Iain Little 2nd November 2021

Cash on Cash, Gold on Gold

They say that the gold mining business is a hole in the ground with a liar at the bottom and a fool at the top. The more cynical say there are two fools, one at each end.

Mining is a terrible business. You spend 10 years before you see production. You must find a mine, raise seed capital, obtain permits and geological assessments -no easy business with Greta patrolling the touchline- then raise large scale capital from unwilling ESG investors, pay off indigenous peoples and their politician friends, and then move a team and equipment to the middle of the Ulu to find out if your expensive surveys were really correct. Only then are you ready to shift dirt. But, wait, did you know that the gold price was going to halve, making your cash flow forecasts as worthless as the tailings and environmental hazards that are piling up behind your diggers and chemical treatments? And when you mothball production because you can't afford to continue, just watch that water fill up your mine, as the lawyer letters flop through your letter box.

To be successful, you need a strong gold price *and* a technically successful and environmentally sensitive logistical operation, and all at the same time. Small wonder that there have not been any major (>1mn ounce) gold discoveries for over a decade. Success stories and heroes are few and fabled.

For most of my 40 year career, analysts have mocked poor management in the mining business. The wisdom is that gold mines -perhaps with the exception of royalty or streaming financiers- are low quality, cyclical investments that only work when the cycle is right. Management doesn't matter. The gold price -and luck with your timing- do.

So I was intrigued by this chart. After decades of devouring investors capital for capital-intensive projects and surviving on shareholder bounty, the current generation of gold miners have finally got the message. They have done so when most of their all-in, sustainable costs cluster around USD 1,000 an ounce. Gold trades near USD 1800.

Free cash flow yield (FCFY) measures the free cash flow (net profits plus depreciation less annualized capex) as a percentage of a company's market value. It can be compared to the yield on a bond or a cash deposit. Gold mining, handcuffed by capital constraints after years of shareholder abuse, is now the highest yielding sector on the planet, with a FCFY of 7%, roughly double that of the rest of the market. During the last 2001-2012 bull cycle, when most gold shares multi-bagged, they never really got close to cash positivity. This is money -or maybe gold- that can be paid to investors and it is on the increase. In a yield deprived, inflationary age, is this not El Dorado?