Which Royalty Company Belongs in Your Portfolio?

Description

There are very few businesses that are nicer to be in than the royalty business. After all, the basic function of these businesses is receiving a check, then cashing it. They don't have to build any mines or hire any labourers. Cost overruns are thus nonexistent.

As a result, Canada's royalty companies tend to trade at fairly high multiples. But does one of them still belong in your portfolio?

Franco Nevada

Canada's largest gold royalty company is **Franco Nevada** (TSX: FNV)(NYSE: FNV), and it has become a very popular way to bet on the price of gold. No wonder — since the company's IPO in 2007, its share price has approximately doubled, even though gold itself has only increased 50%. At the same time, the **S&P/TSX Global Gold Index** has decreased in value (with all the difficulties suffered by companies like **Barrick Gold**, **Kinross**, and **Allied Nevada**, it's easy to see why).

To the company's credit, part of the reason for its outperformance is the ability to sign good royalty deals. But the stock has also done well because it is a levered bet on gold; in other words, when gold goes up, Franco does even better. And when gold goes down, Franco does even worse.

Investors should thus be very careful before buying shares of Franco. You rarely, if ever, want to buy a company's stock just to bet on a commodity price, because it can often lead to paying *too* high a price. If you're looking to bet on gold, you're better off just buying an ETF.

Silver Wheaton

The silver counterpart to Franco is **Silver Wheaton** (TSX: SLW)(NYSE: SLW), Canada's largest royalty company. And like Franco, Silver Wheaton has outperformed its corresponding commodity price; while silver has appreciated 56% over the past five years (as of the beginning of May), Silver Wheaton shares have nearly tripled.

The company has other things in common with Franco, including a record of strong performance, low administrative costs, and plenty of upside from future growth. But also like Franco, there's a serious risk of overpaying for the shares, and less visibility on the future than you would get with an ETF.

If you're looking to bet on the price of silver, an ETF is again likely the best option — even though Silver Wheaton shares have been a much better investment thus far.

Labrador Iron Ore Royalty Corporation

Labrador Iron Ore Royalty Corporation (TSX: LIF) is a unique company. It not only collects a royalty from the Iron Ore Company of Canada but owns a 15.1% stake in the IOC too.

LIORC does not trade at the same lofty valuation of companies like Franco or Silver Wheaton. Nor should it. First of all, the growth opportunities are not the same. Secondly, not so many people are looking to bet on the price of iron ore.

And iron ore has not been a good bet either. Prices for the commodity are almost entirely dependent on China, which consumes two-thirds of global supply. As China has slowed down, iron ore prices have dropped below $100 per tonne, down 25% just this year. Further price drops could be on the horizon if China continues on this path. Even if demand rebounds, there is plenty of supply worldwide from industry heavyweights like **BHP Billiton** and **Vale** to meet that demand. Investors should steer clear of LIORC.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:FNV (Franco-Nevada)
2. TSX:FNV (Franco-Nevada)
3. TSX:LIF (Labrador Iron Ore Royalty Corporation)
4. TSX:WPM (Wheaton Precious Metals Corp.)

Category

1. Investing

Date
2025/07/02
Date Created
2014/05/29
Author
bensinclair