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Vail ValueX 2012

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Sitka Pacific Capital Management, LLC

"Value Investing From the Top-Down"

My Best Absolute Return Idea

- A sub-sector idea for the next 1-3 years
- Many cheap stocks across geographies, cap sizes
- Favorable demand trends for product with limited supply capacity + barriers to entry= pricing power
- Not without risks

Cheap Stocks

<u>Group Valuation- current year (15 stocks)</u>

Dividend Yield: ~2% (0-3%)

P/ Book Value: ~1.2x (0.7x-1.8x)

P/Current Free Cash Flow: ~8.5x (2.5x-12.7x)

EV/EBITDA: ~6.5x (2.2x-9.9x)

P/NAV using DCF (5%): ~1.2x (0.5-1.7x)

A Great Product

Global appeal and demand

Especially among those with high savings, propensity to consume

- Emerging Market Consumers, Commodity Producers
- The Wealthy Globally (the 1%)

Cache

- Long history of consistent demand with occasional spikes
- Widely coveted as an aspirational good

Limited Supply

- Highly regulated, capital intensive, difficult jurisdictions, long supply response time

Remarkable Pricing Power

- Centuries of consumers around the world willing to pay ever higher prices
- Often displays NEGATIVE demand elasticity (demand rises with price)- bubble prone

What is the product?

- Gourmet Coffee?
- Single Malt Scotch?
- Fine Wine?
- Art?
- Resort Property?
- NO…..

GOLD!

Have I lost you yet?

It's perfectly *understandable* for traditional value investors to have an aversion to gold…

"Gold is a great thing to sew onto your garments if you're a Jewish family in Vienna in 1939 but I think civilized people won't buy gold – they invest in productive businesses." – Charlie Munger

From: Vitaliy Katsenelson <vitaliy@me.com>
Sent: Thu 3/15/2012 10:20 AM
To: JJ Abodeely
Cc:
Subject: RE: VALUEx Vail 2011

JJ, we'd be happy to have you at VALUEx, but one caveat – no gold discussion. From past experience gold conversation adds little value, and diverges from real focus of the conference.

… but it is not *rational*. Gold is not in competition with stocks any more than cash is. Holding gold is necessary when holding currency may be detrimental to protecting future purchasing (or investing) power.

WWBGD?

But I'm not here to convert you

- You either believe gold is money or you don't
- Forced religious conversions are messy affairs

For the agnostics…

From: Vitaliy Katsenelson <vitaliy@me.com> Sent: Wed 5/30/2012 12:40 PM
To: JJ Abodeely
Cc:
Subject: RE: VALUEx Presentation Topic Due Friday June 1st

JJ, mining companies would make an interesting presentation, if you could approach it of how you analyze/value them. What gold price is built into them.

The Important Questions:

1. Where is the margin of safety in a stock that produces something that is "hard to value"?
2. What value do these companies have at current gold prices? … or if gold goes down?
3. What conditions make NOW a good time to own mining stocks?
4. What would make us change our thesis; what are the risks?

The Fun/Scary Questions:

1. What would make gold go much, much higher? What are these stocks worth then?

With apologies to Warren…

Determining Intrinsic Value:

1. Cash flow from current production available to shareholders
   - Cash margin of currently producing mines
   - P/FCF, EV/EBITDA, etc.

2. PV of gold that is likely to be produced in the future
   - Proven and probable **reserves** (P/NAV, P/ Oz.)
   - **Resource** optionality (Black-Scholes or wait until free!)

Cheap Stocks on Current Production

<u>Group Valuation- (15 stocks 80% of $200B)</u>

Dividend Yield: ~2%   (0-3%)

P/ Book Value: ~1.2x   (0.7x-1.8x)

P/Current Free Cash Flow: ~8.5x (2.5x-12.7x)

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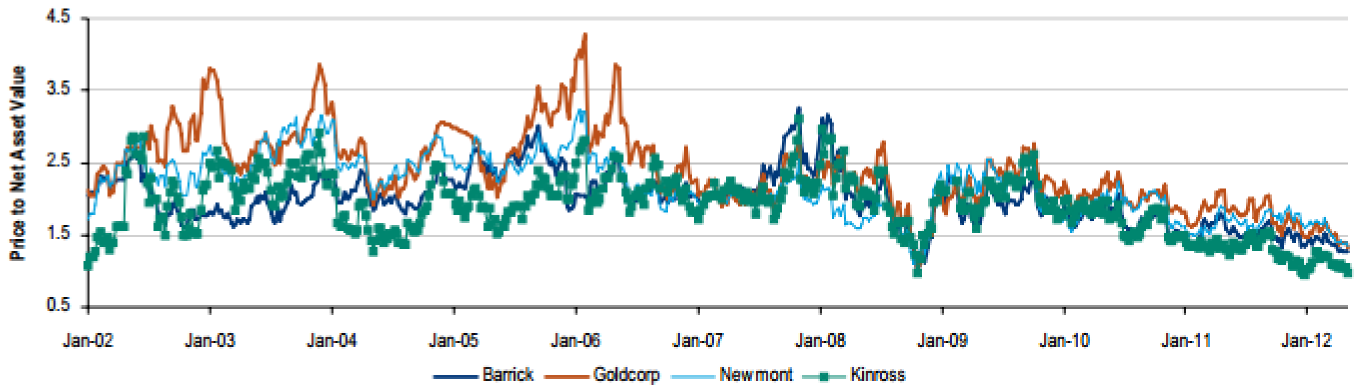
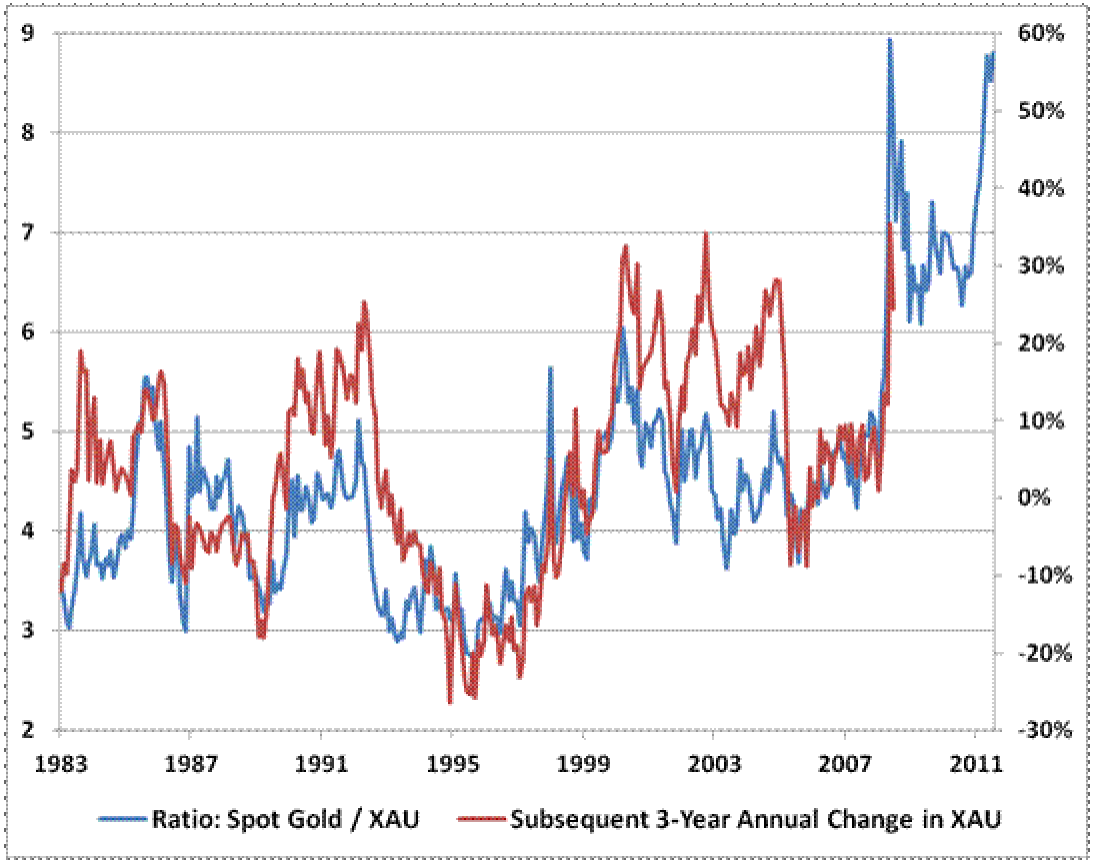
Select Senior Gold Producers		Price as of	**P/Cash Flow**			
		6/21/2012	2010A	2011A	2012E	2013E
Barrick	ABX	$ 38.29	9.3	6.7	5.4	5.5
Kinross	KGC	$ 8.37	6.3	5.9	5.7	5.5
Newmont	NEM	$ 47.80	6.0	6.0	6.2	6.0
AVERAGE			**7.2**	**6.2**	**5.8**	**5.7**
Source: Company data, Consensus estimates from Bloomberg						

Cheap Stocks vs. Value of Gold



Source: BofA Merrill Lynch Global Research

A Pretty Good Guidepost



Source: Hussman Funds

Caveat Emptor: Buyer Beware

West African Gold Miners	Ticker	Market Cap	P/ CFPS	EV/ EBITDA	P/NAV	MC/ P+P (cash cost)
Goldenstar Resources	GSS	$340mm	2.4x	2.2x	0.49	$83 ($1,202)
IAMGOLD	IAG	$4.3B	7.0x	4.3x	0.78	$289 ($700)

What Gold Price is Built In?

Sell Side Mining Analysts: : “Chase and Raise”

For current (1-3yr) production, revenue, cash flow, earnings estimates: ~$1,700/oz

For NAV estimates, a “long-term” price: ~$1,200/oz

What do you pay for 1 oz?

Priced as of: June 01, 2012	BofAML	Share	Shares	P&P Gold		Production		Adjusted Market Cap Per Oz of Prod. (USD)		Adjusted Market Cap	Total Cash	Adjusted Market Cap
Senior Gold Producers[1]	Sym	Price	O/S	Reserves (million oz)	Total Gold Resources including P&P (million oz)	2012E ('000 oz)	2013E ('000 oz)	2012E	2013E	Per Oz of Reserves	Costs 2012E	Per Oz of Resources
Barrick Gold	ABX	41.91	1,000	139.9	260.5	7,486	7,731	6,497	6,291	348	556	187
Goldcorp[8]	GG	39.40	810	64.7	116.0	2,490	3,160	12,235	9,641	471	210	263
Kinross Gold[7]	KGC	8.53	1,138	62.6	108.0	2,630	2,727	4,654	4,488	196	705	113
Newmont Mining	NEM	50.30	495	98.8	140.9	5,143	5,364	5,397	5,175	281	659	197
Market Cap Weighted Average								**7,519**	**6,702**	**348**	**507**	**201**

Source: BofA ML

<u>**If Mr. Market sold us the four largest producers**</u>

~$7,500 per oz of Production (5 years at current production and prices)

~$348 per oz of RESERVES

~$507 cash costs for us to extract

~$855 per oz to purchase and then produce something we can sell for

~$1,600 per oz in spot market

A Case Study: Newmont (NEM)

- Annual Production: 5mm oz
- P&P Reserves: 100mm oz (at $1,200 gold)
- Market Cap (~$25B)=
  - 3.3yrs of production at current prices, levels
  - $281/oz of P&P reserves + $659 (or lower) cash costs– we get company for $940/oz
- Profitable Reserves: 5% delta to $950
- 6% increase in gold → 17% increase in EPS
- Gold linked dividend policy- ~3%

Newmont Continued

Aswath Damodaran: “compare the price you are paying for growth with the value of growth”

1	**Input page**	**NEWMONT**			
2	***Market inputs for your company***	***in Millions***			
3	Market Capitalization =	$25,000,000		***Measures of profitability, leverage & growth***	
4	***From the balance sheet***	This year	Last year	ROE =	14.55%
5	Book value of equity =	$17,475,628	$15,771,000	ROIC =	16.23%
6	Total Debt Outstanding =	$6,100,000	$4,300,000	Net margin =	21.27%
7	Cash & Marketable Securities =	$3,200,000	$1,850,000	Pre-tax operating margin	27.40%
8	***From the income statement***			D/E ratio (book) =	34.91%
9	Revenues	$10,792,750	$10,358,000	D/E ratio (market) =	24.40%
10	Operating income (EBIT) =	$4,225,325	$4,179,000	Growth rate (revenue)	4.20%
11	Effective tax rate =	30%		Growth rate (EBIT)	1.11%
12	Net Income	$2,295,328			
13	***Your growth inputs***				
14	Expected growth rate in operating incom	5%		***To solve for the implied growth rate in your mark***	
15	Return on Invested capital on growth =	12.76%		1. Open the Goal Seek function in Excel (und	
16	Length of growth period =	10		2. Set cell B24 to the value in cell B28 by char	
17	***Your cost of capital inputs***			cell B14.	
18	Cost of equity =	7.90%		3. You should see the implied growth rate in	
19	Cost of capital =	6.60%			
20	Riskfree rate =	2.00%			
21					
22	**Intrinsic Value**			***Market Value***	
23	Value of assets in place =	$44,814,053.03		Market value of equity	$25,000,000.00
24	Value added by future growth =	$10,115,057.07		Enterprise value	$27,900,000.00
25	Intrinsic enterprise value	$54,929,110.11			
26	Intrinsic equity value	$52,029,110.11			
27	**Growth Analysis**				
28	Price you are paying for growth =	-$16,914,053.03			
29	Value of this growth =	$10,115,057.07			
30	Price of growth/ Value of growth	-167.22%			

EV: $27.9B
Value of Assets: $44.8B

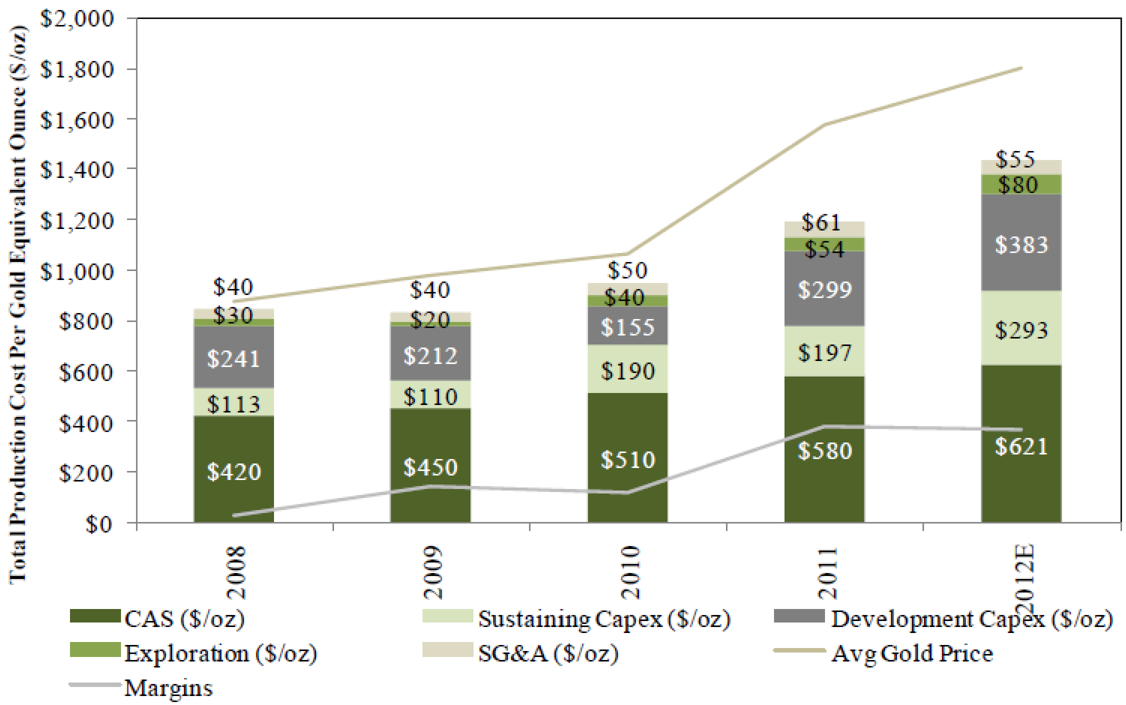
$16.9B UNDERVALUED (60%)

Value of Growth: $10.1B
Intrinsic Equity: $52B

$27B UNDERVALUED (108%)

Another way to look at it

Figure 57: Senior Gold Miners' All-in Production Costs vs. Margins since 2008



Source: Newmont Mining, Sterne Agee
Note: Senior Gold Miners for this Exhibit include ABX, GG, KGC and AU

<u>In 2011:</u>

Cash Costs: $580/oz

All-in Costs: $1,191/oz

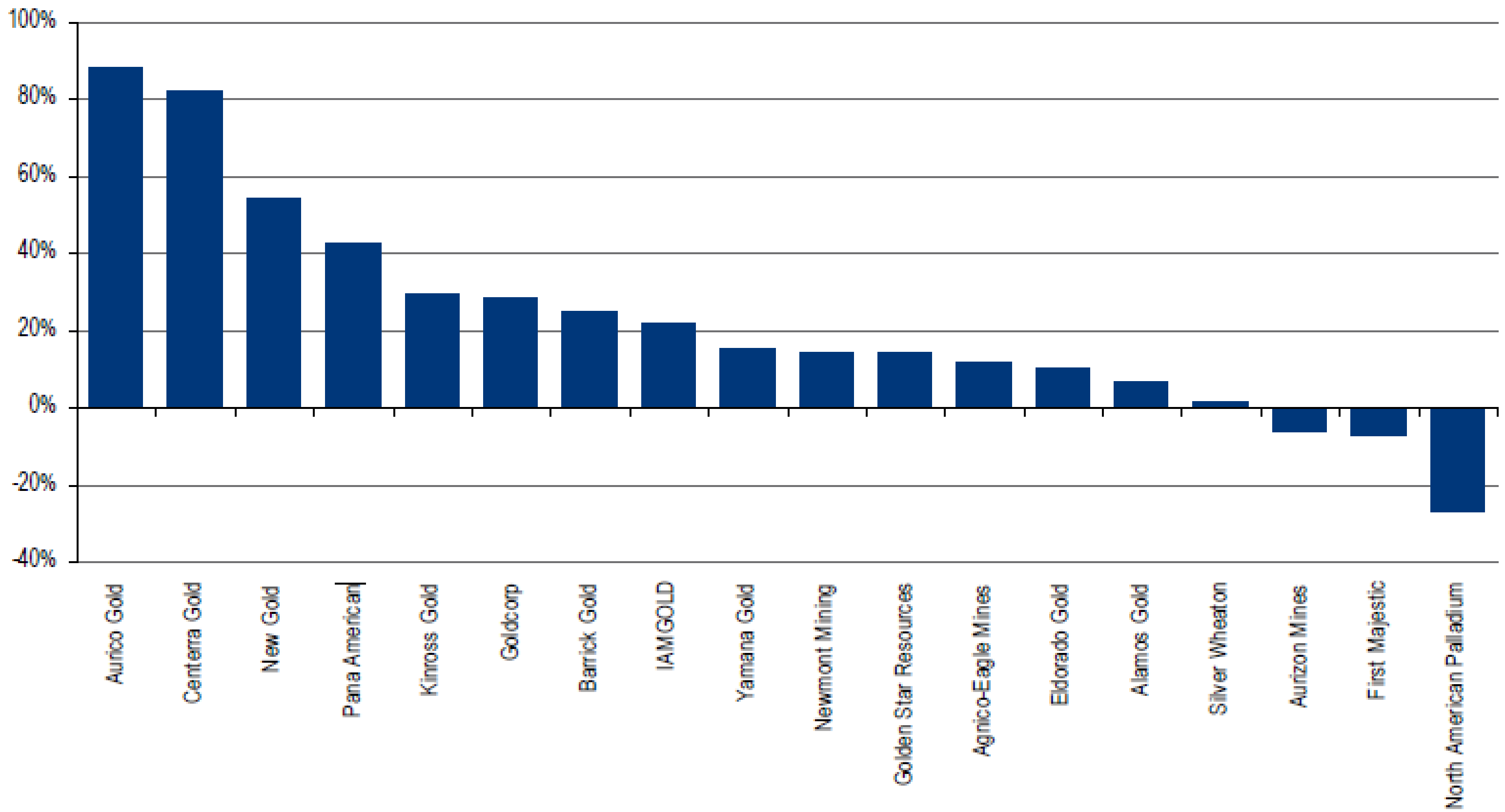
Avg Price: $1,573/oz

Avg. All-in Margin: $382/ oz or 24.2%

Why is Mr. Market So Generous?

1. Gold will not go up significantly and may decline

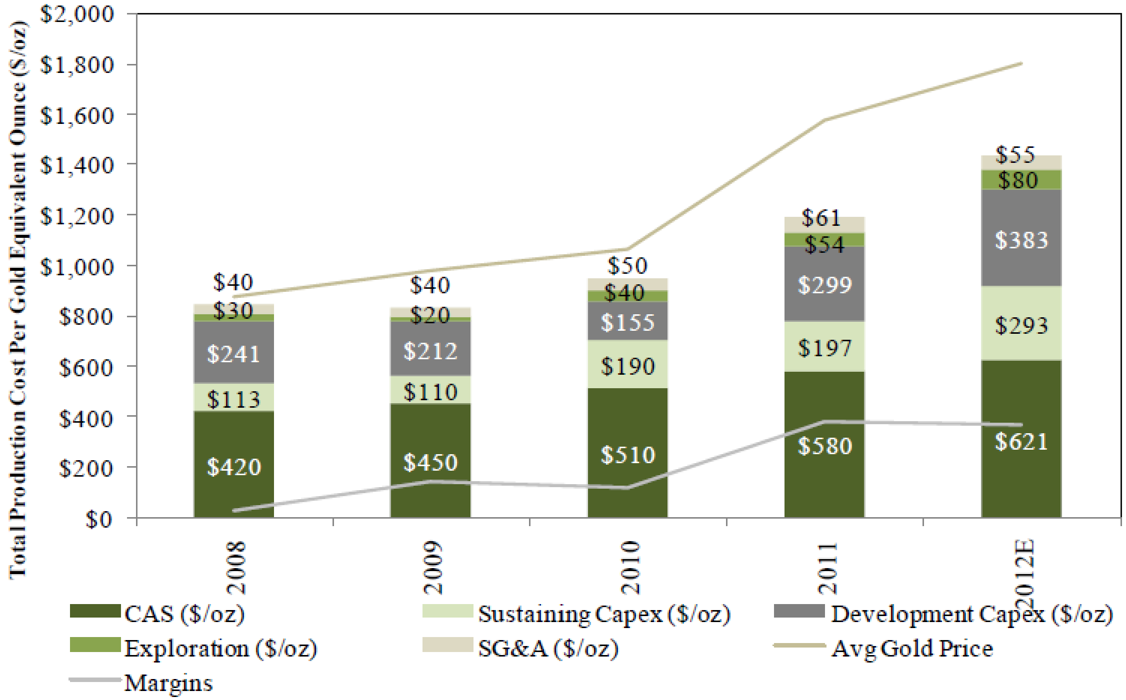
Chart 4: YoY % change in forecast Q1'12 gold cash costs



Source: BofA Merrill Lynch Global Research

Another way to look at it

Figure 57: Senior Gold Miners' All-in Production Costs vs. Margins since 2008



Source: Newmont Mining, Sterne Agee

Note: Senior Gold Miners for this Exhibit include ABX, GG, KGC and AU

In 2011:

All-in Costs: $1,191/oz

Avg Price: $1,573/oz

Avg. All-in Margin: $382/ oz or 24.2%

In 2012????

All-in Costs: $1,432/oz

Avg Price: LOWER?

Avg. All-in Margin at $1573: $141/ oz or ONLY 9.0%!

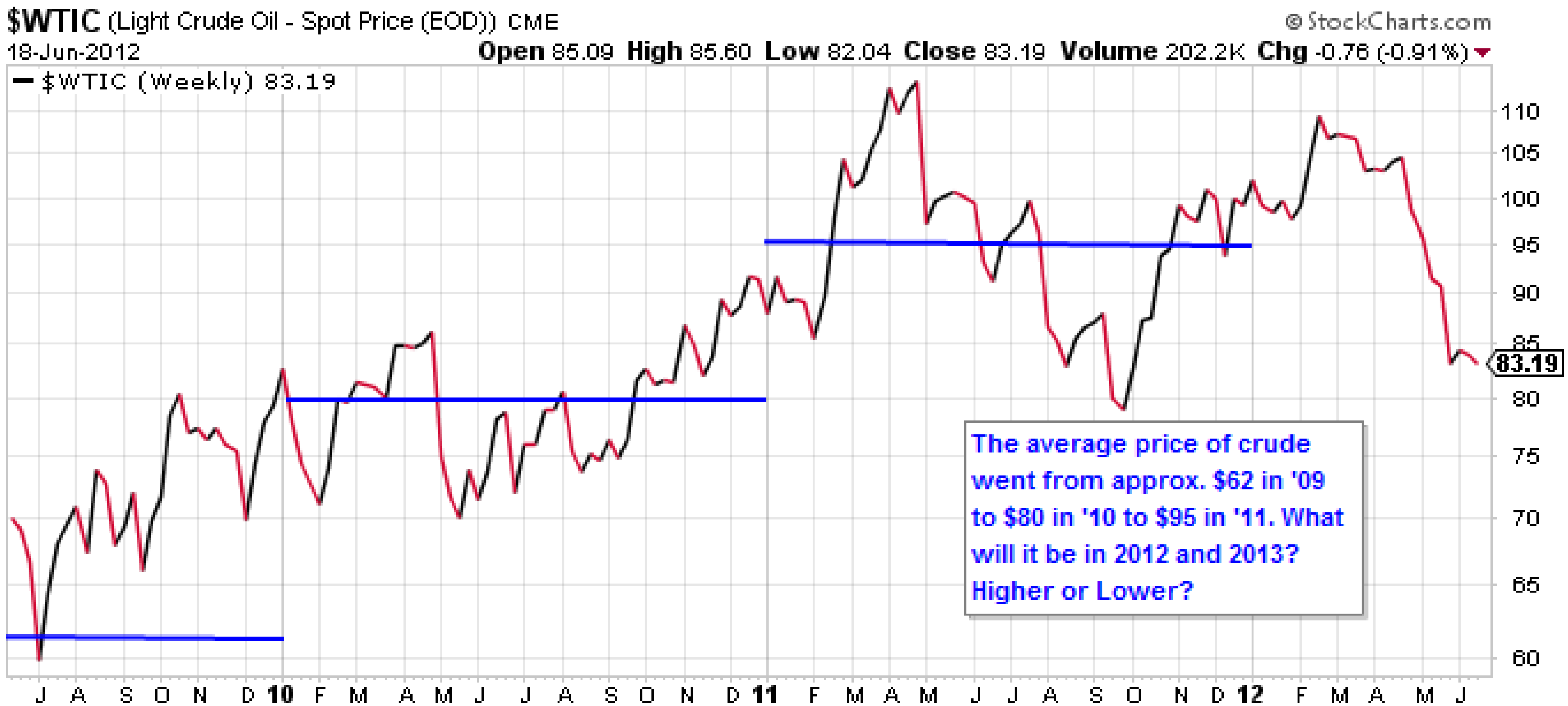
A 62% drop in margins is feared/expected?!!

Is the Fear Justified?

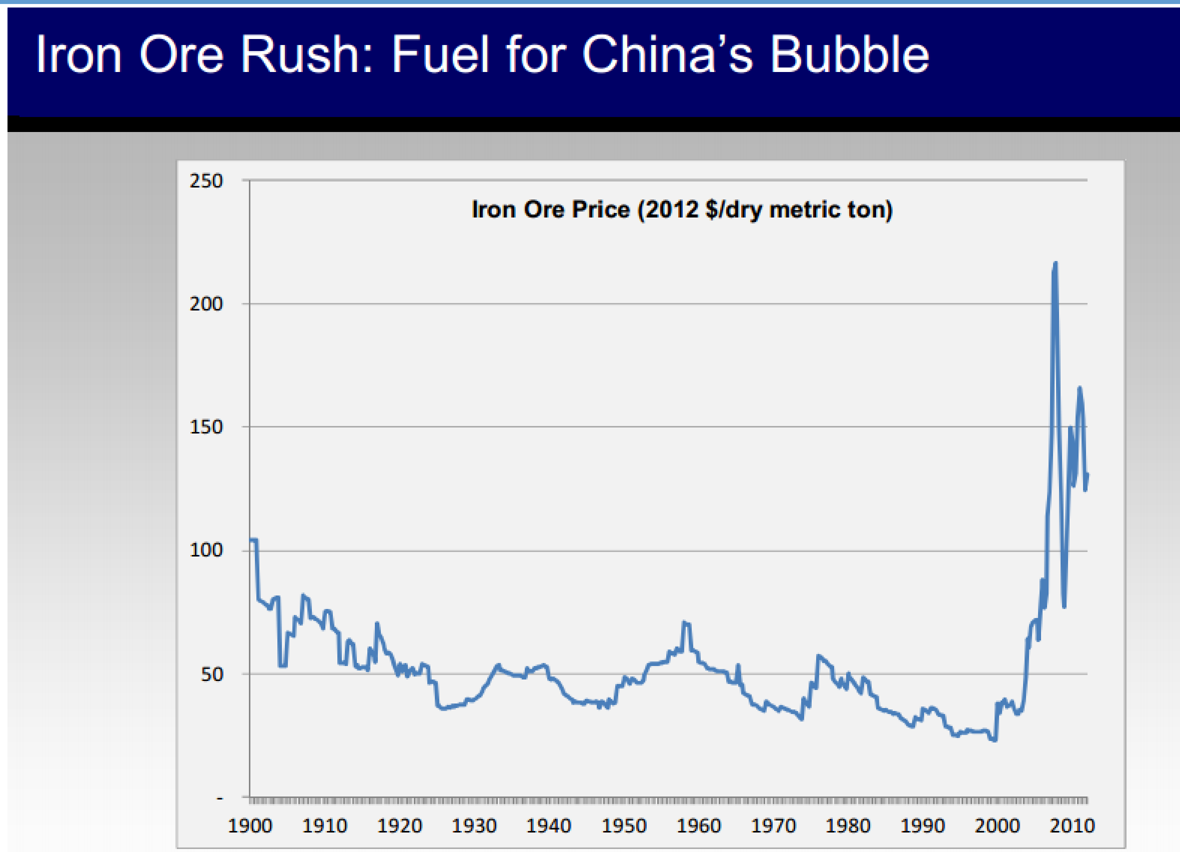
Rising Cost Pressures:

- Energy prices, especially diesel
- Mining equipment prices, driven by higher base metal prices among other things
- Wages for relatively scarce mining-related labor (though SG&A appears fairly well contained)
- Merger & Acquisition costs
- Taxes, Environmental and Regulatory Costs, etc.

Mr. Market's Weakness: Extrapolation



Mr. Market's Weakness: Extrapolation



Thank you Jim Chanos

Gold mining stocks currently represent less than 10% of global commodity-related equities by market cap.

Gold's Lost Luster…

Gold tips to losses on profit-taking

03/27/12

The end of the gold bull is on the horizon

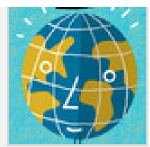
03/15/12

Gold selloff risks halting investors' buying spree

02/29/12

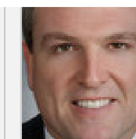
TOP STORIES IN
Personal Finance

1 of 12
SmartMoney



2 of 12
A Smarter Way to Invest Globally?

3 of 12
Quirks of High-Yield ETFs



UPSIDE | June 1, 2012, 5:33 p.m. ET

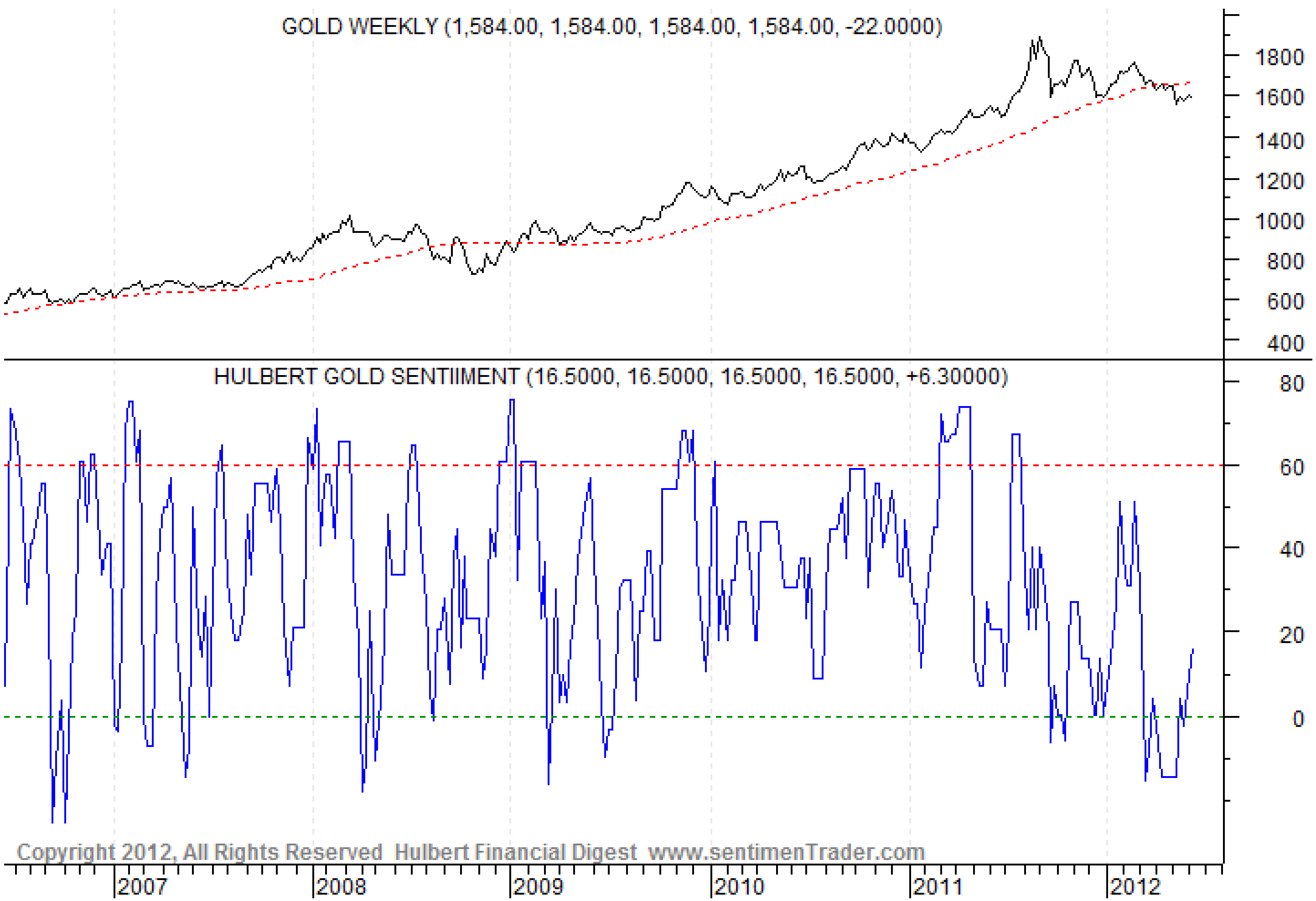
How Much Gold Do Investors Need? Zero Should Suffice

By JACK HOUGH

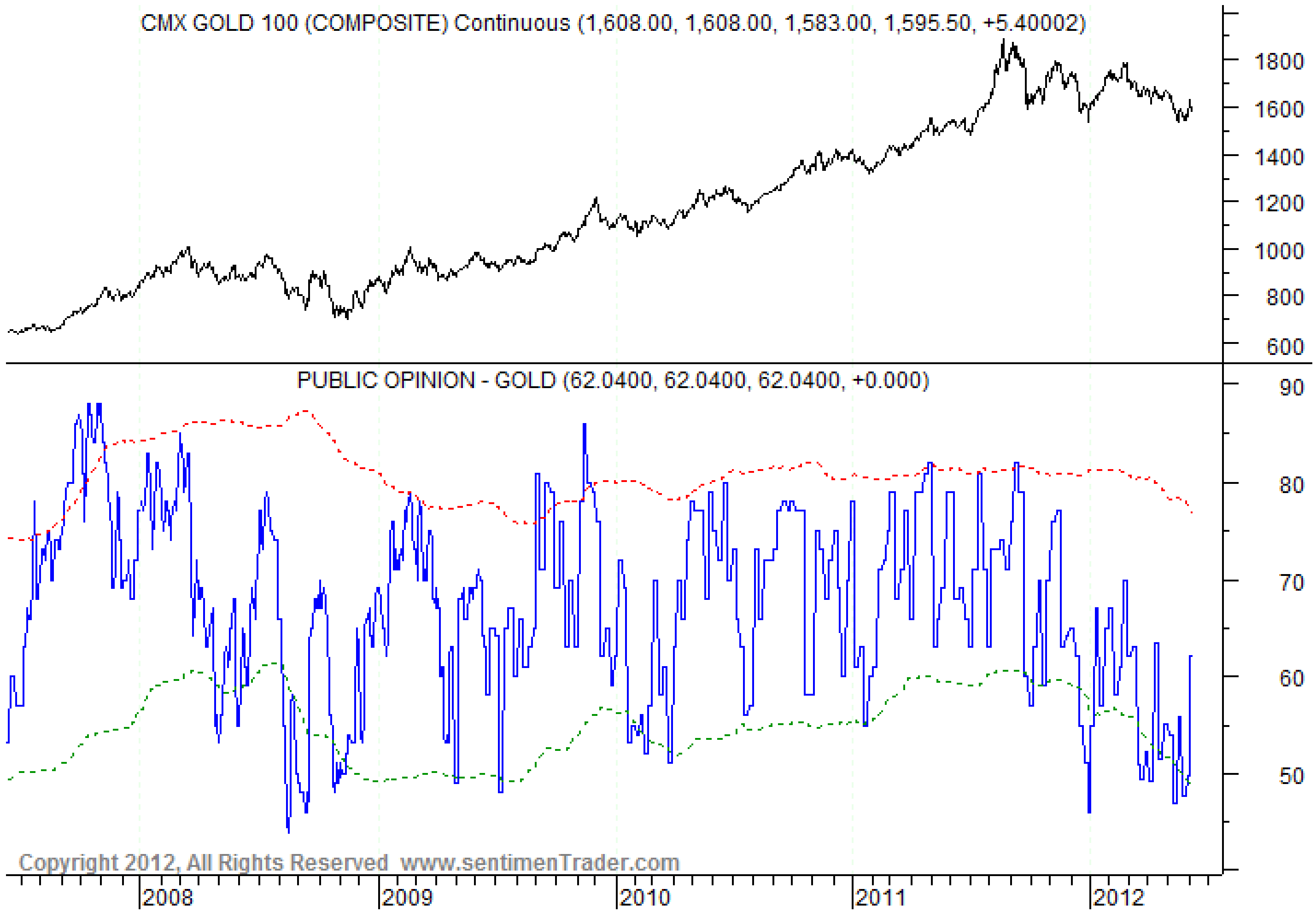
Why Your Portfolio Doesn't Need Gold

06/04/12 | SmartMoney Online

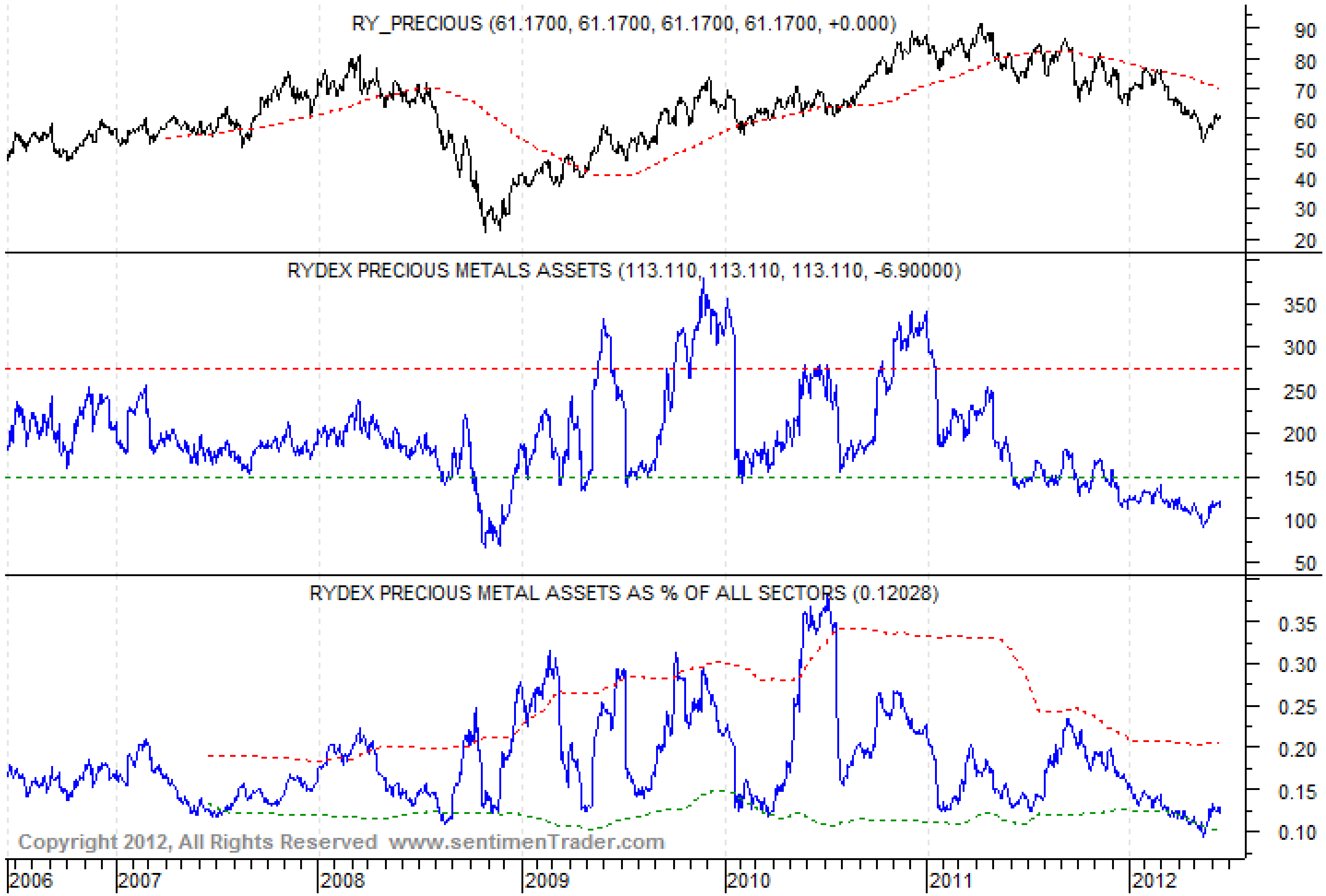
Gold-Focused Newsletter Writers



The Investing Public…



The Investing Public's Money…



Miners In Summary

- Investors are extrapolating recent gold price weakness and thus sentiment is very negative
- Mining stocks are pricing in lower gold prices AND/OR higher input costs based on NEGATIVE market implied growth rates
- If gold rises OR cost pressures abate (proxy: global commodity prices) miner's are very attractive
- Mining stocks respond very favorably to environments where the economy is weakening, real interest rates are falling, and the stocks are priced inexpensively relative to the metal.

Are Gold Miners A Value Trap?

Value Traps: Some Common Characteristics

- Cyclical and/or overly dependent on one product
- Hindsight drives expectations
- Marquis management and/or famous investor(s)
- Appears cheap using management's metric
- Accounting issues

Thank you, Jim Chanos.

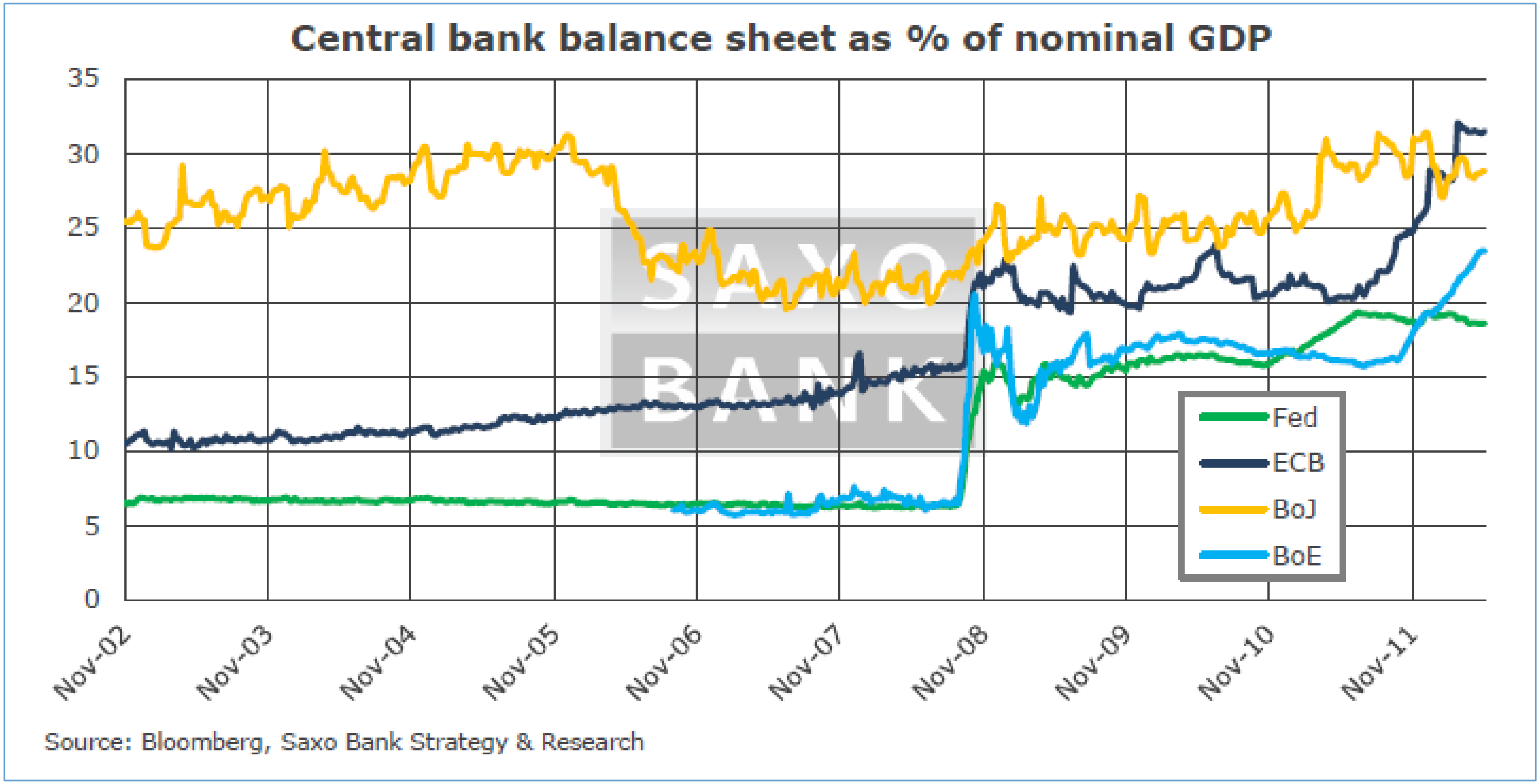
What gold is worth

Gold Price= 1/n

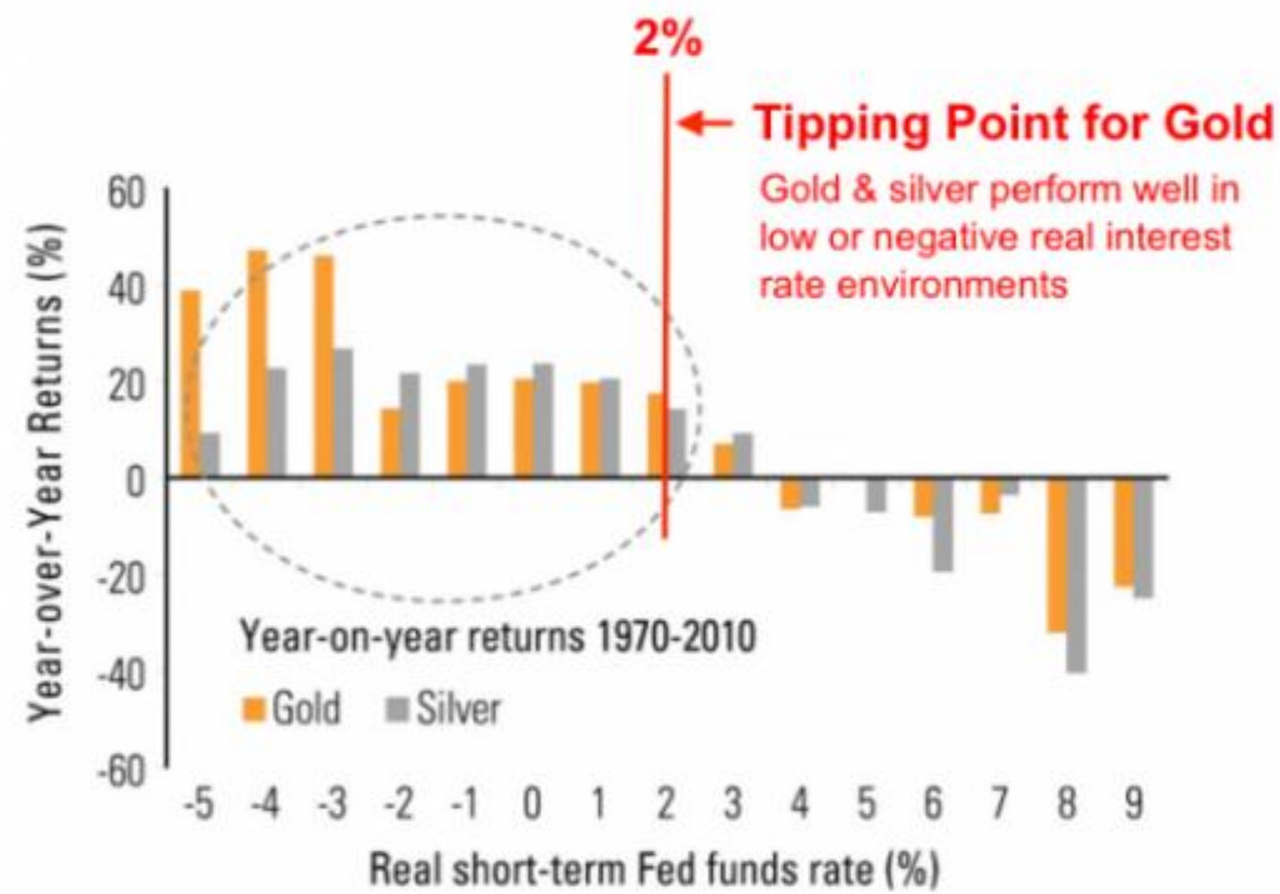
where n= the world's trust in the institution of paper money and in the capacity of central bankers to manage it RESPONSIBLY

Thank you James Grant

Is this responsible?



Protection from Financial Repression



Source: Bloomberg, Deutsche Bank, & US Global Investors

Risks

Specific to Miners:

- Increased taxation, environmental & gov't regulation (corporate repression)
- Poor Management
- Liquidation type sell off will hurt miners like any other asset (opportunity)
- An organic, non-stimulus driven economic recovery featuring a strong dollar and shrinking CB balance sheets.
- That was a joke.

How to Hedge

- Short Energy Stocks (ex NG)
- Short Building/Construction Materials Stocks
- Short Transportation Stocks
- Long the USD

Thank You and Disclaimer

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