Royal Gold

Fiscal 2018 Third Quarter Conference Call

May 3, 2018 at 12:00 PM Eastern

CORPORATE PARTICIPANTS

Tony Jensen – *President and Chief Executive Officer*

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PRESENTATION

Operator
Good day and welcome to the Royal Gold Fiscal 2018 Third Quarter 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 (0). After today's presentation, there will be an opportunity to ask questions. To ask a question you may press star (*) then one (1) on your touchtone phone. To withdraw your question please press star (*) then two (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, Alison. Good morning and welcome to our discussion of Royal Gold's third 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, 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. Tony will give you an overview of the quarter followed by Stefan with the financial update, and then we'll open the lines for a Q&A session.

I will now turn the call over to Tony.

Tony Jensen
Thanks, Karli and good morning, everybody. Thank you for joining the call. I'll begin on Slide 4. We reported another solid quarter operationally. Higher revenue during the quarter included our full quarter of production from Rainy River, our newest royalty property. We also benefited from a gold price that was up 9% from year ago. Quarterly operating cash flow topped $100 million for the first time ever, reflecting continued strong performance from the portfolio, and a $21 million tax refund collected from Chile. Even without the impact of the tax refund, Q3's cash flow from operations was a record for Royal Gold.

Our reported earnings were impacted by an impairment at Pascua-Lama where Royal Gold has a 5.45% gold royalty and a 1% copper royalty on the Chilean deposits. In coming to this decision, we balanced our view of the long-term potential of an asset with 16.5 million ounces of resource subject to our interest in one of the world's most prolific mining regions with the recent announcements by Barrick to re-categorize reserves to resources and to suspend work on the underground prefeasibility study. While the impairment is reflective of the project conditions today, we continue to believe that Pascua-Lama represents significant option value for our Royal Gold shareholders. Absent non-cash impacts, our adjusted earnings of $0.48 per share continued our trend of consistent and solid performance over the last several quarters. We're allocating our strong cash flow to dividends, debt reduction, and new business. We paid out $16 million in dividends during the quarter. We reduced our debt for the fifth straight quarter by paying down another $75 million. This leaves us the outstanding balance under our revolver of just $75 million, which we expect to pay off completely before the end of the year. And we now have over $1 billion of total liquidity for new opportunities.

On Slide 5, we have some updates on some of the properties. At Rainy River, New Gold announced 39,000 ounces of gold production in their second quarter of operations and the milling rate averaged 17,500 tons per day, lower than the designed throughput of 21,000 tons per day due to a combination of relatively minor operational issues. The project is still ramping up and we are encouraged that the mine has demonstrated ability to improve both throughput and recovery. On specific days, throughput has achieved 22,500 tons per day, and New Gold had commissioned a study to determine if design capacities could be exceeded. I'll have a bit more about that later. Gold recovery was 81% during the quarter, but recent operational improvements resulted in 87% average gold recovery during the first three weeks of April. New Gold expects Rainy River production to increase throughout this calendar year due to improvements in throughput, grade, and recoveries.

At Wassa and Prestea, production of over 57,000 ounces was driven by stronger than expected performance from Wassa underground, and Golden Star reiterated gold production guidance of 230,000 to 255,000 ounces for the year. Wassa underground experienced a 13% increase in grade and a 26% increase in the mining rate to 2,400 tons per day, while the mining sequence at Prestea continued to improve, particularly with the second Alimak stope now in production. Golden Star also released some excellent exploration updates, more than doubling the inferred resources at Wassa underground to 5.2 million ounces. We have been talking about exploration potential within Golden Star's significant property position in the Ashanti belt, and we are pleased to see such impressive results less than 36 months after Royal Gold made its initial investment. And finally, per our agreement with Golden Star, our gold stream percentage increased to 10.5% on January 1st. At Mount Milligan, Centerra sequentially restarted milling operations during the quarter following a temporary shutdown at the end of December. They are currently operating at 40,000 tons per day and will increase production once water supplies are adequate. Centerra is guiding to average throughput of 55,000 tons per day in the second half of this calendar year. Lower processing rates during the quarter were somewhat offset by higher gold and copper grades.

Looking forward to the June quarter, we expect sales related to our streaming agreements to be in line with the March quarter as inventories will be reduced according to our routine sales procedures, offsetting lower expected deliveries from Mount Milligan in that period. However, we do anticipate lower overall sales in the September quarter as the final effects of the Mount Milligan temporary suspension are realized.

Turning our focus to growth on the next few slides, I will start with the near-term catalysts and then highlight longer-term reserve updates, and then finally talk a bit about our portfolio optionality. We expect that New Gold will continue to make progress ramping up to their design parameters. But as I mentioned earlier, they're also finalizing a study to evaluate the potential to increase Rainy River's throughput by approximately 15% to 24,000 tons per day from the current design of 21,000 tons per day. We expect Rainy River to be a top ten revenue generator for us, and this study may enhance the stream value further with the potential to pull more ounces forward. At Cortez Crossroads, waste stripping continues. We anticipate that sporadic ore will be encountered in the second half of the calendar year, and we expect meaningful production to build early in 2019. At Peñasquito, Goldcorp reported that construction of its Pyrite Leach circuit was 86% complete with wet commissioning of the carbon pre-filtration circuit already underway. Goldcorp expects commissioning of operations in the fourth quarter of this calendar year, and projects that the project will add an incremental 1 million ounces of gold and 44 million ounces of silver over the mine life.

Turning to Slide 7, I'd like to highlight the depth of our portfolio. We have 192 properties in the portfolio, of which 39 are currently producing. Amongst our development stage assets, Sabina has made excellent progress at the Back River project, where Royal Gold has a 1.95% NSR, and there are approximately 2.5 million ounces of reserves subject to our interest. Sabina has received most of its key permits with the last major permit, a Type A water license, anticipated by the end of this calendar year. In the September quarter, Agnico Eagle plans to begin production at LaRonde Zone 5 where we have 2% NSR. 2018 guidance calls for gold production of 20,000 ounces, growing to 42,500 ounces in 2020. Within our operating properties, we've been pleased to see double-digit reserve increases within the royalty portfolio at Wharf, South Laverton, Gwalia, Leeville, and Twin Creeks, while calendar year production guidance at Dolores is up 35% due to pulp agglomeration and underground mining. While our royalties are generally not as large as our streams, they provide interesting option value, and we expect additional organic growth from our large portfolio in the future.

On Slide 8, turning to our Peak Gold joint venture in Alaska. Three years ago when we first told you about this project, we said that we would invest on a success basis. We committed $5 million to it initially, and we said that if we like what we saw, we'd continue to invest up to $30 million to earn a 40% interest by the end of 2018. And indeed we've now earned our 40% interest, but earlier than was scheduled, because we are encouraged by our exploration success. The gold resource consists of 11.3 million tons, creating 3.5 grams per ton, and is located near surface. This equates to approximately 1.3 million ounces of gold, and there is a bit of silver and copper present as well. The Peak Gold joint venture has set a budget of slightly over $9 million this calendar year to explore exploration -- to continue exploration and to complete an economic evaluation of the property. Royal Gold will be responsible for funding its pro rata share of the budget. We anticipate the PEA being complete during September quarter of this year.

Tetlin is a native village in Alaska and owner of approximately 675,000 acres under lease by the Peak Gold joint venture. On the map on Slide 8, the darker green is the land associated with the Tetlin lease, and we've also extended our interest to the west onto approximately 175,000 acres of state land. You can see that the size of our property position is significant compared to our friends at Fort Knox or Pogo or even across the border into the Yukon. Consistent with our success-based investment strategy, we opportunistically agreed to purchase a 13.6 equity position in our joint venture partner, Contango ORE. This purchase increases our overall effective ownership stake in the property. While we haven't considered exploration an integral part of our growth strategy, we will continue to pursue opportunities where we find them as long as we can identify a means to exit into our core business.

Turning to Slide 9, I want to highlight some long term optimality in the portfolio. For example, Barrick recently announced a scoping study to evaluate pre-oxidation heat bleach and flotation concentrate at Pueblo Viejo, which proved successful, paving the way for a prefeasibility study this year. This plan has the potential to increase the conversion of approximately 7 million ounces of current gold resource into reserves on a 100% basis, which would extend the mine life and enhance the annual production profile. Another prefeasibility study was recently completed at NuevaUnión, which is the joint venture between Teck and Goldcorp. A few years ago, we purchased 1.4% NSR on an area covering roughly 30% of the La Fortuna deposit. Our interest is in the heart of the deposit, which is expected to produce gold and copper in years four through 18 of the current mine plan.

Finally, I want to remind you of our trial related to Voisey's Bay, which is set to begin in September. We have a 2.7% NSR in all metals produced, but are currently receiving no royalty revenue from the mine according to Vale's calculation of the royalty. Given the significant production profile from Voisey's Bay, we are eager to resolve this matter in court.

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

Stefan Wenger
Thanks, Tony, and turning to Slide 10. We ended the quarter with over $1 billion in total liquidity, an increase from $975 million last quarter. This includes approximately $100 million of working capital plus $925 million of revolver capacity. For the remainder of fiscal 2018, we continue to expect to pay down debt aggressively and absent any new transactions, we will fully repay the remaining $75 million outstanding under our revolver by the end of June. On Slide 10, there's a snapshot of our debt reduction efforts over the last five quarters. We paid down $270 million on our revolver over this period, $75 million of that paid in Q3. At March 31, our net debt to EBITDA was right at 1 times. 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. We currently plan to repay the principal amount of the bonds in cash using cash flow and availability under our $1 billion revolving credit facility. As we have the ability to repay the outstanding principal balance of the bonds with proceeds from our revolver, we do not anticipate reclassifying the bonds as current on our balance sheet at June 30, 2018.

On Slide 11, I've summarized our tax stream sales and DD&A outlook for the remainder of fiscal 2018. For the last quarter of 2018, we expect that our effective tax rate will be between 17% and 23% subject to any revisions to our preliminary accounting for the U.S. tax reform. Third quarter ending inventory was comprised of 26,000 gold ounces and 659,000 silver ounces, which was an increase over the prior quarter due to deliveries received late in March. We expect our fourth fiscal quarter 2018 sales related to our streaming agreements to be in line with the third quarter as inventory is expected to be reduced according to our routine sales procedures, offsetting lower expected deliveries from Mount Milligan. DD&A for the third quarter was $455 per GEO and it was about $460 per GEO for the nine months ended March 31st. We now expect DD&A to be between $450 and $470 per GEO for our full fiscal year. We have paid more than $47 million in dividends during the first three quarters of fiscal 2018, reflecting our commitment to paying a consistent and sustainable return to our shareholders. For the nine months ended March 31st, we've paid out nearly 20% of our operating cash flow in dividends.

With that, I'll turn the call back to Tony.

Tony Jensen
Thanks, Stefan. Looking back over to third quarter, we can reflect on several accomplishments. We reported record operating cash flow, even net of the Chilean tax refund. Mount Milligan rebounded from an abnormal water shortage and returned to milling operations ahead of schedule. Peñasquito began wet commissioning of the carbon pre-flotation circuit and continues to post updates that are ahead of schedule for the Pyrite Leach circuit. We had our first full quarter of sales at Rainy River, and the production ramp-up schedule is trending favorably. Golden Star reported a significant increase in reserves, as well as positive underground advancements. And six of our royalty properties reported double-digit reserve increases.

Looking forward to fiscal 2019, which is just around the corner for us, we expect to see initial production from the Peñasquito Pyrite Leach in LaRonde Zone 5 later this calendar year, quickly followed by Cortez Crossroads production. We will release the preliminary economic assessment at Peak Gold, and we will continue to seek opportunities to deploy our strong liquidity.

Alison, with that, we'll -- that concludes our prepared remarks, and we'll turn the lines open 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 (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 star (*) then two (2). At this time we will pause for a moment to assemble our roster. And our first question will come from Carey MacRury of Canaccord. Please go ahead.

Carey MacRury
Hi, good morning. Just a couple questions on Voisey's. Do you have a potential timeline on how long the trial would take? And also, would you have a sense of what the cumulative payment could be retroactively to when they stopped paying the royalty?

Tony Jensen
Thanks, Carey. Look, we're going to start just probably in mid-September and we think that's going to be a couple of months for sure. It may actually drift into December, but the time will tell. And of course, the decision that's rendered from the court will be up to the court at that point in time. We can't give very much guidance as to when that likely will come out. But we wouldn't expect any kind of decision before the end of this calendar year. With regard to what is at stake here, there's some historical claims that we have filed that relate to the very first pound of nickel that was produced there. And we think of those historical claims in the tens of millions of dollars. But what's significantly at stake is the forward-looking royalty after Long Harbour was built. And that's, as I mentioned in my prepared remarks, we're not getting any revenue at all at this point, and, because of the way they're calculated. And so when you look at the volume, I think we put the volume up on one of the slides. When you look at that volume and do your own math, you can see that going forward over the rest of the mine life that could be well over $100 million in value going on a forward-looking basis. So it's certainly something that we're taking very, very seriously, Carey.

Carey MacRury
Great. Thank you.

Operator
Our next question will come from Josh Wolfson from Desjardins Capital. Please go ahead.

Josh Wolfson
Thank you. For the Peak Gold project, I'm operating under the assumption that it's not your main interest to be an operator of this asset. Would you be able to talk a bit more I guess on what the potential options there are available to I guess convert that equity interest into something else? And also I guess in the context of there being any existing royalty on the order of 4% to 7% on the property?

Tony Jensen
Yeah, thanks Josh. Thanks for the question. There are several different things that we can do with Peak Gold, and when the timing's right. We don't think the timing is right to monetize it at this particular point. We very much think that there's additional exploration potential in the project that we'd like to spend some time with first. But the second point I'd like to make is that we're long on this project. We're long on the project right from day one. We like the asset and that's

why we picked up the two different royalties, I guess it's essentially one royalty but it's applicable on two different parcels between 2% and 3%. So we already have an ongoing interest. But with regard to the core of your question, let me just say that we're not particularly interested in gold in, sorry, in dollars, we're more interested in gold. So to the extent that any party that ultimately came in as a partner on the project, or somebody that might take operating control, we'd be much more interested in very strategic and creative options where we can exit into our core business rather than just simply taking dollars in our position.

Josh Wolfson
Understood. And I guess when you -- maybe more broadly, when you look at this type of asset, which has very high grades and likely attractive margins for the operator, is there sort of a rough number in mind that you have that would represent the potential streaming percentage of production, or is that -- is it too early to sort of evaluate that?

Tony Jensen
So Josh, I think we're quite a bit too early to really put pencil to paper on that. I think just now, if you were to look at it from a valuation perspective of what resources are in the ground, that's probably one of the better metrics at this particular point. But we're going to give you a whole lot more guidance about what we think about the quality of the asset when our PEA comes out in September.

Josh Wolfson
Understood. And then maybe just one last question on the asset. Any sort of perspective on timelines when you think it could be in production, or sort of a range of dates that would be reasonable?

Tony Jensen
Yeah, I think it would be too early for us to speculate on that at this time. But let me just turn the question to Mark Isto, who happens to be sitting remotely in Toronto today. Mark, will there be any permitting timelines associated with the PEA, or will it just simply be production estimates from pre-construction and forward?

Mark Isto
Yeah, we'll have a preliminary schedule for sure. I mean, it's obviously hard to get precise, but we know what type of studies need to be done for the permitting. And we'll be able to have a general project schedule, for sure.

Tony Jensen
So Josh, that should give you some strong help in -- we're completing this preliminary economic study on what's there today. But by no means do we expect that to be the end of the exploration potential on the project. So it could be an interim look at the project at that point.

Josh Wolfson
All right. That answers the rest of my question. Thank you very much.

Tony Jensen
Thank you.

Operator
Again, if you would like to ask a question please press star (*) then one (1). Our next question is from Lucas Pipes with B. Riley FBR. Please go ahead.

Lucas Pipes
Hey, good day everybody.

Tony Jensen
Hi Lucas.

Lucas Pipes
I noticed the filing of an automatic mixed shelf, and I wondered if there's particular motivation to file it at this time, and maybe looking for some things on the M&A side, for example. I would appreciate your perspective on the mixed secured shelf. Thank you.

Tony Jensen
Thanks Lucas. Fair question. Look, it's just a matter of our previous shelf expiring. And so we want to be completely ready and available to do any kind of business and be prepared for any kind of opportunity that might come our way, so it's just simply replacing the old shelf, very, very consistent with the prior shelf that was filed.

Lucas Pipes
Got it, got it. But since we are on the topic of M&A, and it's been a while since you've been more active on that front. What's the appetite at this point in time and what sort of opportunities are you seeing in the market at this point in the cycle? Thanks.

Tony Jensen
Do you want to take that question, Bill?

Bill Heissenbuttel
Sure. We're still seeing a number of opportunities. It's very reminiscent of the pre-2015 time period. I think what we're seeing is really more in the development space than sort of balance sheet restructurings. And those just take more time to mature. Oftentimes you need other sources of capital to come along. So we just have to patient there. And I think previously we've talked about transactions in the $100 million to $500 million range. And I'll just give you a sense, we're probably seeing more towards the lower end of that range. But with the growth pipeline that Tony talked about, I just think we can remain patient and just let these opportunities mature.

Lucas Pipes
Got it. That's very helpful. I'll leave it here. Thank you very much.

Tony Jensen
Thank you, Lucas.

Operator
Our next question will come from Mike Jalonen of Bank of America. Please go ahead.

Mike Jalonen
Hi Tony and everyone. I just had a question on Pascua-Lama. What's the book value of Pascua-Lama now post the write down? Then I have a second question.

Stefan Wenger
Sure Mike. The book value post the write down is $178 million.

Mike Jalonen
Okay, thanks Stefan. And then part two, Tony, as you come up for the option value for that 170. Was it $172 million, Stefan?

Stefan Wenger
$178 million…

Mike Jalonen
$178 million. What type of mining plan did Royal Gold model for Pascua-Lama to arrive at the optionality?

Tony Jensen
A very interesting question. We took a look at as much data as we could get our hands on, both publicly and through Barrick, who were quite helpful. And we took our own view on whether an open pit plan might look more promising versus an underground plan. And we had to ultimately use our experience and determine what probability we felt was applicable to both plans. And of course, we used quite a significant discount rate. We used a 9% discount rate once we determined an impairment was applicable, which is quite a bit higher than what we normally do. And we did that because we think it's reflective of the project conditions today.

Mike Jalonen
So you're assuming that one day there might be a mine here still?

Tony Jensen
Oh, yes we are. Otherwise, we'd have written the whole thing off. We're still believers that at some point there's going to be production here.

Mike Jalonen
Well, I wonder if I'll still be an analyst. Okay, thank you.

Tony Jensen
Thanks for your confidence.

Operator
Once again, if you'd like to ask a question please press star (*) then one (1). Ladies and gentlemen, this will conclude our question-and-answer session. I would like to turn the conference back over to Mr. Tony Jensen, President and CEO, for any closing remarks

CONCLUSION

Tony Jensen
Thank you very much for joining us today. We very much appreciate your interest and continued support of Royal Gold. And we look forward to updating you on the future progress on quarterly calls to come in the future. And Mike, and I particularly look forward to updating you on Pascua-Lama at some point. All the best, and thank you for joining us.

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