The Next Royal Gold

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Frank Curzio: Hello. Welcome to the *Phase I* Next Royal Gold conference call. I'm Frank Curzio, editor of the *Phase I Investor* newsletter for Stansberry & Associates. This month's recommendation is Sandstorm Gold (TSX V: SSL).

Sandstorm is a small-cap gold royalty company that trades out of Toronto Exchange. It's a company that I believe has enormous upside potential and also limited risk due to its business model. I have a detailed eight-page report on the company. I'm sure most of you have read it by now. If not, just log in to the stansberryresearch.com website, click "Phase I" on the left-hand side, and click "Why This $1 Gold Company Could Become the Next Royal Gold."

On today's call, I have the CEO of Sandstorm Gold, Nolan Watson. Nolan is one of the smartest minds in the resource industry, and those are not just my words. That comes from two legends, Doug Casey and Rick Rule. These guys have been in the business for 30-plus years... very successful investors in the resource space. Nolan was a former CFO of Silver Wheaton, another huge royalty-streaming company. He helped raise over $1 billion in the debt and equity markets to fund Silver Wheaton's growth. Today, Nolan is doing the same thing at Sandstorm Gold.

Also on today's call is John Doody. I consider John the best gold analyst in the world. And he's got the returns to prove it. For the past 10 years, John's *Gold Stock Analyst* newsletter is up more than 1,300%. That's more than twice the price of gold. Also in the same time frame, the S&P 500 is down 4%. So it's safe to say investors did pretty good listening to John's advice.

John has more than 30 years' experience investing in the gold industry. That means he's been through many of the boom-and-bust cycles of gold over the past three decades. John's going to talk about gold prices and where they're heading, since it's relevant to this month's *Phase I* pick.

Gentlemen, thank you for being on today's call.

Nolan, let's start with you. Tell us a little bit about your company, Sandstorm Gold, why you became CEO of a small company after being at Silver Wheaton, and also talk a little bit about royalty streaming and that business model.

Nolan Watson: Absolutely. Well, thank you very much. I guess the reason that we started up Sandstorm Gold is because, at the heart of it, I'm an entrepreneur and was the first guy at Silver Wheaton. I joined the company when there were no other employees. And I was the first one in running the financial side of it. I had a lot of fun helping build that company. And once we got to a certain size (I'm the type of guy who likes to build things, not maintain them), I thought the business model was so fantastic it needed to be applied outside of the silver space. So I went out, launched Sandstorm Gold, and started doing the business model in gold. Subsequently, we've also started Sandstorm Metals and Energy – which is SND on the TSX Venture exchange. It does the same business model in things outside of precious metals.

Frank Curzio: Now get a little bit more into exactly what the royalty model is... to explain if investors are not familiar with this. (Most of the people listening to this call are familiar with this, especially if they read my report.) But talk a little bit more about the royalty-streaming model and what it actually does. How does that actually limit your risk in a lot of situations?

Nolan Watson: One of the reasons we like the model so much is because some of the risks that investors face in mining are capital-cost overruns, so having to announce to your shareholders that you're partway through building a mine, that you've recently run out of money, or operating-cost overruns, where you said you're going to be able to produce gold for $400 an ounce but you're actually producing it at $700 an ounce. And so what we've done is create a contract that allows us to get the exploration upside in a mining company. And it also allows us to get any upside there may be in the price of gold without having the downsides of operating-costs overruns, development-cost overruns, and those types of things.

So basically what we do is we'll go to a mining company who needs to build a mine. We'll give them an amount of money, anywhere from $20 million to potentially as high as $100 million. What we get back is a contract that says we get to purchase a certain percentage of their gold production for the entire life of the mine. So, for example, we may pay $400 per ounce for 20% of a mine's production for the whole life of the mine. And every time they produce five ounces they have to sell one to us at $400. We take that ounce at $400 and we sell it at the spot rate, which today is over $1,500 an ounce. And the $1,100 is our free cash flow.

We always fix that cost per ounce so that 20 years from now we'll still be buying ounces near $400 an ounce... even if the cost of producing that ounce at the mine has increased significantly. So our investors have protection against inflation. In fact, these types of vehicles are a way that you could profit off inflation. And there's also a lot of protection against management mistakes that may happen at the mine-operating levels. So you get all the upside of the exploration, you get all the upsides you would if you invested in the mining company, but you don't get most of the downsides. It's a really great model to invest in.

Frank Curzio: And just to put some numbers behind that brilliant description... I'm in the small-cap space. I recommend a lot of companies, and some of them are speculative. You're talking about your company trading a little over $1, cash flow positive, and profitable. You don't really see that in a lot of other companies. It just shows you how successful this business model could be, where it does limit risk (which you want to do in small caps), and also have that potential for huge upside.

Now, Nolan, I'm going to stick with you real quick before we get to John here. Everyone who's on this conference call I'm hoping that you read the report at least once, hopefully twice – but can you give us a brief description of some of your current properties? Just a brief overview is fine. It seems like you have a lot of catalysts coming up over the next 12 months.

Nolan Watson: One of our larger contracts is with a company called Luna Gold. It's got a fantastic mine that it's just getting into commercial production now. It's publicly stating it's going to ramp up to about 100,000 ounces a year. We get to buy 17 percent of everything it produces at $400 an ounce. So that would be, at today's gold prices, about $20 million a year of free cash flow for us just off of that one contract. Luna's recently been doing a lot of exploration and has found a bunch of new zones in a bunch of new areas that I think are going to keep that mine going for many, many years to come. And, in my opinion, the size of the mine actually should be 150,000 to 200,000 ounces a year. So it may take Luna a few years to realize that or to get there, but I think it's something that could happen. We really like that management team and we really like that asset... So it's been a good one for us.

Another one of the deals that we've done is with a company called Brigus Gold. Brigus is a new management team that's come in the last year with that asset. It's doing a great job with it. And so we paid Brigus $56 million and we get the right to buy 12 percent of the gold it produces for the life of its mine at its Black Fox mine. We pay Brigus $500 an ounce for that.

We would expect Brigus' mine to produce about 110,000 ounces a year. If you do the math, we'd get 13,000 or 14,000 ounces a year at $500, which is another $13 million or $14 million a year free cash flow. And it's also a long-life mine.

We've got four other assets as well... some are in Mexico and some are in Canada and some are in the United States. Four of the six assets we have are now built and are starting to get up and running. The other two are permitted and are being constructed as we speak.

Frank Curzio: Now, I've been in this business for more than 15 years. I plan on being in this business recommending small-cap stocks for another 20 years. So I'm going to be very honest with the audience out there. If gold prices pull back below $1,000 it's not going to be good for any gold stocks. And that brings us to John.

If you pull up a five-year chart in gold prices, are you going to see a steady uptrend from $600 to over $1,500? (And that's an enormous gain.) John, where do you see gold prices going, say, over the next one to three years? I know that's very difficult to forecast, because we just came out this week, and Standard Chartered Bank said that gold could hit $5,000 an ounce. Nolan, I know that you've been bullish in looking at the economics. You're looking at how much debt these countries are in and saying we could go a lot higher. But, John, where do you think gold prices are going to go from here?

John Doody: Well, thanks for having me on the call to begin with. And it's nice to say "hi" to Nolan again. But in terms of long-term gold price... really, who knows? We tend to look at the next $100 an ounce and see whether we have the macroeconomic scenario in place that could drive gold another $100 higher, which would put us somewhere around $1,650. In this macro-scenario that I see that's most important for gold is the real interest rate. The real interest rate is the risk-free rate of return, what you get on your savings, account less the rate of inflation.

So, right now in the United States, for example, you got about 0.1 percent return in a savings-bank account, and you subtract the inflation rate (which was 3.6 percent on an annualized rate – came out yesterday), that means that your net return after inflation is a minus-3.5 percent. So you put $100 in a bank account at the beginning of the year, and at the end of the year you'll still have $100 plus $0.10 interest. But the purchasing-power loss of 3.5 percent means that the effective purchasing power of the money in the bank is only going to be around $96.50.

That's why people go to hard assets to protect the purchasing-power loss. We used to think that real estate was a good way to do that, but we don't have that opinion anymore. And there's not many liquid investments around that can give you that purchasing power. Gold did it in the '70s with the same negative interest rate environment, and gold's done it again in the 2000s. I don't see any rationale for gold falling back much. Maybe on a trading basis it would get below $1,500, but I don't really think so. And I don't see really much that's going to change the long-term trend in higher gold prices... certainly not in the United States until we get a new Federal Reserve chairman. And, in fact, we tend to pay too much attention to the United States in terms of gold price, in terms of U.S. economics.

The No. 1 and No. 2 consumers of gold in the world are India and China. Half of the gold consumption goes there. They do it not only for cultural reasons – they have a great respect for gold – but also because they have a less fully developed savings system. There aren't a lot of banks for people outside the cities in China and India. And traditionally they've used gold as a savings vehicle and it's done a great job for them. So China and India have even a worse negative interest rate situation than we have here in the States. So they're certainly going to continue being a buyer. Can I doodle in my daydreams or night dreams and think about $2,000-an-ounce gold? I certainly can. But $5,000... who knows?

Frank Curzio: The big question for me and a lot of listeners out there is, do you see $2,000 or do you see $1,000? We're talking about huge, optimistic forecasts. I do see $2,000 as a realistic goal. Is that fair to say to you?

John Doody: Yes. But $1,000 is impossible. All the mines were shut down. If you load in the average cash cost to produce an ounce of gold, according to our data, is around $550 cash cost per ounce. Then you add in depreciation. You add in exploration. You add in management overhead. You add in the interest rate charges. As a head of AngloGold recently said – and I agree with him – it costs AngloGold around $1,000 to produce an ounce of gold. Anglo is the third-largest producer. So if the all-in cost industry-wide is around $1,000, we're not going to see any pullback to that kind of price. What would be the driver for that? Who would be selling their gold to make that happen?

The only people who have enough gold in their vaults to do that are the central banks, if it's really there. And they've been buyers of gold lately. They've learned that in these times of currency crisis you need to have gold as your bottom-drawer asset.

So I just don't see $1,000.

Frank Curzio: It's a good point if it's really there. And just to let everybody in my audience in on this, a little more about the real interest rate... Again, just to give everyone a heads up on what's going on at the Federal Reserve... Short-term rates are near zero. The Fed is doing everything they can to keep rates low. The programs that you hear all over the news (like QE1, QE2), we also have rising inflation based even on the latest figures that have come out last week on CPI/PBI. Even if the Fed raises rates (which, if they do, it's going to be by very small increments), the real interest rate will likely remain negative – again accounting for inflation – for at least another two years, probably a lot longer, which is great for gold prices. John, I just want to make sure that I explained that correctly. Is that correct?

John Doody: Right. You got it exactly.

Frank Curzio: Let's get back to Nolan here. I think we're all on this call because we believe gold is going higher. That's one of the reasons why I'm recommending your company. What are some of your future plans? Seems like you have a lot of cattle in the shed that you mentioned already over the next 12 months with your existing projects, but what about future projects? Can you give too much, 'cause – from your competitors, but do you see a lot of opportunities out there right now?

Nolan Watson: We do. I think that's one of the exciting things about a company such as ours. We don't have to actually operate the mines themselves – we leave that to our partners – so our entire focus is on going out there and doing new deals that are created for shareholders on a per-share basis. We're really ramping up those efforts right now.

And a little bit of tightening in the equity markets is a healthy thing, not only for the markets, but also for our business model in the sense that people are looking pretty hard for capital... and we are a source of that capital. So we are looking to do more of the same – acquire more contracts, grow the size of the company, and add value for shareholders.

John Doody: I love the royalty business model. One of the reasons I love it is because of the exact reason that Nolan just explained it. One thing people never really understand about royalty companies is how few employees there are. You don't need many people. You just make these deals and move on to the next one. Nolan, how many employees do you have?

Nolan Watson: Between both Sandstorm Gold and Sandstorm Metals and Energy, the total number of employees combined is 11.

John Doody: Amazing.

Frank Curzio: That is amazing. And for people who aren't familiar with royalty companies and what could actually happen in certain projects, we could take Cigar Lake. If you're not familiar with Cigar Lake, it's a huge uranium deposit, the largest undeveloped uranium deposit, they say. We could also look at Cameco, the largest uranium producer, which owns 50 percent of that mine. It got flooded in 2006 and they said, "Well, it looks pretty bad. It's going to take one year." Well, it's 2011 now, and you know what they're saying? "Well, it still looks bad. It's going to take about another year."

So a lot of small-cap and big-cap companies can't afford it, and those costs are up to $1 billion on Cameco right now. I mean, owning these royalty companies, you seem to avoid a lot of that risk, which brings me to my next question to Nolan. This is what I love about your business model also... How important is it to invest in properties in politically stable regions?

Nolan Watson: Well, you can only make money off an asset if you own the asset and continue to own it. So ensuring that you stay away from jurisdictions where governments are likely to expropriate the value of that asset – either through direct expropriation of the mineral claims or through super profit taxes and those types of things – is very important to us. It's always been a focus. Right now, all of our assets are in the Americas, and all of them are in politically stable countries within the Americas. Our focus going forward is to stay in politically stable jurisdictions.

I do think – with a small caveat – that once we get to a certain size and have more diversification than we do now, we may dip our toe in the water (in a minor way) in a country that will give us an above-average risk-adjusted return. But we don't have a lot of appetite for political risk. So we're trying to stay away from all situations where we think we'll lose money. The goal here is to get an above-average risk-adjusted return for shareholders. That's always been our focus.

Frank Curzio: And, also, Nolan, how important is it to have a long-term track record experience in this industry and also great contacts like you have? It seems like not any company can just say, "You know what? We'd like royalty companies. There's a great business model. Let me enter this business or get into this business." It seems like you're traveling around the world. You have to look at these projects individually. You probably have to rely on a lot of contacts that you trust in this industry. That makes it very difficult for just your average person to get into this industry from the competitive standpoint, right?

Nolan Watson: Absolutely. It's competitive not only from a contacts perspective but it's also a bit of a chicken-and-egg problem. It's very hard to launch these companies, because companies aren't going to sit there and negotiate with you for six months if you don't have any capital. It's not worth their time. They don't know if you can raise it. Conversely, the capital markets aren't going to give you money if you don't already have the deal. You can't get the deal without the money and you can't get the money without the deal.

I've seen about 10 to 15 people trying to start up these companies, and no one else has ever been successful at it. So, we're very comfortable with our landscape position here. At the same time, some other complexities are on the tax side. I've spent over $10 million in tax advice over the last five years. We've got this down to a science. A lot of the other people wouldn't even know where to begin.

Frank Curzio: Makes sense. I guess we will leave it there. I wanted to keep this within 20 minutes. Any parting thoughts, John, Nolan – I think we covered a lot here

– that you guys wanted to share before we go?

John Doody: Well, from my perspective I think Nolan's done a nice job and that I'm sure there's more to come, and I'm sure that gold is going higher.

Frank Curzio: That sounds great. And Nolan, you OK? You did a lot of explaining. You did a great job and got right to the point.

Nolan Watson: Well, thank you very much. Thanks for having me on the show.

Frank Curzio: OK, guys. Let's leave it there. We covered a lot today: gold prices, Sandstorm properties, and the future.

If any listeners have any questions on Sandstorm or any other of the other *Phase I* holdings, you can go to our feedback page on the Stansberry Investment website. Again, just log in, click "*Phase I investor*" on the left side, and hit the "Feedback" button. That will go directly to me.

I'm Frank Curzio. Nolan Watson and John Doody, thank you very much for taking the time to be on this conference call.