



Attention: Don't Buy Another Mining Stock Until You Read This

Description

Look, you won't hear this from anyone on Bay Street. You certainly won't hear this from your stockbroker. But I have been saying it for years...mining is a pretty crappy business.

Finding, building, and operating a mine is tough. You have to deal with labour disputes, cumbersome governments, environmental regulations, and expensive engineering problems. Doing all this while making a profit is no easy feat.

And that's when times are good. When commodity prices are falling, resource investors are on the hook for steep losses. We saw this last year when the Canadian mining industry collectively wrote off US\$17 billion in reserves. *Ouch!*

But as long-time *Motley Fool Canada* readers know, there's a way to profit from gold and silver mines without taking all of that risk. And over the past few years, these special investments, rarely advertised to the investing public, have delivered triple-digit gains for shareholders.

I'm talking, of course, about streaming metal companies.

The biggest names in this business are **Silver Wheaton** (TSX: SLW)(NYSE: SLW), **Franco-Nevada** (TSX: FNV)(NYSE: FNV), and **Royal Gold** (TSX: RGL)(NASDAQ: RGLD). These companies don't actually operate any mines. Instead, they provide mining firms an upfront cash advance in exchange for a percentage of a mine's production.

This is a real win-win for both the mining company and the royalty business. For miners, these royalty and streaming contracts provide a low-cost source of funds to complete construction of their project. For the streaming company, the firm can lock-in a source of cheap (and sometimes free) gold and silver production once the mine is built.

This business model allows a streaming company to generate profit margins in the neighbourhood of 80% to 90%...a heck of a lot better than your typical mining stock. And because the company's 'production' expenses are fixed, there're fewer surprises like cost overruns that could bite into returns.

This has all translated into above-average returns for investors. As you can see in the chart below, streaming metal companies have handily outperformed their mining counterparts over the past decade.

Company	10- Year Return	5- Year Return
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Silver Wheaton	1,478%	180%
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Franco-Nevada	N/A	113%
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Royal Gold	299%	60%
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Yamana Gold	221%	-18%
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Goldcorp	86%	-29%
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Barrick Gold	-28%	-52%
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Source: Google Finance

And there's more upside ahead...

You see, streaming metal companies are exceptionally cheap. Scared off by plunging commodity prices, investors have abandoned anything related to precious metals. And as a result, streamers are trading at a discount to their historical valuations on every financial metric.

Many of these streaming metal companies are also sitting on a boat-load of cash. Franco-Nevada has amassed a \$680 million war chest. Royal Gold and Silver Wheaton are sitting on US\$646 million and US\$82 million in cash and equivalents respectively. And because their costs are so low, all three of these companies are still generating enormous profits from their operations in spite of lower precious metal prices.

This is in stark contrast to the rest of the mining industry, which resembles the walking wounded returning from a battlefield. Most can't even generate enough cash to keep the lights on, let alone fund their business. This has allowed streamers to 'buy low'... negotiating exceptionally good terms from miners for their future metal production.

But a quick word of warning: Wall Street is beginning to move in. Morgan Stanley began covering this group in May and gave an 'Overweight' rating on the entire sector. And in June, SEC filings revealed the billionaire hedge fund manager George Soros had begun accumulating positions in both Franco-Nevada and Silver Wheaton. Other firms are following suit as we speak.

What would make some of the smartest financial minds in the world take notice of this little mining niche? I'd say it means only one thing: they see a big rally coming.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NASDAQ:RGLD (Royal Gold, Inc.)
2. NYSE:FNV (Franco-Nevada)
3. TSX:FNV (Franco-Nevada)
4. TSX:WPM (Wheaton Precious Metals Corp.)

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