



Thinking About Buying Gold Mining Stocks? Read This First

Description

Mining is generally a terrible business.

You probably won't hear that from your stockbroker, but I've been saying it for years. Building and operating a mine (while making a profit) is tough. You can run into all sorts of issues like labour strikes, cumbersome regulators, and expensive engineering problems.

And that's when business is good. In 2013, plunging metal prices forced the world's top 40 mining companies to collectively write off \$57 billion in assets. That's an enormous amount of shareholder capital flushed down the toilet.

But as regular Motley Fool Canada readers know, there's another way to invest in the mining industry without all of the risk: streaming metal companies.

The biggest firms in this niche are **Silver Wheaton Corp.** (TSX: SLW)(NYSE: SLW), **Royal Gold, Inc.** (TSX: RGL)([NASDAQ: RGLD](#)), and **Franco-Nevada Corporation** ([TSX: FNV](#))([NYSE: FNV](#)). These companies don't actually operate any mines themselves. Instead, they finance lots of early-stage mining projects in exchange for a steady stream of royalty payments.

It works like this: A streaming company provides a mining firm an upfront cash payment to fund a new project. In exchange, the streaming company is allowed to purchase a percentage of the mine's production at a fixed cost, and usually at a steep discount to market prices. Once the mine is built, the royalty becomes a reliable stream of income that can last for decades.

This business model has a lot of advantages over your traditional mining operation. First, it's a safer, more diversified way to invest in the materials sector. Streaming metal firms often have contracts with dozens of different mining companies and aren't focused on one big strike.

Additionally, after a streaming company makes the first payment its cost of revenue is virtually zero. This business model allows streaming companies to generate enormous profit margins between 80% and 90%. That's a heck of a lot better than your typical mining stock.

All of this has translated into market-beating returns for shareholders. As you can see in the chart below, streaming metal companies have handily outperformed the **NYSE ARCA Gold Bugs Index** (^HUI), a good barometer of the gold mining industry, over the past five years.

[Screenshot 2014-08-22 at 1.17.37 PM](#)

Image not found or type unknown

Source: *Yahoo! Finance*

And there could be much more upside ahead. These three companies have amassed \$1.5 billion in combined cash and cash equivalents. With most mining firms struggling today just to keep the lights on, streaming metal companies have been able to negotiate exceptionally good terms in new royalty deals.

Unfortunately, Wall Street is starting to catch on to this opportunity. Over the past few quarters a number of billionaire hedge fund managers including George Soros, Jim Simmons, and Ray Dalio have begun accumulating positions in Silver Wheaton. There has also been a noticeable uptick of hedge fund activity in other streaming companies like Royal Gold and Franco-Nevada.

What could all of these financial titans see in this industry? I'd say it means only one thing: they see an epic rally ahead.

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.)

Category

1. Investing

Date

2025/08/19

Date Created

2014/08/25

Author

rbailieul

default watermark

default watermark