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Mercenary Alert: A Royalty Company for Your Consideration

A Special Alert Musing from Mickey the Mercenary Geologist

For Subscribers Only

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The gold resource sector continues to decline with little hope for a short-term recovery. There are many reasons why this is occurring, which I outlined one year ago in an essay that still rings true entitled, "Why Gold Stocks Suck" (**Mercenary Musing, April 30, 2012**).

That said, the royalty companies, which constitute a small segment of the gold mining industry, continue to prosper even in these down times. Speculators interested in gold equities favor royalty companies as a relatively low-risk way of gaining exposure to the precious metals sector. As a result, they have maintained strong market capitalizations compared to the rest of the sector.

There are four types of royalties common to the metals mining industry:

- A net smelter return (NSR) is a royalty structure whereby the miner operator pays the royalty owner a percentage of the net production value returned from the smelter or refinery less transportation charges.

- A gross royalty (GR) is a structure based on a percentage of the final unit sale price of the metal produced. It is seldom employed in base and precious metals mines but is common in the uranium business.

- A metal stream is a royalty structure where the royalty owner receives a certain volume of a mine's production less a fixed price deduction per unit of metal produced.

- A net profits interest (NPI) is a royalty structure that provides the royalty owner with a percentage of a mine's net profit less deductions related to production costs.

Since most precious metals mines process their ores on site and produce dore bars of nearly pure metal alloys, transportation and final refinery charges are generally low-cost items.

Most prospectors, geologists, small miners, and land speculators who own mineral properties will lease, option, or sell this ground to a larger group or company with the financial wherewithal to explore, permit, develop, and mine it. These agreements generally contain a clause whereby the original or underlying owner retains a royalty interest on mineral production.

Therefore, a royalty is a carried interest requiring no capital for exploration, development, or mining and can become a significant asset to the original or subsequent owners. The royalty or a portion thereof can be sold by the original owners to a mining company or an outside party prior to or upon start-up of the operation. This monetizes the royalty, giving the owner a substantial amount of money up-front, though at a discount to the royalty's net present value.

Royalties are well-defined, cash flow-generating stakes in mining operations and are attractive assets. A range of financial entities in the mining sector buy and sell royalties. This is where the royalty company business model comes in.

Royalty companies, syndicates, and trusts have existed since the gold rushes and mining booms in the Western United States in the late 1800s. In the early 1980's and concurrent with the musical scene, a "new wave" of royalty companies focused mainly on gold mines arrived, including Franco-Nevada, Euro-Nevada, Royal Gold, and International Royalty.

Two of these, Franco-Nevada (FNV.NYSE) and Royal Gold (RGLD.NASDAQ) remain the largest and most successful royalty companies in North America. In their wake, a number of other royalty and metal stream companies have emerged in the North American precious metals industry over the past few years.

More recently, smaller firms have sprung up and targeted junior resource companies desiring to sell royalties as an alternative way of raising funds. In today's difficult financial markets, a royalty sale enables a small resource company to raise capital for exploration, development, and/or mining projects without incurring equity dilution.

One new company with a small-scale mine royalty model recently attracted my attention and speculative dollars: **Gold Royalties Corporation (GRO.V).**

The principals of the company requested a meeting at the Cambridge House California Resource Conference in late February, and I was intrigued. However, at that time I did not know enough about new-era royalty companies in general and their specific company and its monetization opportunities to get involved.

Over the next few weeks, I researched the royalty and metal stream business models, and then focused specifically on Gold Royalties' company management, corporate philosophy, share structure, current income-producing property, and non-producing royalty interests. After careful due diligence, I put the company in my "prospects" stock basket and kept in touch with management.

We met again at the Calgary Energy and Resources Conference in early April and I decided to accumulate a stock position in Gold Royalties. Finally in late April, we reached an agreement that GRO would become a sponsor of MercenaryGeologist.com.

Gold Royalties Corp was founded in 2010, began operations in early 2011, acquired several royalty interests, and went public on the Toronto Venture Exchange via an amalgamation with Richmond Row Capital Corp in late August 2012.

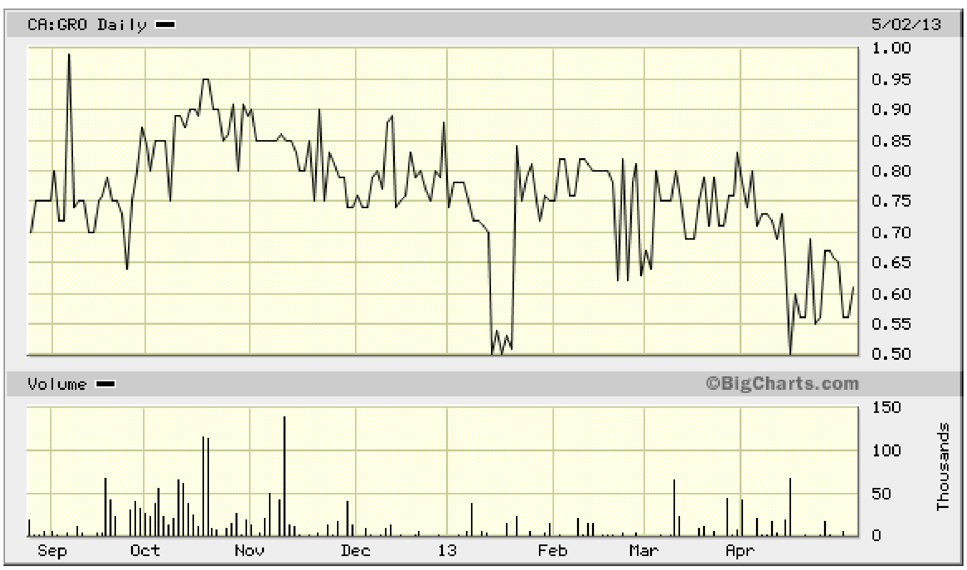
GRO raised $5.5 million in several rounds as a private company. In conjunction with going public, it raised another $9.6 million via $4.2 million in equity and $5.4 million in a convertible debt facility with

Callinan Royalties (CAA.V). Those funds were used to purchase a royalty interest on an advanced exploration/development play in the Yukon for $9.0 million.

Shortly thereafter, Gold Royalties entered into a two-year, renewable, royalty acquisition partnership with Franco-Nevada Corp. This agreement provides that Franco-Nevada can participate up to a 50% interest in any future royalty or metal stream that GRO acquires where the total consideration paid is $15 million or less. The company has acquired additional royalty interests on early-stage projects in Canada and now holds twelve in total.

A chart since Gold Royalties' commencement of trading in late August of last year is presented below. The company has an all-time high of 99 cents and low of 49.5 cents; it closed Friday at 58 cents. It has only 20.5 million shares outstanding and 31.9 million fully diluted. Warrants include: 5.5 million at 50 cents with expiry in October-November 2015; 300,000 at 80 cents and 3.0 million at $1.00 expiring in July 2014; and 1.1 million at $1.20 with expiry in October 2014. There are 900,000 stocks options awarded to management and directors at 37.5 to 82.5 cents with expiries from 2015 to 2022. 600,000 brokers' warrants at $0.70 to $1.00 expire in August 2014.

GRO is very tightly held with insiders, family, and friends controlling a large and long-standing percentage of the stock; therefore, the company has very low liquidity. As mentioned above, Gold Royalties has a convertible debt facility of $5.4 million with Callinan Royalties Corp at 10% with a maturity date of July 2016; all interest is deferred until 2015. Current market capitalization is about $14 million. Based upon December 31, 2012 financials and a company-guidance burn rate of about $75,000 a month, I estimate the current cash position at about $725,000.



Gold Royalties management consists of founder and CEO Ryan Kalt, a lawyer and financier; CFO Ian Fleming; Vice President of Exploration Carl Schulze; Director Chuck Downie, a geologist in the mineral exploration business; Director Steve King, an investment banker with royalty company experience; and Director Brian Hearst, a chartered accountant in the oil and gas industry.

Over the past two months, I have met with and gotten to know Ryan Kalt and Ian Fleming as part of my due diligence on Gold Royalties Corp. In addition, Chuck Downie has been a friend and occasional business associate for 17 years. His work as a principal of Eagle Plains Resources, a long-lived and successful prospect generator company, speaks for itself.

Gold Royalties Corporation owns mining royalty interests across Canada on an operating mine, a deposit in development, advanced exploration projects, and early-stage prospects. Let's review those interests with a map of their locations and brief descriptions:

Gold Royalties Corporation Royalty Interests

- The Bachelor Lake Mine is a new underground mine and mill complex operated by Metanor Resources (MTO.V) and located in western Quebec between Val d'Or and Chibougamau. Metanor delivered an initial royalty payment to Gold Royalties in Q1 2013 of $604,000 that included buyback of a 0.5% NSR. GRO now retains a 0.5% NSR on life-of-mine production at the Bachelor Lake and Hewfran properties. Current Bachelor Lake qualified resources total 300,000 ounces of gold in measured, indicated, and inferred categories with nearby historic resources of 60,000 ounces at Hewfran.

- The past-producing Barry gold deposit is located in western Quebec near the Bachelor Lake mill of Metanor Resources. Barry contains qualified resources of 310,000 ounces indicated and 472,000 ounces in the inferred category. The company holds a 1% NSR.

- The Eagle Zone gold property (Dublin Gulch) located north of Mayo, Yukon Territory, is an advanced open-pit deposit in development by Victorio Gold Corp (VIT.T). It has a probable reserve of 2.3 million ounces and an indicated resource of 4.9 million ounces gold. Eagle Zone is scheduled for production in 2015 and Gold Royalties Corp holds a 2% GSR that reverts to 1% after receipt of $1.0 million of commercial production royalty payments.

- The Hart nickel deposit is located southwest of Timmons, Ontario. It is owned by Liberty Mines Inc, a Chinese-controlled company and includes a permitted but mothballed nickel mill. Indicated resources are 1.5 million tonnes grading 1.4% Ni. Gold Royalties owns a 1% NSR.

- The Blende polymetallic deposit is located north of Keno, Yukon Territory. The dormant project is owned by Blind Creek Resources (BCK.V) and has a historic resource of 19.6 million tonnes grading 3.0 % Zn, 2.8% Pb, and 56 g/t Ag. GRO holds a 2% NSR with 1% of that buyable for $1 million.

- The Bermuda property is an early stage project located near Marathon, Ontario, and is owned by Stillwater Mining Company (SWC.NYSE). Bermuda is adjacent to Stillwater's Marathon copper-platinum-palladium project currently being permitted for production. Gold Royalties holds two NSRs: A 0.5% NSR on all production on various portions of the property; and a 1% NSR on the entire property on production in excess of 2.5 million ounces of gold, platinum and palladium.

- Gold Royalties also holds various royalty interests on five early-stage exploration properties including Seymour Lake beryllium-lithium-tantalum and KM-61 copper-molybdenum-silver in Ontario, and the Hit, Justin, and Lynx gold prospects in the Yukon. The company has announced but not yet closed a transaction to acquire a royalty on the Iron Horse iron-ore project in Newfoundland for 1.3 million shares. This is an iron-ore project that has received funding from Callinan Royalties.

Gold Royalties Corp is an aggressive junior royalty company that fills a niche within the mining industry by acquiring royalties on projects that are too small or early-stage to be of interest to large, well-established royalty and metal stream companies. In less than three years, the company has acquired a package of royalty interests that already generates cash flow and has development and advanced exploration projects that offer strong mid-term upside. In addition, the company is well-positioned for longer-term growth thru early-stage exploration plays and prospective ground surrounding defined mineral resources.

Gold Royalties has utilized its corporate philosophy, management connections, and royalty interests to forge a strategic participation alliance with industry giant Franco-Nevada Corporation. It also has a working relationship with Callinan Royalties thru the convertible debt facility that can be payable in cash, a portion of the royalty, or shares and warrants of GRO. In my opinion, these relationships confirm the legitimacy of the company.

CEO Ryan Kalt obviously is bullish on his company's prospects. Since the company went public in August 2012, he has purchased 144,551 shares on the open market at an approximate cost basis of 85 cents. Folks, I like management with skin in the game, and Ryan has been putting his money where his mouth is. From my calculations, he currently holds 6.1% of outstanding GRO shares.

Although junior royalty companies are less risky than explorers or small miners, they are still subject to vagaries of the mining business. As a passive partner in mining operations, a royalty company's cash flow is subject to many factors outside of its own control. The economic success of any mining operation is determined by the ever-changing supply-demand fundamentals of the commodities markets and resulting metals prices. Mine production can be negatively affected by government and social issues such as permitting delays, aboriginal claims, and environmental opposition as well as natural disasters, accidents, and strikes. Simply put folks, mining is a tough business.

That said, I have put my hard-earned dollars into **Gold Royalties Corporation (GRO.V)** and think highly enough of the company to take it on as a sponsor of this website. In these bear market times, I opine it provides a longer-term, lower-risk hedge against my more speculative exploration holdings in the junior resource sector. The opinions presented herein are obviously skewed by my financial interest in the company.

You know the drill: Do your own thorough due diligence and determine if you agree with my assessment before speculating in this or any stock, commodity, or market.

Ciao for now,

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The **Mercenary Geologist Michael S. "Mickey" Fulp** is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 35 years experience as an exploration geologist and analyst searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for over 20 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known and highly respected throughout the mining and exploration community due to his ongoing work as an analyst, writer, and speaker.

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