Rick Rule on Oz gold allure

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Renowned US resources investor Rick Rule speaks with MiningNews about Australia's winning "rocks-to-money" gold corporate focus, certain off-the-radar investment jurisdictions, and value in silver stocks. And we asked him: are US investors finally warming to gold equities?

Oz gold 'rocks-to-money' beats Canada's 'rocks-stocks-money' path

Rule, keynote speaker at the newly launched Mines & Money Americas conference at Toronto, said the industry mood at recent investment-focussed events in the US, Australia and Canada was understandably upbeat. "I think the sentiment here at the conference [and others] is optimistic for the sole reason that they can raise money again," said the president and CEO of Sprott US Holdings, part of TSX-listed Sprott Inc.

"More importantly I think the broad sentiment for resources – especially precious metals but not merely precious metals – is returning. Of particular note in [North America], and I think it's important for your publication to recognise, is the generalist-institution investors are by and large underweight gold.

"So the generalist investors are underweight the one sector that is moving and some of the continued strength of the Canadian gold equities just has to do with the fact that these guys are [starting to] get into gold."

While Rule thinks current gold stock values are generally factoring in higher gold prices – that is, pricing has mostly run ahead of fundamentals – he agrees there is some cause for back-slapping by some gold company leaders over better performances after the sector was lambasted for lack of real leadership, and decent returns, during the recent mining boom.

Not that they should get too carried away at this stage.

“I personally think the industry is on a better trajectory in Australia than it is here [in Canada],” Rule said. “There are a couple of different fundamentals, one purely in Australia’s favour, and that is there is still the assumption in Australia that the value proposition goes rocks to money.
“In Canada the ethos rocks to stocks, and stocks to money, has taken over. There has been a sense that exploration is a story to generate market cap as opposed to an activity that generates economic return. It’s harsh, but I think it has to be said.

“Then there’s the difference in valuation question.

“The criticism that I would have of Australians is there is too much focus in Australia in rushing a small project to production and attempting to use the cash flow to build a big deposit which leads often to wrong-footing, or wrong-sizing mines. I think Australian companies could lower their cost of capital – increase their market capitalisations – if they spent more time drilling the deposit out enough that it’s total net present value was easier to ascertain. So I think the difference in the two approaches is interesting.

“I think the overall Australian orientation that a mine oughta make money is charming [laughs], especially relative to the Canadian [approach]. But the Australian focus on near-term cash is probably problematic.

“The other thing that really works well for Australia, and maybe this is accidental, maybe on purpose, is the softness in the iron and coal markets, and softness in the Australian currency, has meant that Australians have done a much better job than their [international] counterparts in controlling operating costs. A demonstrably better job.

“Maybe it’s because [these] guys don’t have this thing called winter.”

Rule thinks gold explorers/developers are generally over-valued at present “relative to the gold price and their probability of success”, but he also believes gold prices are trending higher, “so maybe these over-valuations are predictive”.

“I’m more comfortable with the big company valuations, not that they aren’t overvalued at this gold price,” he said. The confidence is built on a belief that “some not so subtle lessons were learned … last cycle”.

“Work that we’ve done at Sprott indicates last cycle the gold price moved from US$260/oz to $1,900, and free cash flow per share actually went down as a consequence of … profligacy, silly capital expenditures, and amazingly bad acquisitions. The consequence of that was a lot of senior managers, CEOs, were allowed to pursue other employment opportunities,” Rule said.

“And I think those lessons are fresh enough [here] that the same mistakes are unlikely to be repeated in the next couple of years, which means that margin from increased gold prices will actually in some way shape or form flow through to shareholders. And I think people are missing that [likelihood] in the big gold sector.”

Rule observed earlier this year the total US savings pool was only marginally invested in gold equities – perhaps 0.25-0.33%, compared with as much as 8% in the 1980s. A reversion to mean could see the number rise to 1.2-1.5%, with big implications for gold stocks. But so far a shift is not apparent.
“We have [seen movement] in Canada but I don’t think we have in the US seen the inclusion of the generalist [investor] in the gold trade,” Rule said.

“Understanding the size of the US market … that isn’t to say that uptake in the US for precious metals equities hasn’t increased. But relative to the size of the market it hasn’t increased at all. Some people say – and they may be correct – that this is a function, in the early stages, of the ETFs, which are growing rapidly and distorting the market in many ways.

“But we haven’t seen in the US any pick-up in generalist retail … and we haven’t seen almost any uptake from the US generalist. Naysayers can point to exceptions, but I think the fact that they have to dig so deep for exceptions probably proves the rule.”

Rule said while he didn’t see a mining investment culture redeveloping in the US, “we may develop once again a gold culture in the US, which is a different discussion”.

“We’re seeing, and really have for four years now, a very broad uptake of physical precious metals buying by Americans and not merely by the grumpy old men like me; we’re seeing a broad uptake in physical gold ownership,” he said.

“It’s still small in percentage terms, but the country is so big the quantities of gold and silver sold are massive. We’ve seen on several occasions government mints run out of coin strip – that’s pretty steep demand.”

Similar to gold equities in some ways, there wasn’t much current value in silver stocks outside those companies offering ready leverage to higher prices via long-term reserve and production bases.
“The US investor is solely to blame for that,” Rule said.

“There’s a subset of US investors called silver bugs who are the world’s greatest manic depressives and if you give them a hint – and silver gave them a fairly broad hint – they pile into the silver equities.

“We own silver stocks that American investors are predisposed against. Hochschild, Buenaventura, Fresnillo – stocks that middle Americans can’t pronounce – and Silver Wheaton, of course, the dean. But junior silver stocks have had such an amazing romp.

“The exception to that actually would be an Australian silver explorer, Azure [Minerals], which we own quite a lot of.”

Azure had “a number of shares outstanding that exceeds the capabilities of my calculator” – generally anathema to North American investors. The company aims to restructure its capital base ahead of a TSX listing next year. Its managing director, Tony Rovira, was “tireless” as a promoter.

“[They’re] really going places,” Rule said.

As someone who has made a lot of money for himself and others from investments in ‘emerging markets’, Rule is often asked for his views on standout mineral-investment jurisdictions. His response is usually the same: “I’m fairly agnostic when it comes to jurisdictions – I think they’re all bad.”

“To me the best mining culture has always been Chile. That isn’t to say there isn’t room for improvement. But if you compare them apples to apples against any other jurisdiction on the planet that I’m familiar with, Chile wins,” Rule said.

Off the roads well-travelled, though, he’s done exceptionally well out of countries ranging from Congo, to Nicaragua, to Russia. Now he adds Nigeria to a list of countries where competition for ground with “astonishing prospectivity” is thin.

“I think one of the things that we forget in the mining business is that societies will accept you when they need you. That’s the way it works.

“And if you have the courage to go into countries at a period in time when other people don’t, for whatever reason, the regulatory climate that you find is much more welcoming. I remember investing quite a lot of money in Nicaragua 15 years ago, and the perception was that Nicaraguans were anti-American, anti-capitalist, anti-gringos-in-suits. And the reality was that they were completely welcoming.

“All the Nicaraguans ever asked in 15 years of doing business is that we do what we said we would do, which shouldn’t be a tough test.”

Presenters at the Toronto Mines & Money event included Ecuador’s mines minister, Javier Cordova, who gave a polished talk on a rejuvenated policy and regulatory platform.

“I had a meeting with the Ecuadorian ambassador to Canada [and mines minister] yesterday,” Rule said.

“I went over to their office and listened. And what they say and what they do may be different things, but they certainly seem to be prepared to do the right thing. I started off being polite – Americans are ill-advised to talk to other people about politics right now – but as the discussion became more and more frank it was more and more obvious that they regard mining as a solution.

“One of the reasons I’ve been relatively successful as a speculator is I’ve got a tolerance for failure. I’m willing to make asymmetric bets [in frontier markets] where the probability is I lose, but the possibility if I win is I win very, very large.

“I certainly understand that in exploration your winners have to amortise your losers.”