Midas Fund's Thomas Winmill looks for these attributes in gold-mining stocks

COVID-19 virus scare? Consider those with multiple mines, open-pit operations that benefit from lower fuel costs, streaming and royalty companies, and producers that won't have to scramble for financing in order to keep operating, according to one fund manager.

At least that's the approach being taken by Thomas Winmill, portfolio manager of Midas Fund (MIDSX), a mutual fund focused on precious-metals and natural-resources companies.

Gold prices fell over the last two weeks amid the carnage in the broader stock market and industrial commodities, and mining stocks followed.

"We have seen days where people had to raise cash," Winmill said.

That meant selling gold, which had initially risen on safe-haven demand as the stock market's slide began. However, this liquidation pressure in gold doesn't mean the metal's fundamentals are weak, the fund manager continued, commenting that he remains friendly toward the precious metal and mining stocks.

The pullback in gold means producers' revenues will be less than would have been the case at the higher prices seen at the beginning of the month. However, Winmill pointed out, prices are still a ways above gold-price assumptions of $900 to $1,100 an ounce used by many

miners in their modeling. As of 2 p.m. EDT, spot gold was at $1,481.70 an ounce.

“At this level of gold price – and even at $50 lower – most of the established gold-mining companies are producing excellent free-cash flow,” Winmill continued.

Winmill said one investment strategy for gold-mining stocks would be to look toward companies that rely on multiple open-pit mines, which should benefit most from lower oil prices, as well as those that are located in remote areas, which hopefully means less likelihood of a traveling virus infection.

Remote camps can better control who enters, he pointed out. Thus, mines in places like far northern Canada may have the best chance of keeping COVID-19 away from their operations.

Meanwhile, the recent plunge in oil prices – not only due to worries about the global economy but an OPEC-Russia price war – reduces a significant expense for producers with open-pit mines, Winmill explained.

“The open-pit miners are probably just pinching themselves because one of their largest variable costs would be fuel consumption,” Winmill said. “The open-pit mines typically use a lot of diesel fuel either to power their trucks and other equipment or to generate electricity….So as oil prices drop by 50%, these costs have come down and that should be very productive toward their [producers’] bottom line and generation of cash flow.”

Still, Winmill said, there are some concerns for investors to take into consideration when choosing mining stocks. One would be possible situations in which COVID-19 would be more likely to mean a suspension of operations at mines, such a reaction to government precautionary rules. Several precious- and base-metals miners in Peru and Argentina announced 15-day closures this week due to measures instituted by authorities.

Mines that may be most vulnerable would be those that require steady maintenance, Winmill said. In particular, he pointed to underground mines and their need for ongoing maintenance, such as shoring up walls and maintaining ventilation. Thus, he continued, mining stocks that may face the most risk would be those with a single mine that is underground.

Meanwhile, Winmill also likes royalty and streaming companies. With the disruption in equity markets, financing is becoming more difficult, with the financing that is available likely going to the bigger producers first.

“So companies that are relying on financing to either maintain operations until they get to a break-even point, or to develop new operations, are going to be sorely tested in the next six months,” Winmill said.

One way mining companies can obtain financing is to enter into an agreement in which they provide a certain amount of their future production – often their by-product output – to a

royalty and streaming company in return for up-front cash.

"What Midas has been trying to focus on is companies that have scheduled their debt already, so if they have debt, it's maturing at least two to three years out," Winmill said. Further, he favors companies that do not require fresh financing to maintain or expand existing operations.

When taking all of these many factors into consideration, Midas likes Barrick Gold Corp. and Agnico Eagle Mines Ltd. as companies that are "well managed," have multiple mines and good cash flow, Winmill said. "B2Gold is another excellent company that is in a very prodigious free-cash-flow-generation position right now, and they have been excellent acquirers."

Among streaming and royalty companies, Winmill said he likes Franco-Nevada, Royal Gold Inc. and Sandstorm Gold Ltd. Franco-Nevada is involved in both precious metals and oil, thus could benefit two ways if/when prices recover in these two commodities, Winmill pointed out.

'I don't think it's over yet for gold'

As for gold, Winmill looks for a repeat of the period after the 2008 financial crisis, when metal prices likewise initially fell on liquidation to offset losses in other markets, before eventually rising steadily. He looks for gold to close 2020 around $1,700 an ounce and test the 2011 high just above $1,900 next year.

"Gold did not skyrocket like some people thought it would in this [current] financial crisis," Winmill said. "I don't think it's over yet for gold.

"Obviously, gold cannot contract the virus. It's a store of value. We think the use of gold, and the capital-preservation part of gold, is going to be an important part of the story going forward."

News reports suggest that President Donald Trump and Congress want to have the government send checks to every American in an effort to limit the economic damage of lockdowns as a result of the virus threat. If so, this will add to the growing U.S. deficit, Windmill pointed out.

"The fiscal imbalance that we've seen for years and years and years is only aggravated," Winmill said. "Plus, the super-aggressive monetary policies the U.S. has been embarking upon – following the rest of the world – can only lead to one of the usual outcomes when a sovereign government outspends its revenue."

The first tends to be inflation, although the U.S. dollar is strong for now, which means the country is essentially importing deflation, he continued.

Winmill said he favors gold over silver due to the potential of a recessionary hit to silver prices

because of this metal's far higher usage in industrial applications. However, if silver were to fall to “single digits” below $10 an ounce, Winmill said he would take a second look. For one thing, prices this weak could mean a curtailment in supply from primary silver producers that would be losing money.

“There are only a few primary producers in the world that can produce for any length of time at $8 [silver prices],” he said.