Sandstorm Gold Ltd. Is Coming Back to Life

Description

Since its lows in January, **Sandstorm Gold Ltd.** (TSX:SSL)(NYSE:SAND) has more than doubled in value, reaching levels not seen since 2014. The biggest factor driving the stock price has been rising gold prices.

Can Sandstorm continue its latest run?

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A business model primed for success

Since 2013 most gold miners have been pummeled by a deadly combination of falling gold prices and rising costs of mining. Even when gold prices were rising, price gains were often not enough to cover the equally extreme rise in mining costs. Coined a "metals streaming company," Sandstorm set out to give investors a lower-risk vehicle to invest in commodities.

Essentially, Sandstorm acts like a bank, lending money to gold miners to start or expand the production of precious resources. However, Sandstorm gets paid back in fairly interesting ways.

The company generates money through two types of arrangements: royalties and streams. Royalties are where the company receives a portion of the revenue generated from a mine.

In a stream arrangement, Sandstorm purchases a portion of the gold produced from the mine at a fixed and typically drastically reduced price (e.g., $400/oz). This method of lending comes with some unique advantages. Chiefly, the firm incurs no exploration costs, can diversify its investment across dozens of mines, and can generate cash flow at a wide range of gold prices.

The latest run is a win-win

Sandstorm's model has been stressed by the magnitude of gold's demise over the past few years. Typically, the company can tout its low-risk model. For example, it's not on the hook for cost overruns (which are frequent in the mining industry) and, unlike most mining companies, Sandstorm has almost no debt.

Still, the mining industry has been stressed so much of late that Sandstorm's ability to keep producing has been greatly hindered, all but eliminating its ability to make money. Even if it has rights to buy gold at an attractive US$400 an ounce, that right is worthless if there is no production. Sandstorm stock rallied so strongly because not only can it sell its share of production at higher rates, but volumes will likely rise as well. That's a win-win.

All aboard the cash train

If gold prices stay above US$1,200 an ounce, Sandstorm expects to generate plenty of cash in the years ahead.

Image Source: Sandstorm Corporate Presentation

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If the company hits its target of roughly $40 million in cash flow this year, shares would now trade at a 4.7% cash flow yield. Based on 2021 estimates, it trades at a 7.5% cash flow yield. While that valuation is hardly enticing, earnings could pop immensely if commodities continue to run. For example, if gold reaches US$1,600 an ounce, Sandstorm expects cash flow to hit $108 million in 2021–a 12.9% cash flow yield.

After its latest run, however, Sandstorm stock appears to have priced in future commodity runs. At its current valuation, investors are likely better off waiting for another dip. Unless you're a major gold bull, it looks best to stay on the sidelines for now.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. TSX:SSL (Sandstorm Gold Ltd.)

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