Mining MarketWatch Journal Review

Sector Insight

Precious Metals

Interview with Eric Sprott

Chief Executive Officer & Senior Portfolio Manager, of Sprott Asset Management

Eric Sprott provides valuable insight in this transcribed interview with Mining MarketWatch Journal, shedding light on various issues including physical supply imbalances, paper market distortions, macro economic fundamentals, and global demand forces in play that will be key drivers in 2014. Eric Sprott also discusses the opportunities setting up for the majority of precious metal equities as gold makes a drive over $2,000/oz and silver over $50/oz;

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Eric Sprott, Chief Executive Officer and Senior Portfolio Manager, of Sprott Asset Management and recent recipient of the Order of Canada took the time to share his thoughts on the current environment for the precious metals sector in an interview with Mining MarketWatch Journal. The interview touched on pressing questions on the mind of many investors seeking exposure to precious metals and Eric Sprott provide his insight, explaining his theories on what occurred in 2013, in-part, and offering his insight on what to look forward to in 2014.

Interview:

The precious metals sector took a haircut in 2013, coincidently the S&P500 was up, as well as the DOW Jones Industrial, were up similar to the inverse side of gold, which was down 28%. Eric Sprott was asked if there a correlation, or at least if he had any thoughts on what happened:

Eric Sprott: *Yes, I have lots of thoughts on it. I have always believed, and I have written a number of articles on this about the physical demand for gold versus the physical supply of gold. I wrote an article late in 2012 saying "Do the western central banks have any gold left?" and my simple analysis was that it looked to me like there was 2,500 tonnes a year of new demand at the same time that supply, which typically runs around 2.700 tonnes per year from mines, never went up in the last 13 years. But we saw all this new buying coming in; central banks use to sell 500 and they now buy 500, the Chinese came and bought, the Indians, the mint sales, the ETFs, --- you could see all this buying coming in but there was no increase in the supply from the mining area in that 13 year period per year and I think they were running low. Germany asked for their gold back and almost from that point on there was these orchestrated raids on the price of gold, culminating in the biggest one in April and the beginning of June low at $1178. The raids were quick, steep, and have all the hallmarks of not being normal. If you subscribe to the thesis that the central banks had no gold but needed gold because of contractual commitments they've made, then what happened is very explicable to me. What happened was that they ended up getting, for some reason the Western investors to sell out of the various ETFs such that they were able to drum up about 900 tonnes of gold, which worked very well in the first instance. There was only one problem; all of a sudden the Indian's and other Asians, particularly Chinese, started buying in massive quantities -- so much so that it was easy to identify for example in the month of May that the world was buying twice as much gold as was being mined in a month. So it was a great success in a sense that they scared everyone out of the GLD and other ETFs, but it was a failure in the fact that all this buying came in, and it is my thesis that the Western central banks went to India and said "You must stop your people from buying gold", plain and simple, "because you have a fiat currency too, as we do, and we can't have people find out that we have no gold." As you know there have been so many draconian things go on in India, you have the 2%, 4%, 10% tax, the export restrictions, the import-export rules -- they have more rules there, I think one month, maybe October, they got the importation down to 7 tonnes a month that would normally run 80 tonnes a month. I think it was absolutely necessary because the physical imbalance that was going on at the time, and it's just ongoing by the way. So I think that if the Indians are ever allowed, well -- either smuggling helps, which unfortunately we can't ever record, you've read all sorts of stories about smuggling in India, and as this thing ramps-up India consumption will be met by smuggling. Between Hong Kong/China who imports seemingly 120 tonnes per*

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Almost Every Passenger On A Flight From Dubai To India Was Found Carrying 1 Kilo Of Gold

Insatiable appetite for gold fuels India's smuggling industry

London Spot **January 17, 2014;** *Palladium:* **$742/oz** *Platinum:* **$1,443/oz** *Gold:* **$1,243.80/oz** *Silver:* **$20.09/oz** *month and India that can certainly support demand of 80 tonnes a month -- you've got 200 tonnes a month just in those two countries in a world where mines only supply 185 tonnes a month, and I have not even put central banks in there yet -- there would be another 35 tonnes a month -- I can come up with 235 tonnes of buying in a 185 tonne market and I still have 175 countries left to deal with. I think it was all orchestrated. It was very unfortunate what the Fed has done; all of us know that zero interest rates and printing of money is financial insanity -- we know it in our hearts -- believe me, Bernanke knows it, and Kuroda (Japan's Central Bank Govenor) knows it, and Carney (Governor of the Bank of England) knows it, and Draghi (President of ECB) knows it. But they don't want it to seem that way, and part of that was making sure the canary in the coalmine, which is gold, did not act well -- and it didn't. So you have the two forces; you have the physical shortage and -- oh how convenient that we can knock the price of gold down as we're launching this most irresponsible amount of printing, which of course coincided with Japan coming in and buying $65 Billion a month. So, for a central planer it was absolutely wonderful, but there will be price to pay for that as the demand for gold and silver has moved up. You know for your readers, every time you pick up a paper and you start looking at the percent that the US mint sold or the Perth mint or anyone selling coins -- they held up 'The U.K. mint sold runs out after the first five days of January'. You say 'Well how does this line up with this supposed weakness in gold? Everyone's buying the dam stuff! How does that work?', you see that 'Chinese consumption doubles in a year', and 'Thailand's consumption doubles in a year' -- you say hold on, am I in the wrong world here. Because everyone tells me there is all sorts of gold around, but everybody in the world is buying more. So I think it was 100% orchestrated, it happened in my view.*

Hence the sector going forward, what are the upcoming catalysts?

Eric Sprott: *Well I think the catalysts are this, we've seen a big draw down in COMEX (NYMEX Commodity Exchange) inventories here, like the dealers have next to no inventory left. I think you are going to see a failure, someone is going to fail to deliver, and in essence I could say to you that the US failed to deliver to Germany. They were suppose to deliver 80 tonnes and they delivered 37.5 and they may have had to scrape the bottom of the barrel to get that 37.5 tonnes over there. So I think there will be a sever tightness and is a sever tightness, and is a sever tightness in physical gold. There is only so much you can get out of the ETFs, you know the ETFs are already down 40%. So there are not much easy pickins left in those and you will find it very interesting that in this huge selloff of gold and silver, next to nothing was taken out of the SLV inventory which is usually ironic. Why did gold loose so much physical tonnage and silver lost none? Well I have a reason; because the central banks didn't care about silver, they cared about gold.*

Gold bounced off just under $1200 recently in December, are the lows in here?

Eric Sprott: *I think the lows are in here. The data on the supply side just couldn't be better in my mind. Imagine gold even hanging in there when you take the largest consumer in the world out of the market. We took India out of the market and the prices held in. Just wait till India comes back and starts buying their normal fair, or these smuggling routes get more and more developed, which they are getting more and more developed. So, I am pretty certain we've seen the lows here. We've already had some mine closures, we've had some guys that say they are going to maybe high-grade a little and produce less but they will have less people. So, I think supply in gold is probably more than likely to go down this year while the demand continues to be quite strong in the markets that we can observe. And there are lots of markets that we can't observe by the way; what gold goes into China not through Hong Kong, some people suggest that last year China effectively bought all of the western world's mining supply of gold, and I tend to believe that's correct. Which means where did the rest come from? And I would argue it came from central banks who are already on fumes in their inventory.*

Although supply is exhausted the paper market continues.

Eric Sprott: *Anyone can do anything in a paper market. If took my net worth and wanted to bomb wheat today in the paper market, it might go down 5%, just don't ask me to deliver it. You can almost do anything you want in the paper market, just don't ask me for delivery. It is always interesting, you look* *back when silver got to $49.50, you know that in the paper it would trade over 1 billion ounces a day -- we only mine something like 800 million ounces a year, but we trade a billion ounces of paper silver in one day. I always ask people to think what would you think of the guy whose selling the billion, what's he thinking? Where is he going to get this billion ounces that he just sold that one day, and the next day, and the next day? The paper markets are so far out of touch with the real world it's mind boggling.*

There is some discussion that gold has moved from a bull market to a bear market because of FED QE/money printing, that it has not led to inflation nor has it impacted the price of gold, almost as if the fundamentals do not have an impact. What's your thoughts there?

Eric Sprott: *Well, first of all most of us realize that the inflation numbers as reported are always incorrect and I just ask people to think about your own expenditures you know. I find it rather ironic, you know if you ask a gold miner if there is any inflation he will say 'yes, I've experienced like 7 - 8 - 9% inflation every year for the last 13 years. I say why is that? Well because I have to buy something real. So whenever you want something done by someone who is a trades person, there's no disinflation in that area, there is nothing but inflation. So, in the real world there is lots of inflation. As reported under the US CPI and other peoples statistics there is no inflation, but there is no doubt that it is very prevalent and the big fear that if it ever got truly unleashed, that people thought that paper currencies couldn't hold their value -- which of course would have happened had gold gone through $2000, silver gone through $50, and carried on and everyone would have questioned paper, and you might of unleashed this preference where somebody says 'I want something physical rather than paper'. Well, that's how you truly get massive inflation -- we haven't experienced that hyper inflation yet, but it's coming. I kind of look at Bitcoin -- you know you see all these people racing in, thinking there is a new currency and is better than the dollar -- what's it gone up by 1,000? - 10,000 percent? If that ever happened in gold -- I think the reason gold came under pressure is because it is your indicator of inflation, it's an indicator of what people in the financial community think about inflation and that's why I think it was meaningfully bombed, almost exactly as the financial situation is deteriorating and the money printing is going into high-gear, and I think it was quite purposeful at the time. I think inflation will come. Not that it's truly left as much as it is reported to us. You must have all noticed that when you buy a package today, it's got less in it than it had before but the price is the same. And one of the points about inflation, people say there is no inflation, but don't tell that to people whose currencies have gone down. You know when your currency goes down, your inflation goes up. Here in Canada we now have the dollar at what $1.09 (1 dollar USD buys 1.09 Canadian, up ~0.10 in 1 year) -- well have got 10% increase in the cost of everything we import? Yes we have. Like the cost of oil is 10% higher for us in Canada today than it was a year ago -- that's inflation. Everything we import will be going up in response to the currency. The same thing happened in India when the Rupee went down. Argentina, when the currency devalued -- Venezuela's, you talk to those people about inflation, they realize their currency is just not worth it -- in part that's why there was a scarcity of goods in Venezuela, because nobody wants the currency. Once people see that there is real inflation they will want to convert the paper to real things.*

There are a number of talking-heads on television and the mainstream media that argue it is time to sell gold due to the tapering that the FED is talking of, and they claim that money printing has not led to inflation, and that the economy shows signs of improvement. What's your thought?

Eric Sprott: *Well I think that the media pretty well says what they are suppose to say for one thing. And two, everybody follows the price (of gold); if the price is going down it is obviously not a good time to buy, right. And of course, if it starts going up we'll come up with the 'real' [sarcastically stated] reason it's going up. All I know is that I always fall back on a couple of the primary principles; 1) is the demand for the product, which is incredible, and then 2) the whole printing, which is just outer-world size printing, like don't we all get it here. Sooner or later you know there are going to be unintended consequences of printing. Let's say that you bought into the argument that the western central banks wanted the price of gold to move, you can rest assured they would influence what the media has to say. I think there is a huge debate as to whether the media just espouses what the government wants them to, everything is okay -- that's what I happen to believe. Nobody ever seems to report the truth. I'll give you one example; when the US government comes out with what they call their 'generally accepted accounting principles* *true method' for the year, which I think came out January 15th this time last year and the deficit was $5.6 Trillion, I'll guarantee you no mainstream media reported it. Because we don't talk about things like that, it will depress people and we want them to all feel good, and everything is wonderful. Even though we've had hardly any economic recovery for the $4 Trillion the FED's put in to the system, and probably if we are properly accounting for things we've accomplished nothing. Look, we've put 20 million people on food stamps at the same time as we have created a couple million jobs, well how does work? Is there something I'm missing there, that 10 times as many people all of a sudden qualify for food stamps versus the people that got new jobs? It tells you that the jobs numbers aren't real.*

Gold mining companies, they are close to their cheapest relative to book value in at least two decades. A number of astute investment bankers (e.g. Barclays PLC's Paul Knight, Cowen & co.'s Adam Graf) see gold-mining rebounding in 2014 as producers target assets at fire sale prices. I note Goldcorp taking a hostile run at Osisko for example. What are your thoughts on this or what are some companies that you would suggest to keep an eye on given they are on sale?

Eric Sprott: *I think that what I have done is I have looked at producers, more so than exploration companies and potential developers, I want a producer, because if the price goes up like I think it's going to do, the producer will feel that immediately in its cash flow and I think the market will react immediately. I'm not saying quite frankly that the producer will go up more than an exploration guy will, I think they are both going to go crazy. In the final analysis the exploration guy might go up more because it will bring the market back into excited about some of these discoveries we can make. And I have a little way of doing that, I think about the price going to $2,000/oz and I think about what the guy will make at $2,000/oz and I will find out that I am paying like 2 and 3 times earnings for the company and I say 'okay, fine I'm willing to take that risk' and get that reward by the way. And the reward is stocks go up by 500 and a 1000 percent, that's the kind of reward I think we are staring at these days -- certainly if my targets are reached.*

Any major producers that you like? Barrick, Goldcorp?

Eric Sprott: *I have never been much of a proponent of the major guys because they have such a tough time increasing their production. They really do. Goldcorp has been the standout, they have this template for doing things, in fact making what I'm sure will be regarded as a very opportunistic time to bid for Osisko by the way. Like here we are basically at the bottom of the gold market and here they are making an offer for the company -- but that's the expertise of Goldcorp. But most of the major producers are having a tough time increasing their output and that's why I would rather buy a company who maybe produced a 100,000 oz where if they start the next mine they could produce 200,000 oz and you get this quantum improvement in fundamentals. So that's kind of why I've always liked smaller companies rather than big companies. I remind you that back in 2000 I bought a small company on that same basis and it was Goldcorp at the time.*

Two gold producing companies that are in a growth phase, Metanor Resources Inc. (TSX-V:MTO) whom you know and Veris Gold Corp. (TSX:VG). Any comments on Metanor Resources?

Eric Sprott: *Obviously their production is ramping up here. They look like they've hit a new plateau. I don't know what the market cap is specifically today, but if you want to use pen and paper and just imagine a price of gold at $2,000 an ounce, and if it can get its costs all-in at $1,200, make $800 an ounce, it could be making $40 Million a year. I think its market cap is currently around $40 Million if I am not mistaken -- that gives you the dimension of what can happen with a price move. The stocks will only perform when the price of gold goes -- I don't blame any of the companies for their stock prices being down, it's really got to do with the prices of the metals and the carnage that's gone on in the precious metals market. The upside in these things is phenomenal if the price targets are met. I think it's a great bet. The downside loss versus the upside gain, you are looking at a stock that as you already suggested are almost at their lowest ever vis-a-vis the price of gold, I'm sure they are. But imagine if things are half-full here and all of a sudden we get to where the price of really should be, what are we going to value them at? The potential return, the multi-bagger, that kind of intrigues me right now.*

On the subject of Metanor for a quick second. They also have their Barry deposit, I guess they produced out of an open pit scenarios a few years back for a while to prove up the Bachelor mill before the Bachelor mine was ready. And since then they had SGS Geostat geological firm come in and suggested the Barry deposit is comparable in potential to rival other multi-million ounce deposits such as Osisko's Malartic gold deposit and Detour Gold's Detour deposit. Barry appears a second gold production front for Metanor in time. Osisko we see today, you know a lower grade deposit, it's a target obviously of Goldcorp -- one would think that something like Metanor's deposits and production scenario would be a target as well for a major.

Eric Sprott: *Totally, you know, you see we all forget where gold was and why it was there, and of course the reason why it was there are all the same. And if we ever got our head back around to okay it could go back up there again. I mean think about what having that extra deposit there would do for a company like Metanor, all of a sudden you got a second producer who can generate as much as the existing mine. That's why these things can change so quickly, you can double your output with a little bit of good luck in the precious metals market. And not even good luck, I mean common sense in the metals market, which we didn't experience here in the last two years.*

And then Veris Gold, again another producer, actually having some success, I think they produced about 8,000 ounces from their deposit last month I believe and they have custom milling as well for others in the area. Again another company that has tremendous upside I think. Relatively low market cap under I believe 30 some odd million.

Eric Sprott: *I mean the leverage is massive right. I mean just take again a $2,000 price [for gold] and if their costs come all-in at let's say even say $1,200, you're going to make $100 million dollars and the market cap is probably under $50 million, something like that. Again it's the same dimension, that it's more the price of the metal has to improve. In fact their production's been going up, they sort of can produce at a rate of 1,500 a month, which gets you 180,000 a year. It's the same thing with Metanor, where you know it started slow but now it's sort of getting steady state. Of course these companies have to prove to the market that they can produce at those steady states, that it's not just an anomalous monthly situation, but should they be able to prove that, then the market will be a little bit more resilient, and of course as prices go up it'll provide that much more lift to those companies.*

Then in your opinion, what's the most important consideration for investors seeking exposure to precious metals in this upcoming year in 2014.

Eric Sprott: *I think the biggest question is what's the price of gold and silver doing, and that's why I spend all this time looking at the physical supply of gold and silver and I can tell you both are unbelievably good. When India comes in this year and buys 15% more out of the silver market and theoretically only half of the market is available for investment, and this would have been all for investment, so they took 30% of the investment market, and the price of silver goes down!?... Now, I say that's impossible in the real world. Something really odd is going on here. So I think we will break out of this stranglehold that I think the central banks have put on precious metals and I think people will be shocked by where the prices go, and I think the stocks will be by far the best place to be. I know it is hard sometimes to buy these stocks when, you know, funding is sometimes always up in the air at these prices -- but I guarantee you that if the price of gold and silver go up the funding issues will all disappear very very quickly.*

It reminds me of the story of Aurelian Resources several years ago, do you recall that company? It was bought out by I believe Kinross, they were in Ecuador. It was a 40 cent stock in early 2006, and a few months subsequent to that the price was at 40 dollars. So, where else do you get that kind of leverage, that kind of pop?

Eric Sprott: *Where do you get that kind of leverage? That's the whole point -- you don't get it anywhere else, and you don't need many of them to win. Right? Ya, but the reality is probably 9 out of 10 they will all win because it's all a function of the price of the precious metals here. The precious metal price will I think bail everybody out.*

Last question is without having a crystal ball scenario going on here, what is your pick for the December 31, 2014 closing price of gold?

Eric Sprott: *Over $2,000 per oz.*

What about silver?

Eric Sprott: *Over $50 per oz.*

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