Gold Stock Correction: Time to Buy?

Description

After having a super rally from 2019 to mid-2020, gold prices have pulled back meaningfully from their highs. Specifically, the gold spot price has fallen more than 15% from US$2,050 per ounce to the US$1,732 level.

This has caused a selloff of gold stocks, too, from the highs. Gold is one of the traditional inflation hedges that investors use as a way to maintain their purchasing power against inflation.

Holding gold bullions or coins in a safety deposit box would work against that goal, as the safety deposit box costs an annual fee. Depending on the size of the box, my bank charges an annual fee of $60-$350. Unless you already use a safety deposit box for other valuables or important documents, it might not be worth it to get one just to store gold.

Additionally, gold isn't productive. It doesn't produce anything for investors in the holding period.

Investors might turn their direction to gold stocks instead. Large-cap gold stocks tend to pay some sort of dividend yield, which gives some returns while holding the shares.

Franco-Nevada (TSX:FNV)(NYSE:FNV) is a top-quality gold stock you can consider. It has outperformed the gold ETF over different timeframes. This results in a marked difference in the wealth created for investors over time. Indeed, Franco-Nevada has been much more than an inflation hedge.

Here's a long-term comparison between the wealth creation from $10,000 invested in Franco-Nevada stock versus the gold ETF under the ticker NYSE:GLD.

Data by YCharts.

The gold business

Franco-Nevada is primarily a gold royalty and streaming company with a large and diversified portfolio of assets from which it generates royalties. Therefore, it doesn't explore, develop, or run any mines, which is costly to do.

It's no wonder the gold stock enjoys some of the highest margins and one of the strongest balance sheets in the industry.

The company's 2020 EBITDA margin and adjusted net margin were 82% and 51%, respectively. It also has zero debt and exactly US$1.9 billion of available capital to access at the end of 2020, including 32% in working capital, 10% in marketable securities, and 58% in credit facilities.

Currently, Franco-Nevada's portfolio spans across 400 assets, including 318 in gold and gold-equivalent assets and 82 in energy assets.

Over the past 12 years, you'll notice that the gold business's adjusted EBITDA has stayed resilient through economic cycles and rose roughly in line with its revenue. So, its revenue and adjusted EBITDA are some of the key metrics investors should take note of.

The gold stock's superb recent results

Franco-Nevada reported a record 2020 thanks to the super rally in gold prices. Specifically, it increased its revenue by 21% to more than US$1 billion, its adjusted net income climbed 51% to US$516 million, while its adjusted EBITDA saw growth of 25% to nearly US$840 million.

Its fourth-quarter results were also strong. Revenue, adjusted net income, and adjusted EBITDA climbed 18%, 47%, and 26%, respectively.

The Foolish takeaway

Franco-Nevada's superb recent results have allowed it to increase its dividend at a higher rate than normal. This month, it increased its dividend by 15.4%, marking the start of its 14 consecutive years of dividend growth.

In comparison, its dividend compounded by 4.1% per year over the past five years. The new annualized payout is US$1.20 per share, which turns out to be a yield of about 1% from FNV's recent quotation.

The gold stock's persistent price momentum over the long haul suggests it could be a good idea to buy it on dips. After the stock corrected more than 30% from its high, the investing community has finally shown renewed interest in the stock.

The stock currently trades at a discount to its normal multiple, which implies near-term upside potential of 20-40% is well within the realms of possibility.

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