounces of gold in its first quarter of operation.

At Wassa and Prestea, Golden Star's production of 267,000 ounces of gold allowed the company to achieve its full year 2017 gold production guidance. Production increased 38% for the year and 34% for the fourth quarter relative to the same period in 2016. Wassa underground grades improved during the quarter, and the company was able to extend the expected contribution of the Prestea open pits to mid-calendar 2018.

Golden Star is expecting to produce 230,000 to 255,000 ounces of gold in calendar 2018, a slight reduction from last year as they focus on higher margin underground ore as mill feed. And under our streaming agreement, our Gold Stream percentage increased to 10.5% on January 1st of this year.

Finally, at Mt. Milligan, Centerra restarted mill processing operations at partial capacity earlier this week following a temporary shutdown at the beginning of the year. During that shutdown, Centerra completed a number of steps to increase the flow of water into the tailing storage facility from which Mt. Milligan draws all of its water requirements to supply milling operations.

These activities included adding pumps to existing water wells, increasing pump sizes to increase the flow rate and drilling additional wells. Centerra expects to resume milling operations at full capacity in April when additional fresh water becomes available from surface runoff after the spring melt.

As a further longer term mitigation measure, Centerra received an amendment to Mt. Milligan's environment assessment to allow pumping of water from a nearby lake.

Due to the timing of shipments and deliveries of gold and copper, the impact of the temporary shutdown is likely to be reflected in Royal Gold's mid-calendar 2018 results as some of the deliveries of gold and copper that were expected in the June through August 2018 period will be deferred.

Sources of embedded growth in the portfolio are summarized on slide six. They include catalysts over the next year, including Rainy River, Cortez Crossroads and the Penasquito Pyrite Leach project as well as longer term development activity at the Peak Gold joint venture.

For example, New Gold expects to deliver approximately 21,500 ounces of gold and 185,000 ounces of silver to us in Rainy River's first full year of production. We expect Rainy River to be a top ten net revenue generator for us in calendar 2018.

At Cortez Crossroads, Barrick reports that waste stripping is progressing with initial production expected in late 2018.

At Penasquito, Gold Corp reported that construction of its Pyrite Leach circuit was 62% complete as of mid-January. Commissioning is expected later this year. Once the Pyrite Leach project is in operation, 40% of the gold and 48% of the silver now reporting to the tails are expected to be recovered in the new circuit.

Finally, we are continuing with exploration at our Peak Gold joint venture in Alaska. As a reminder, in June 2017, we published a 1.3 million ounce gold resource at 3.5 grams per ton, and the resource also has 5 million ounces of silver grading 14 grams per ton and 40 million pounds of copper grading 0.16%. We have commissioned a preliminary economic assessment, and we expect it to be completed in the third calendar quarter. We look forward to sharing the results with you later this year.

Turning to slide seven, I'd just like to point out a few smaller project developments within our Royalty portfolio. We have 194 properties in the portfolio, of which 39 are currently producing. Amongst our 23 development stage royalty interests, we've seen development and permitting activity at LaRonde Zone 5, Back River, Relief Canyon and Hasbrouck Mountain. As development and permitting activity progresses, these royalties represent future revenue generation potential. And while none of these royalties would be top ten contributors to our net revenue, they represent examples of the benefits to us of having such a diverse royalty portfolio.

I'll turn the call over to Stefan for a financial update.

Stefan Wenger
Thanks, Bill. I'm on slide eight. In Q2, we delivered another solid and steady quarter with revenue of over $114 million and operating cash flow of $76 million. While we reported a loss per share of $0.23, adjusted results of $0.41 were up 16% from the prior year quarter.

Tax reform and other adjustments created a bit of noise in our reported numbers, so I'll walk you through those changes here. During the December quarter, we recorded onetime tax charges totaling $42.3 million or $0.64 per share related to new tax legislation and to a functional currency election for tax purposes. Of the $42.3 million, $26.4 million was associated with tax legislation and $15.9 million was associated with the functional currency election. Only $11.5 million of these charges will result in cash tax payments to be paid over eight years while the remaining balance are non-cash. Absent the tax legislation and functional currency election, our earnings per share would have been $0.41 for the second quarter.

And now a bit more on the new tax law - on December 22, 2017, HR1, originally known as the Tax Cuts and Jobs Act, was signed into law in the United States. As a United States domiciled company, we expect that the new tax law will have a positive long term impact on Royal Gold's future financial results through the reduction in the US corporate tax rate from 35% to 21% and by allowing us to efficiently repatriate future earnings from our foreign subsidiaries, primarily from Switzerland.

However, upon adoption of the tax legislation, we were required to record a one-time repatriation tax of $11.5 million on deemed repatriated earnings of foreign subsidiaries and to reassess certain balance sheet assets and liabilities resulting in $14.9 million of additional tax expense.

In addition, at December 31, we recorded the effects of a foreign currency election to use the United States dollar as the functional currency for a foreign subsidiary that previously reported for tax purposes in Canadian dollars, which will reduce volatility in our effective tax rate in future periods.

Because of the tax charges noted above, our effective tax rate for the second quarter and the six months ended December 31 was 148% and 84% respectively. Absent the impacts of the tax legislation and the foreign currency election, our effective tax rate for fiscal 2018 to date would have been approximately 20%.

Moving to slide nine, we ended the quarter with nearly $975 million in total liquidity, an increase from $916 million last quarter. This includes approximately $125 million of working capital plus $850 million of revolver capacity. For the remainder of fiscal 2018, we expect to pay down debt aggressively, and absent any new transactions, we will fully repay the remaining $150 million outstanding under our revolver by the end of June at which time we expect our net debt to EBITDA ratio will be less than 1 times compared to the 1.3 times that we show currently.

On slide nine, there's a snapshot of our debt reduction efforts over the last four quarters. We've paid down $195 million on our revolver over the last 12 months with $50 million of that paid during Q2. As Bill mentioned at the outset of the call, we are focusing our significant cash flow on strengthening the balance sheet to prepare for additional opportunities to grow our business.

Following the repayment of our revolving credit facility, our only remaining indebtedness will be the $370 million of convertible bonds, which mature in June 2019. As you've seen, we've repaid about $200 million over the last year and will continue to use cash to repay our remaining indebtedness. We currently plan to repay the principle amount of the bonds in cash using availability under our $1 billion revolving credit facility as needed. As we have the ability to repay the outstanding principle balance of the bonds with proceeds from our long term revolving credit facility, we do not anticipate reclassifying the bonds as current on our balance sheet at June 30, 2018.

Delving into a few more details on slide 10, I've summarized our tax DD&A and dividend outlook for the remainder of fiscal 2018. For the last two quarters of 2018, we expect our effective tax rate to be between 17% and 23%, subject to any final revisions to our preliminary accounting for the tax legislation. DD&A for the second quarter was $469 per GEO and was $460 for the six months ended December 31. We continue to expect DD&A to be between $450 and $500 per GEO for our full fiscal year.

We've paid more than $31 million in dividends during the first half of fiscal 2018, resulting in a 21% cash flow payout ratio. On January 19, we paid the first quarterly installment of our $1 per share annual dividend, which represents our expected dividend level for calendar 2018.

Lastly, we are aware of Barrick putting out a release reclassifying the reserves at Pascua-Lama. We are evaluating that news along with any impact it may have on our carrying value.

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

Tony Jensen
Thanks, Stefan and Bill.

So, in summary, while the quarter had a couple of significant one-time events, we are pleased that the United States has modified its tax code to be more competitive internationally. From our point of view, these changes are a substantial improvement from the prior tax code and will be on balance positive for our business.

Near term catalysts to watch are the ramp-up of production at Mt. Milligan and Rainy River as well as the development projects underway at Cortez Crossroads and Penasquito Pyrite Leach, which we expect will start up in late calendar 2018 with revenue building into 2019.

In addition, we'll be speaking more about our Peak Gold joint venture in the coming quarters as we work through the preliminary economic analysis.

In closing, and as I mentioned earlier, Royal Gold has delivered another quarter of solid and steady operational performance, generated strong operating cash flow and continued to strengthen the balance sheet. We are positioning the company today to take advantage of future acquisition opportunities.

With that, operator, we will open the line for Q&A if we have any.

QUESTION AND ANSWER

Operator
Thank you. We will now begin the question and answer session. To ask a question, you may press “*” then “1” 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 “*” then “2.”

Our first question comes from Lucas Pipes with B. Riley FBR. Please go ahead.

Lucas Pipes
Hey, good morning, everybody.

Tony Jensen
Morning, Lucas.

Lucas Pipes
I wanted to follow up a little bit on the Pascua-Lama development, and specifically, I think you identified $417 million or so as the carrying value for your royalty interest as of December 31st. And on a percentage basis, by the accounting definition, what does this Pascua-Lama royalty represent roughly of your portfolio? Thank you.

Tony Jensen
Lucas, let me just explore the question just a bit more. Are you asking how much of the reserves does this make up of Royal Gold or what's the nature of your question exactly?

Lucas Pipes
No, the--so, you have a carrying value of $417 million.

Tony Jensen
Okay. Right.

Lucas Pipes
And what percent of your total carrying value across your portfolio does that represent? Thank you.

Tony Jensen
Okay, yeah. Thanks, Lucas, for the clarification. Stefan, do you have that percentage at your fingertips there?

Stefan Wenger
I can just give you the numbers. $417 million of our balance sheet that has $2.8 billion of mineral interest on it, so you can do the math there.

Lucas Pipes
Got it. And then how do you--sounds like--.

Stefan Wenger
And that's [indiscernible] value, just to be clear.

Lucas Pipes
Got it. And so, it sounds like you're still evaluating the situation. What are the potential pathways from here on forward with this particular interest?

Tony Jensen
Yeah, the first thing we need to do is understand the current circumstances upon which Barrick took their write-down and understand how the project looks at the present time. But, beyond that, we are very much looking forward to Barrick finishing up their underground study, and that seems to be their preferred pathway at this time. We don't have any particular guidance to provide you any further than what Barrick's given us and given the public, but I do know that there's a couple of additional Barrick public comments that'll be coming forward in their financial reporting, which I believe is as soon as next week. And then I think they also have an Investor Day on the 22nd of February, so we certainly will be looking for a little more clarification, as I'm sure you will, as well, Lucas.

Lucas Pipes
Yes, that's very helpful. Thank you. That makes perfect sense. And maybe switching over to Mt. Milligan, can you tell us, and maybe for the ones who don't follow Centerra, just a little bit of an overview as to what measures are taken to maybe provide a little bit of a longer term solution to the water issues? Thank you.

Tony Jensen
Well, look, we've been operating there for several years, and we haven't had a situation there in the past with regard to water, and it was bit of a combination of a number of years of very dry summers and then the very harsh winter weather that we received in December. So, the operation hasn't had a water balance problem in the past. But, having said that, with the work that is required now, the system would be even more robust because they'll have additional water wells that are permanently in place there in the pumps permanently in place as well as what we understand is probably a desire to have surface water permits for the longer term, as well. So, I think we'll have a much more robust water balance going forward than what the project even had in the past.

Lucas Pipes
Got it, got it. Thank you. And then maybe one last follow-up question on the Pascua-Lama side - any covenants tied to the net asset value, or would that be not impacting any of your debt instruments if they were a write-down?

Tony Jensen
Stefan?

Stefan Wenger
This is Stefan. There are no covenants tied to net asset value. Our only covenants are related to net debt to EBITDA and an interest coverage ratio, which both of which are covered very well.

Lucas Pipes
Excellent, great. Well, thank you. I really appreciate your color, and good luck this year.

Tony Jensen
Thanks, Lucas.

Operator
And again, if you would like to ask a question, please press "*" then "1".

Our next question is from Josh Wolfson with Desjardins. Please go ahead.

Josh Wolfson
Thanks. I just had a couple of very fun tax questions. Maybe, Stefan, it's best directed towards you. In terms of the expected repatriation benefit, are you able to quantify what the new, I guess, penalty would be for repatriating capital back to the U.S.?

Tony Jensen
Go ahead, Stefan.

Stefan Wenger
Sure, I'm happy to take that. And really, the U.S. with respect to the tax reform, one of the benefits to us is that it moves towards a territorial system. So, in the past, we were paying the

local tax rate in our foreign subsidiaries, and then if we were to move the cash back to the United States, we would have to top up to the 35% rate. But today, the U.S. has moved more towards a territorial system, and following the one-time $11.5 million deemed repatriation tax that I mentioned in my remarks, there is no additional tax for our repatriating dollars back to the U.S. So, it really provides us a lot of flexibility.

Josh Wolfson
Okay. Wow, that's a big benefit for sure. And I guess in terms of the structure of the debt currently, my understanding is the converts are held in the U.S. and the credit line is held outside the U.S. Is that correct?

Stefan Wenger
No, both instruments are in the U.S.

Josh Wolfson
Okay. And then lastly, in terms of cash taxes this quarter, they were higher than expected. It seemed like the $11.5 million you mentioned, that will be paid over a longer period of time. Were there any short-term impacts from the changes in tax laws for cash taxes this quarter, or is that just normal variance that we saw?

Stefan Wenger
That's just the normal course. The second quarter is usually a larger quarter for estimated tax payments in U.S., and then--so, there's nothing unusual. The $11.5 million that I spoke of will be paid over eight years. So, that wouldn't have played into this December quarter.

Josh Wolfson
Got it, all right. That is it for me. Thank you very much.

Tony Jensen
Thanks, Josh.

Operator
Our next question is from Tanya Jakusconek with Scotiabank. Please go ahead.

Tanya Jakusconek
Good afternoon, gentlemen. Well, good morning to you guys. Have some questions on tax, if I could, Stefan, just on going forward now with the U.S. tax reform, is the 17% to 23% the normalized tax rate that we should see like fiscal 2019 onward?

Stefan Wenger
Sure, happy to give a little color. That rate is what we're estimating for the rest of this year. We don't typically give guidance further out than that. However, I can say--I can just give you a general comment on how--what our tax situation would be. For our foreign subsidiaries, for Switzerland, our streaming business today, we would look for--to pay taxes at a rate of about 13.1% going forward on all our streaming income. And then our royalty business would be taxed at the higher of either the 21% U.S. rate or in some instances like in Canada where there's a higher tax rate, it would be at the local rate. I remind you that our streaming business is about 70% of our business now, so you can look to the math there. Essentially, we'll give better guidance once we get to 2019, but that sort of gives you a couple of points as to where our income is taxed.

Tanya Jakusconek
Okay. No, that's very helpful. Thank you. And then maybe keeping on with your reporting your first copper inventory level this quarter, can you just give us an idea of what you believe to be a normal level of copper inventory going forward that you are liable to keep?

Tony Jensen
This is Tony. I don't know if we have a number at hand. Mark, do you have anything that you would provide? I think just while you're thinking about that, I would say somewhere around 20,000 gold equivalent ounces converting the copper back to gold would be a general number that we've had in the past, Tanya, but with regard to copper specifically, I'll just ask Mark if he might have something there?

Mark Isto
Well, I think our strategy has really been to sell the copper as it came in. I think this is probably a little bit better question for Stefan to give us an answer on, but--.

Stefan Wenger
--No, sure, I can comment, Mark. And Tony hit on the head. You typically--we're carrying about 20,000 GEOs in inventory every quarter, and we try not to build inventory. So, this quarter, just as a reflection of timing, we received a shipment late in December of copper from Mt. Milligan that we did not sell. So, typically, we would sell copper over a shorter period of about--within about three weeks after we receive it. So, depending on the timing of shipments, we may have a balance similar to what you saw at the end of December in inventory, but depending on timing, it could be zero, as well.

Tanya Jakusconek
Okay, okay. No, that's helpful. And maybe, Tony, if you could comment a little bit - you're generating a lot of cash. You mentioned the payment reducing, your debt, you have mentioned the increase in dividends, which you look at annually. Is your strategy for acquisition still in the $100 million to $500 million range, still focused on precious metals? Maybe a little bit of what you're seeing out there and if that has changed at all?

Tony Jensen
Yes, thanks, Tanya. We are very much focused on business development activities, but $100 million to $500 million that you mentioned as far as the range goes, that's kind of where the market bears today. We would certainly have more capacity, more desire to do larger deals, but generally, we're not seeing the billion dollar deals that we did two years ago. So, while we're ready to do those kinds of things and capable, the market is at a bit of a lower level.

We are seeing good deal flow. And in the absence of any deals, we'll continue to service that debt. That was our plan all along. We didn't issue any shares when we did the acquisitions of $1.4 billion a couple of years ago. We took on what we thought was efficient debt. I think it's proving to be that. So, we're still paying for the acquisitions we did some time ago without any dilution to our shareholders.

So, that's where we're focused - reducing debt and building the company to do additional acquisitions when they become available. And we always are very, very dedicated to that dividend. And you're right - we take that up in November of each year, and we just don't see ourselves backing away from that. We've been able to service that dividend in any kind of gold price that's come our way over the last 20 years, and we'll certainly continue to make that a cornerstone of the company.

Tanya Jakusconek
And, Tony, what about the focus on just the precious metals - is that still the focus, gold and silver?

Tony Jensen
Yes, thanks for the follow-up. I forgot about that in your initial question. Very much, precious metals focused. We at times see some non-precious things, mostly base metals that might come our way, and we'll have a look at those if they come our way, and if the size is right so that it doesn't upset the balance of precious metals in our portfolio, and if the quality is right, you might see us do some modest deals there. But, we're very much focused on precious metals side and I should say very much focused on gold.

Tanya Jakusconek
And is it more streaming deals you're seeing or--I mean, there's some portfolios of royalties within companies. Is it a mixture of the two or is it mainly stream?

Tony Jensen
Yes, I think it's fair to say that we're seeing a mixture of the two. Anything new that we create, there's efficiencies associated with the streaming of products. So, generally, new products will be on the streaming side, but we're always looking for new royalties. And as you've heard me say in the past, I don't think I've seen a royalty that I didn't like. So, we're very much looking for any of those that come to market at a reasonable price.

Tanya Jakusconek
Okay, that's good. Congrats on the quarter.

Tony Jensen
Thank you very much, Tanya. Thanks for the questions.

Operator
Our next question is a follow-up from Josh Wolfson with Desjardins. Please go ahead.

Josh Wolfson
Thank you. Just one follow-up question on the tax rate that was mentioned for the Swiss streams - the 13.1% number, is that higher than the old number of I think it was 8.75 because of the U.S. tax law changes or is that, that was always the same and this is just an effective sort of rate that was not previously talked about?

Tony Jensen
Yes, Josh, Tony here. So, you're remembering correctly. We have a current rate that's just here under 9% as our Swiss rate, but we anticipated that that would be moving very close to the rate that the U.S. has put on now for international income. And so, we don't look at that the 13.1% as a significant slippage in any degree with regard to our effectiveness in getting new business opportunities.

Josh Wolfson
Okay. But, it's safe to assume that the new streaming rate will be slightly higher than the old rate, the 13.1 versus 8.75 - is that correct?

Tony Jensen
On a long-term basis, that's--well, I should say that's what you should be building into your models going forward for our international streaming business.

Josh Wolfson
Got it. Okay. That's it from me. Thank you.

Tony Jensen
Thank you, Josh.

Operator
This concludes our question-and-answer session. I would like to turn the conference back over to Tony Jensen for any closing remarks.

CONCLUSION

Tony Jensen
All right. Well, thank you for joining the call today. We very much appreciate your interest and continued support of Royal Gold. We look forward to updating you in the progress during our next quarterly call. We apologize for being a little bit disjointed with three different locations, but the team did a wonderful job, and we very much look forward to updating you as new information comes to us. Bye for now.

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