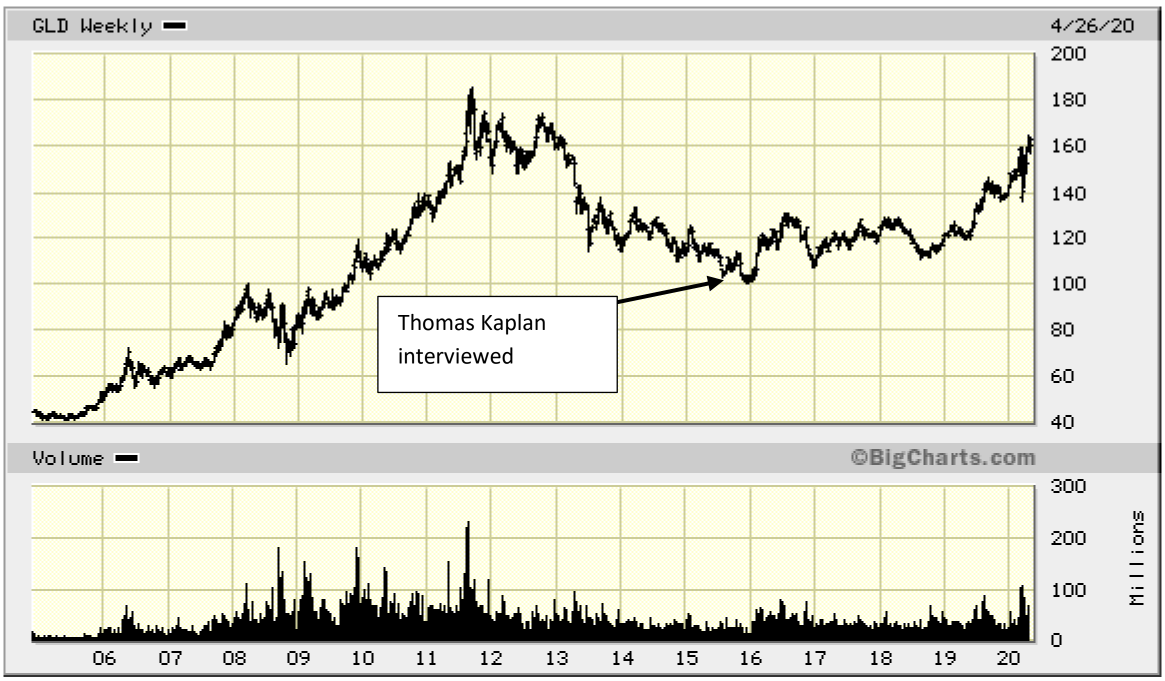
THE HISTORIAN

AN INTERVIEW WITH **THOMAS KAPLAN JUNE 2015**

Perhaps no other asset inspires as much strong emotion, often negative, as gold, which has been a store of value for five thousand years. ***And gold has perhaps no greater advocate than Thomas Kaplan, investor, historian, billionaire, and among the metal's most articulate spokesmen, a man known for making over one hundred times his money more than once as an owner and builder of world-class commodity assets.*** *While the markets for other assets have levitated against a backdrop of money-printing, a recently frustrated band of gold bulls and contrarians has sought value in a much-unloved sector. In an exclusive interview with* The Octavian Report, *Kaplan explains his enthusiasm for gold, why his conviction has never been higher, and why his flagship gold asset, NYSE-listed NovaGold, is an extraordinary opportunity.*



Flickr. Thomas Kaplan takes the historical view when it comes to gold.

Octavian Report: You're one of the gold sector's most ardent proponents. In a world that seems to want to punish gold bulls, how does it feel being a contrarian?

Thomas Kaplan: While I've taken positions on occasion that are contrary — sometimes very contrary — to prevailing sentiment, I've never thought of myself as a contrarian. **As a philosophy of life, it suggests being a disagreeable person simply for its own sake.** Who wants to wake up in the morning with a cynical outlook towards your fellow man? It seems to me neither a pleasant way to live, nor a particularly rational way to go about making investment decisions. To take a stance against an established trend simply because the sentiment is skewed towards it is not a strategy. **We know from history that trends can last a long time and that the crowd can be right for long periods of time.** In other words, as we've seen from many famous short positions that blew up the participants, to be reflexively contrarian can be very unrewarding. The key, I believe, is to determine when the fundamentals have changed sufficiently enough that you discern that the trend is overshooting and can reverse.

The prerequisite here is not simply to be contrarian *per se*, but to believe the crowd is now getting it wrong. That's a big difference. **If you genuinely, dispassionately believe that the fundamentals have changed in your favor, and that the market's disagreement with your thesis allows you to take a position at great price levels as a result, you're not a contrarian so much as lucky to be able to avail yourself of a great risk/reward opportunity: what Warren Buffett would call "the fat pitch."** If you can connect with that fat pitch, and if you've done your homework, eventually — when the crowd agrees with you — you will enjoy the biggest rewards.

OR: So being a gold bug today is a purely rational decision?

Kaplan: The short answer is yes; stripping emotion out of the equation, there are many rational and quite positive reasons to own gold. I will, however, **confess that the negative sentiment is really assisting us at the moment** as we seek to build more positions.

But tell me — is there another area of the market where being a bull categorizes you as an insect? I'm not insulted by the expression, and indeed I find it encouraging that people use it. **Great trends are born and sustained out of such derision and skepticism. And if there's one thing we know, it's that gold qualifies by this standard in today's world.** It is the asset that people love to hate and hate to love. I'll go further than that: to be a gold bull today can literally harm one's career. The best-performing financial asset in the world over the last decade is so despised that to express bullishness regarding its future path is to take a career risk. I have seen people who are — and remain — genuinely bullish recede from their public views because they think association with gold can taint their reputations. Not for me, perhaps, because natural resources are our family business, and the dozen or so of us that still exist in our space are used to being considered outliers in the investment world. But for a generalist fund manager it can take great courage to be — how shall I put it? — open-minded.

OR: Surely that's bullish?

Kaplan: Of course it is. You don't have to be a contrarian to welcome or even love such anecdotal indictors. **Negative extremes in sentiment**, as we know, are often a hugely bullish sign that those who are going to sell have already done so — or will be flushed out soon — and that those who might be buyers haven't built their positions yet. Moreover, because markets are partially driven by such dramatic sentiment, it enables one to seize great assets at valuations that in retrospect will appear ridiculous.

OR: Did you start your career being a bull on gold?

Kaplan: Actually, I didn't. In fact, when I started to invest in natural resources more than two decades ago, I didn't have a particularly positive view on gold. My **focus was on silver,** which was then trading at below $4 an ounce, and on which I was hugely bullish. To those who asked at the time if I was also bullish on gold, my response was that **I didn't see any reason to buy gold that wasn't multiplied for silver — so why bother?**

OR: Why was that?

Kaplan: To me, gold is basically a monetary metal. Silver is a monetary metal as well. In fact, as Milton Friedman put it, the major monetary metal throughout history has not been gold, but silver. But silver is also an industrial metal with unique physical properties. It has literally hundreds of applications that make it extraordinarily useful. So in the 1990s, to me it seemed logical to focus on the metal that had not one, but two personalities. In a gold bull market, silver would behave like gold on steroids and, in a bullish commodity environment, silver would outperform gold due to industrial demand.

OR: So do you prefer silver to gold?

Kaplan: One should own them both. But people need to understand that, to own silver, one has to accept the consequences of its attributes**. As an industrial metal, silver can initially underperform gold during the kind of financial crises or economic downturns that can hit commodities and favor gold.** We saw that during the last crisis. Nonetheless, when gold really kicks in, silver tends to recover from its industrial slump and ultimately outperform gold as the more leveraged of the two metals to financial considerations — and the fact that the industrial buyers still need to go into the market to buy it. So silver is inherently more volatile than gold. Hence the expression "gold on steroids," and hence why I like them both. Having said that, this bifurcated approach is much more suited to a longer-term investment philosophy than a trading mentality, which is a trait that I do not possess.

OR: Is that because you remain a historian at heart?

Kaplan: Well, **it's certainly been my relative advantage to be able to see our markets through the prism of history.** It helps me to visualize what the target will look like years hence — and what needs to happen to our thesis for us to get there. I'd love to have a trader's talent, but it's not in my DNA.

OR: That doesn't seem to have hurt your performance. **Eighty percent compounded annually since 1994 is a great track record. And it hasn't simply been in one commodity: you've had success with silver, then platinum, then energy, and then gold.** How do you decide the sector on which to focus?

Kaplan: I look for resources where the supply-demand fundamentals are improving markedly, and yet where **John Templeton's concept of maximum pessimism is the prevailing sentiment.** In the 1990s, that trade for me was silver. Having fallen from $50 per ounce to $3.50, and tainted by the Hunt debacle, silver was extremely misunderstood. The zeitgeist was that it was finished and had much more to go on the downside as digital would supplant silver halide film. I felt that the investment community didn't understand the data and that the supply-demand equation argued more vigorously for silver to someday return to $50 than the $2 generally predicted. Armed with that conviction, the opportunity to buy silver assets to gain leverage to this prediction was extremely tempting and, despite having no background in engineering or geology, I created a silver mining company, Apex Silver. Fortunately, it is a truism that bear markets unearth not only great buying opportunities, but also great talent: I was able to assemble a fine management team to take advantage of the disarray in the sector. Similarly, when oil was trading under $20 a barrel a decade later, and the prevailing view was that prices would likely recede, I felt the data was misunderstood and created an energy company, Leor Energy, as a means to play a move toward my $100 target.

OR: Did you know anything about energy exploration?

Kaplan: Nothing, really. But my thesis on silver exploration had worked out well. I also felt my experience at Apex was fungible, and that I knew how to create a vehicle from scratch. Also, I was feeling lucky.

OR: Had you also changed your mind on gold at this point?

Kaplan: Yes, I had. In 2001, Dr. Larry Buchanan, the discoverer of Apex's San Cristobal silver property in Bolivia, and I had started a gold exploration company. Gold was around $300 per ounce at the time. When the Bank of England dumped its gold — the "Gordon Brown Bottom," as we called it — **it seemed a classic capitulation** and I added gold to my focus on silver. Electrum, a naturally occurring alloy of gold and silver, seemed the perfect name and so we began the branding under that label.

OR: Other than what you saw as a selling climax, were there fundamental reasons for your renewed interest in gold?

Kaplan: Yes. As with silver years earlier, **the simple supply-demand equation for gold had become very favorable.**

OR: When you sold Leor Energy in 2007, it was one of the fastest-growing privately held companies in the space. What made you sell it and go all-in on precious metals?

Kaplan: Beginning in 2007 I began to feel that things were too good for the world in general — and my family in particular. We had a 100x return in energy, and also in platinum, on paper. I decided it was time to ring the cash register on those commodities, which were dependent on industrial demand, and to pivot to an under-owned currency: gold. I felt that if the world continued to do well, gold would do well. After all, it had multiplied off its lows without crisis. But I also began to suspect that if I were right and the good times were indeed simply too good, **gold might be the only thing that would do well in a severe downturn.**

OR: You sold your oil and gas company in 2007 when oil was at $120 and moved into gold at $650 per ounce. Now that oil is in the $50s and gold is at $1,200, has your view changed on these assets?

Kaplan: Nothing that caused me in 2007 to view oil and gas as vulnerable commodities and gold and silver as under-owned currencies has been altered by the subsequent price action or macro environment. On the contrary. If anything, between the collapse in hydrocarbons and the whirring of the central banks' printing presses, I'm experiencing what psychologists would call positive reinforcement.

OR: Are you tempted to buy oil now?

Kaplan: Not really. Oil could be worth $20 or it could be worth $120. I simply don't feel that I know, **and I need conviction to play.** If the global economy should ever be allowed to correct its excesses, oil could collapse further. Or the Saudis may decide they don't have the stamina to crush American shale and Tehran after all and turn the switches back off. There are too many exogenous factors that can affect commodities, whereas the supply-demand equation is so much more obvious to me with the monetary metals.

OR: Does it surprise you that gold has held in against a rising dollar as much as it has?

Kaplan: Gold is shrouded in myths. **Along with the myth that gold is simply a commodity is another: that gold needs a weaker dollar to thrive.** The dollar was far weaker in late 2007 than it is today. So if I had told someone that oil could go from $120 to $50 or lower at a time when gold had doubled, they'd have said I was delusional. But if I added that the dollar could go from $1.45 to the euro to $1.10 while gold surged, I'd have been locked up. The market loves myths.

OR: Any other myths we're missing?

Kaplan: Actually, there is one: that gold needs inflation to thrive. Gold is up 500 percent from its lows against the dollar. Yet I cannot remember a time during the last 15 years when inflation was a big deal in the West. It certainly isn't these days. In fact, if there is one word that seems to define this era, it is deflation. And yet gold is performing quite well.

OR: Does the supply-demand equation for gold still augur higher prices?

Kaplan: **Absolutely. On the supply side, starting with the gold-mining industry itself, I can see a crisis looming.** Most miners are producing gold faster than they can replenish their reserves. This comes at a time when the quality of the reserve grades has halved over the last decade. Meanwhile, there haven't been big new discoveries that can move the needle in years.

These industry dynamics are important. At a time when the central banks are high-fiving each other after finding cleverer and cleverer ways to destroy money and savers**, I like the fact that gold is the only currency in the world that people can't print. Put another way, while the gold miners can't even find this scarce currency, central bankers can't resist any temptation to debase their limitless paper.** As if to underscore the point, on the demand side the official sector has moved from being a copious seller of gold to a net buyer of it for the first time in decades — and at just the moment when the Indians and Chinese are competing to be the largest consumers of a scarce brand that has even better brand recognition than Apple or Coca-Cola.

We really could get a perfect storm. I love buying bubbles early as much as the next person. **Gold's the inevitable bubble.** So now's the time to position oneself, sit back, and wait.

OR: With these positive factors already in place, aren't you surprised gold isn't higher?

Kaplan: Not really. My guess is that what we've seen over the last few years is a correction within a bull market. The first leg lasted for 12 years. That's extraordinary. For 12 years gold ended each year higher, whether that year had been a period characterized by strong commodities or weak commodities, inflation fears or deflation fears, a strong dollar or a weak dollar, war or peace, prosperity or crisis. *That* is a bull market.

OR: So why is gold, to use your term, derided?

Kaplan: There are several reasons for that. You know Jim Grant's brilliant line that "a 'bubble' is a bull market in which the user of the word 'bubble' has not fully participated." While that certainly applied to gold when it was higher, the fact is that most people don't take the time to understand gold. They view it as a relic, whereas paper, for which there is so little scarcity value, is supposedly understandable. It's a fascinating disconnect. Yet it's that cognitive dissonance that gives such an exceptional opportunity to those that make an effort to learn. I should add that many of the same people who thought I was crazy to start an energy company when oil was at $20 and, in their view, on its way down, said I was nuts to sell it when oil was at $120 and, in their view, on its way up. It's not dissimilar with gold today. Many of the same people who loathe gold for retracing its steps back to $1,200 per ounce from its $1,900 highs hated it all the way up from $300 per ounce to $1,900. And at $2,900, they will find a way to justify why it wasn't a buy today but it will be then.

OR: Even if you're right, wouldn't it be classic for gold to go lower before it rises to new highs?

Kaplan: Yes. I call that the BHP Scenario. Once upon a time, BHP shut down its North American copper assets as copper spiked down to $0.50 a pound. For all intents and purposes, that marked the end of the bear market. So another sentiment-driven spike down before gold resumes its long-term bull market would be par for the course. But that doesn't mean it *has* to happen. We don't need production to get crushed for gold to resume its uptrend.

OR: Do you have a short-term view on gold?

Kaplan: I'll tell you what I have told NovaGold's shareholders when asked that question: I don't think about it. If I get the short-term right, it will be a function of luck.

OR: What do you think the trigger will be for gold to break out?

Kaplan: **I don't think there will be a trigger.** I think it will just go up a lot one day and that will be it.

OR: Won't people look back on all the money-printing going on now and ask: how is it that no one noticed?

Kaplan: Sadly, yes. To me, the right analogy is the frog in the pot of lukewarm water with the temperature rising to a boil. Not that I want to see that happen. The social implications could be severe. There's no example in history where this experiment comes right without unintended consequences. I just don't know what those consequences are, so I choose to play it safe with something whose fundamentals I can understand, and where my frame of reference professionally gives me a leg up to profit from the time when others will come around to my point of view. This strategy goes hand-in-hand with my experience that — other than luck — making real money is chiefly a function of conviction and patience. If one feels right on the fundamentals, the key is to find or create a vehicle that will allow you to make a lot of money when the market comes around to your point of view — and then just wait. Don't try to be too cute. Don't look at the screen. Spend extra time with your kids or grandkids. **Read a book or two on Stoic philosophy**. **Watch anything with Gene Hackman.** And then just wait. This kind of risk-reward scenario is playing out in great precious-metals mining assets.

OR: Seneca and *The French Connection*. I love it. Tell us about where you think gold is going.

Kaplan: As a secular trend, I see a great many similarities between the Dow in the 1980s and where we are today in gold. During the 1980s, if one bought the DJIA at 1,100, 1,200, or 1,300, it didn't have a material impact on long-term returns. At any of those levels it was a great buy. I feel the same for gold. If one gets that one last leg down to complete the cycle, so much the better. But prices are headed much, much higher after this correction is over. I've been in this movie before.

OR: Give us a reasonable target.

Kaplan: For the record, I believe a reasonable equilibrium level for gold **is $3,000 to $5,000. Maybe higher.**

OR: So should people be snapping up gold itself or mining stocks or what?

Kaplan: One should own some of both: the metal itself because it is an under-owned currency, and some miners because, when the supply-demand equation becomes more obvious, the leverage they provide will be particularly rewarding.

OR: How much exposure should someone have to gold in all its forms?

Kaplan: That's not for me to say. What I will venture, however, is this: in the future, fiduciary managers will ensure that everyone will own some gold as a portfolio diversifier. The challenge will be to find it at that point. ISI came out with a report a few years back that suggested that if gold were to move from half a percent or so of global financial assets to a bit over one percent, **it would require 26,000 tons of gold, or 10 full years of production.** Could it happen? Why not? In the 1970s and 1980s, gold was a multiple of that percentage. I don't have to tell you what would happen to the price of gold if even a fraction of that scenario occurs.

OR: And you don't see mining production rising to meet that increased demand?

Kaplan: There are great barriers to entry in gold mining, and they are actually growing. Exploring for gold is still basically undertaken by a passionate prospector with a pick and sample bag. Having explored for energy, I can appreciate the great advantage of 3D seismic and other useful geophysical tools. By comparison, mining is primitive. And even if it weren't, geology is what it is. There are no great untapped reservoirs of trapped gold waiting to be unlocked by brilliant engineers, as the energy industry found to be the case with shale. And none of these factors even takes into account the increasing difficulty of doing business in most parts of the developing world. The barriers to entry in gold are as profound as in any industry in the world.

"But tell me -- is there another area of the market where being a bull categorizes you as an insect? I'm not insulted by the expression, and indeed I find it encouraging. Great trends are born and sustained out of such derision and skepticism."

—Thomas Kaplan

OR: What should investors look for in a gold miner?

Kaplan: **Start with the assets.** The industry's dismal exploration results support the contention that the easy stuff has already been found. I am, for example, one of the sector's only remaining wildcatters. This means that the size of the endowment matters. Great assets with significant production profiles get great valuations, and it takes as much management attention to build something small as it does something big.

Equal to the concept of size is quality. **Grade matters.** Many a mining company has compromised on grade only to find out that, in a cyclical downturn, the leverage can be a killer. The recent bankruptcy of Allied Nevada in March 2015 is a case in point. It costs as much to take a gram per tonne out of the ground as it does two. The difference is simply in the revenue. Is it any wonder, then, that the cost per ounce of production has multiplied for the sector? Additionally, from a supply-demand standpoint, we are seeing some companies high grading (mining out the highest-grade material and leaving the worse stuff in the ground) just to maintain that already low average — a practice that will lead to even lower average grades for the industry over time. So err on the side of assets that are forgiving.

OR: What about valuation?

Kaplan: We keep an open mind. Obviously it matters. Nonetheless, investors often make the mistake of extrapolating well into the future the mood, and hence the quantitative conservatism, that prevails during periods of maximum pessimism. We are seeing such a phenomenon playing out now. **They don't remember that revitalized sentiment hugely impacts normative valuation parameters.** For that reason, I don't believe in indiscriminate net present value analysis. It's pretty useless for assessing the big, long-life assets that are the backbone of the industry, i.e. exactly the ones that achieve the premium valuations. Overreliance on NPV over category-killer attributes is a major reason the industry is in such desperate straits. Most of the assets out there are simply mediocre — products of ill-considered compromises.

OR: You are a big believer in the safety premium on secure jurisdictions, correct?

Kaplan: At this point, I believe that is likely the existential investment criterion. In his book, *The Alchemy of Finance*, George Soros noted that the existential decision for all investors is deciding in which currency one's investment should be denominated. This point is eminently logical and is, I think, yet another reason to own gold.

We can take this existential argument a step further when it comes to mining companies. The new reality is that the first decision they face is the same one real-estate people cite: location, location, location. Heightened resource nationalism and jurisdictional uncertainty are second only to investor sentiment as the most significant factors negatively affecting shareholder value among natural-resource companies. When sentiment returns to the space, they will be number one. By the way, I am not talking my own book. I have invested successfully in less-than-sturdy locales such as the Congo, Bolivia, Zimbabwe, South Africa, and Venezuela. I know whereof I speak. That era was fun as well as profitable. But I reckon it is well and truly over for the average investor.

I think we need to look to the U.S., quite frankly**. The paucity of North American plays has become pronounced. If I'm right, there will be a <u>bubble</u> in the remaining high-quality North American gold equities as institutional investors pile into the few still standing.** M&A will follow institutional sentiment as the majors cater to the newfound investor focus on jurisdictional safety for their exposure to gold. I think even now fund managers are coming to the point that, when told by brokers that they have a world-class asset to present, the one question they will ask is: "But where in the world is the asset?" And why shouldn't they? Is it worth taking a career decision on investments in places where the rule of law is a novelty item? It makes no sense, especially in today's distressed environment for mining assets: you don't even have to pay a big premium for the downside protection of being in a tier-1 jurisdiction.

OR: Your favorite way to play gold, we understand, remains NovaGold?

Kaplan: Yes. It's beautifully managed by Greg Lang and the A-Team he has assembled, and the company's half-ownership of two great assets, Donlin and Galore, render it unique in our view. That's not to mention its having over $130 million in cash and being debt-free. Donlin in particular, which would be the largest pure gold mine in the world, and located in the safest jurisdiction, really has it all: size, grade, exploration potential, production profile, community support, mine life, and jurisdiction. As NovaGold is the best in breed and a true category-killer, we couldn't ask for more from an investment. NovaGold gives us all the leverage I could wish for to multiply Electrum's returns when higher gold prices return and is located in a place where we get to keep the fruits of that leverage, and yet it is simultaneously in the great position of having no need to raise capital until it and its partner Barrick make a construction decision on Donlin Gold. This is something that we would both consider when gold prices have resumed their uptrend in earnest. **We don't want to give away two-and-a-half-gram material until we're paid a higher price for it, and we genuinely believe that our equity is at least as precious as the metal itself.** So with NovaGold, the downside and upside are both secure, and with the fundamentals for gold being what they are, time is clearly working in our favor.

OR: How are NovaGold's relations with Barrick today?

Kaplan: The relationship between our companies has never been better. In fact, I'd characterize it as perfect alignment.

OR: Would you buy Barrick's shares?

Kaplan: Yes. My family bought shares after the company's first-quarter conference call and we expect to buy more. Not even taking into account their new narrative on Donlin, which I expect will in time add a nice boost to Barrick's share price, I'm basically a real fan of Barrick's new management. Their "Back to the Future" theme of pure gold in safer places is a refreshing message for the gold mining space.

OR: It's not just rare metals you like, but rare animal species too. The conservationist David MacDonald said of you that while the whole world is trying to turn tigers into gold, you are trying to turn gold into tigers. What's that about?

Kaplan: Wildlife conservation was my abiding passion when I was a boy, and has remained so. Had I the aptitude, I'd have made it my career. While that was not to be, I never lost the desire to save endangered species and turned to it as soon as I had the resources to be able to make a real difference. It's that which led my wife and me to found an organization with the great Alan Rabinowitz, named Panthera, which focuses on saving the big cats and their critical ecosystems globally. Enabling great scientists and practitioners to save these iconic species from extinction — turning gold into tigers — has been one of the great missions, as well as greatest joys, of my life.

OR: We wish you the best of success with both the bullion and the lions.

Kaplan: Thank you. I wish the same for your publication. It's a truly excellent read.

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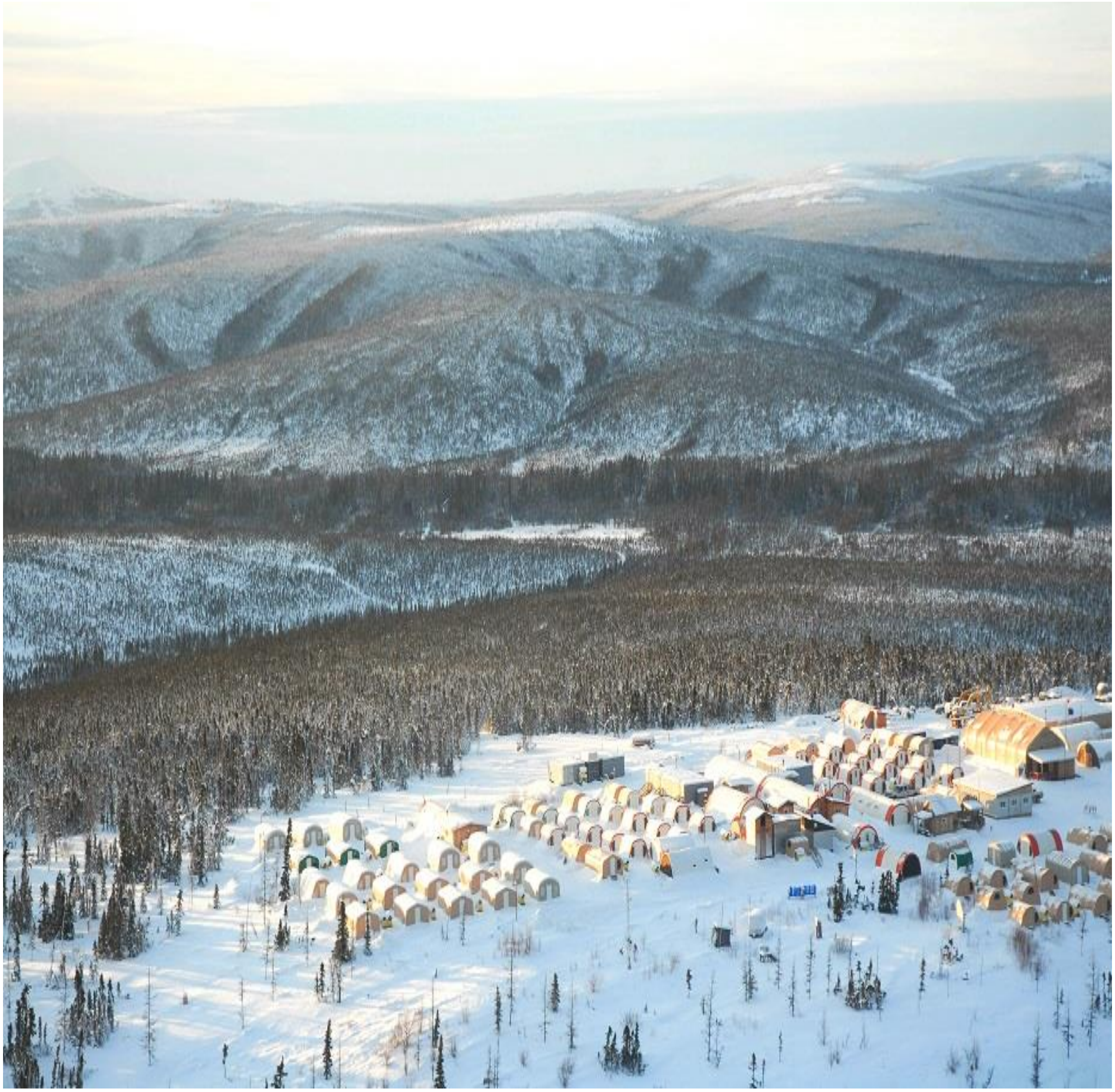
THE GREAT GOLD WHALE: A CATEGORY KILLER IN ALASKA
BY **RICHARD HUROWITZ**

The Klondike gold rush may be over, but that doesn't mean that those bullish on bullion won't find value in the remote and snowy location that forever changed American culture. NovaGold, chaired by commodities guru Dr. Thomas Kaplan — whose exclusive interview with *The Octavian Report* you can read here — offers fantastic leverage to the price of gold via a possibly game-changing asset in the form of Alaska's Donlin gold mine, one of the largest recent finds in a sector where big deposits are now increasingly rare.



NovaGold. The mine at Donlin is a potential "category killer," in the words of the company's chairman.

"Opportunity is tremendous in Alaska," Willy Loman's older brother Ben advises him in Arthur Miller's *Death of a Salesman*. "Surprised you're not up there." The largest state in America has, at various times unlike our own, been a magnet for those for spellbound by the prospect of gold. Over three years, the great Klondike gold rush lured hundreds of thousands of formerly upstanding U.S. citizens north to Alaska in search of gold, and inspired immortal stories by Jack London and the classic Charlie Chaplin film *The Gold Rush*. But for gold bugs, the real action in Alaska may be just beginning.

If you are looking for a stock with high-octane leverage to gold, a CEO expert in mine-building, a chairman with a history of hitting it big in commodities, and a high-grade enormous find in the world's safest mining jurisdiction, then NovaGold (NYSE: NG) might be up your alley. By definition, to like it, you have to love gold, but if you love gold, you'll probably love its leverage to an increasing price of bullion. As Jim Grant points out elsewhere in the issue, there's reason to believe that being long gold is one of the more logical plays you can make in today's macro environment, as the printing presses of various central banks whirr and the hands and minds operating them seem to have no plan or no way to stop. Grant likes Barrick Gold (NYSE: ABX) as a way in on the yellow metal — but if you're looking for a junior developer with more potential upside, we recommend NovaGold which, coincidentally, represents a pure play on a joint venture with Grant's pick for what some are calling the Holy Grail of recent gold discoveries: the Donlin Gold project in Alaska.

Donlin was first discovered by NovaGold when the company was under the leadership of Rick Van Nieuwenhuyse, an award-winning geologist. Geological studies to date already show proven and probable reserves of 34 million ounces of gold, a figure that jumps to 39 million in terms of measured and indicated resources and 45 million ounces including inferred resources. The mine is a whale, with a projected annual output of 1.5 million ounces during the first five years of its life and a lifetime annual output of 1.1 million ounces. It's also worth noting that Donlin is likely to contain a lot more gold, a fact that should be confirmed once the owners can turn their attention back to exploration. (This has been suspended during the permitting process, which is still ongoing.) There are several reasons for this optimism. Firstly, Donlin's contained within just three kilometers of an eight-kilometer-long gold-bearing trend, and secondly, the in-pit area of the mine covers only approximately two percent of the 80,000-acre land package the property comprises. The sheer volume of the resources at Donlin put the project squarely among the largest in the world, an anomaly at a time when gold discoveries are getting rarer and more expensive to find. In fact, 2012 saw precisely *zero* new discoveries, anywhere — period. And technical innovation won't fix this decline, either: gold is where it is, and no genius is going to unlock it with a mineral version of fracking.

Size is only part of what makes the Donlin deposit unusual. Its other distinctive characteristic is its remarkably high grade. Once the mine is up and running, the company expects to be digging up gold with an average grade of 2.24 grams per tonne — 2.5 grams in the first five years — more than double the average grade of one gram (and falling) for projects currently in development. There's also the fact that NovaGold would be able to get the gold out at an all-in sustaining cost per ounce of $735 life-of-mine, very low relative to other comparable projects.

Despite its most valuable asset being located in Alaska, a very safe jurisdiction and thus a rarity for gold finds of this caliber (which normally face major jurisdictional risk), NovaGold has a colorful history. After inheriting half of the project when it acquired Placer Dome, gold major Barrick made a hostile takeover bid for NovaGold in

2006 at $16 per share, recognizing even then the enormous potential of its flagship asset. NovaGold's stockholders rejected the bid. It was a somewhat pyhrric victory at the time for NovaGold, however, as litigation at another project and a massive increase in projected development costs caused the stock to crater. The company stood on the verge of bankruptcy in the post-Lehman financial crisis. Then, in 2009, it was rescued by the Electrum Group, the vehicle for the commodities investor Thomas Kaplan (interviewed elsewhere in this issue) which acquired 27 percent of the company's shares at around $1 per share. Thus began a multi-year process of restructuring and refocusing NovaGold. The company's litigation was settled and two successful financings were undertaken — first to George Soros and John Paulson at $5.50 per share and then a larger offering at $9.50 per share — that ensured the company would be fully financed until a construction decision. A mega-copper project was spun off to shareholders as NovaCopper, with Van Nieuwenhuyse at its helm, and a new CEO was recruited — none other than Gregory A. Lang, the head of Barrick's North American division and the man who had overseen the Donlin project for the former predator. Lang, a 30-year industry veteran, has tied his fate to that of NovaGold, representing a career bet on the viability of Donlin. He specializes in mine-building — exactly the right experiential profile one would want to see in the executive of a company trying to get a project as massive as Donlin built. Finally, as part of the restructuring, the company also put up for sale its interest in Galore Creek, the largest undeveloped copper mine in Canada, to focus entirely on the Donlin project and put to rest the market's concerns about its ability to finance two mega-projects at once. And against this backdrop, the company has slowly but surely advanced the project.

Things have changed with Barrick as well. Barrick spent years talking down the Donlin project precisely because they still coveted its other half. Following their disastrous acquisition of a copper mine in Zambia and several massive project overruns, a suddenly overleveraged Barrick began to suggest (the rhetoric was aimed at appeasing shareholders concerned about Barrick's debt) that they would not in fact commit the $3 billion needed to build their share of the mine. But now Barrick's management has completely changed its tune. The new CEO, ex-Goldman Sachs executive John Thornton, has gotten religion about Donlin, making glowing statements about it in recent months and touting the mine as a future crown jewel for the company. Moreover, both NovaGold and Barrick have stated they will not build the mine unless prices justify it. But both, of course, believe they most certainly will build it.

So NovaGold could be — in the words of its chairman — a "category killer" as a way to play a gold bull market. But with opportunity, there has to be risk. The first area of concern we want to point out is the question of permitting. For many years, this seemed so far off that investors avoided NovaGold because production was such a distant dream that the near-term price of gold seemed irrelevant. But now NovaGold is advanced a good way through the multi-year permitting process and seems to be heading for a successful result there with little local objection, having last year secured long-term surface rights from the local Native Corporation and being now set to file its draft environmental impact statement by year's end. For a large mining project, Donlin seems to be remarkably non-controversial, and the threat of a green insurgency looks blunted for the moment — as do comparisons to the disastrous Pebble project, a huge but low-grade copper/gold/molybdenum mine far more environmentally sensitive that has lingered in legal limbo for decades.

The second major concern for investors in Donlin is the high capital expenditure required to get the mine online, estimated by NovaGold and Barrick to amount to $6.7 billion — a potentially heavy lift. True, that figure includes a $1 billion contingency. And importantly, NovaGold and its partners have not repriced the lower costs of many inputs. The initial cost to build was assessed at a peak in the commodity cycle when production costs were much higher due to demand; many costs have plunged significantly since then. There's also the possibility that NovaGold will use third-party operators to build and run the massive infrastructure necessary to get all that gold out of the ground. This would include port facilities and power generation, as well as the gas pipeline that is the biggest infrastructural hurdle. And then there is the sale of its non-core asset, its fifty-percent stake in the Galore Creek copper project. While Galore has been on the market for years, and Teck has a right of first refusal, it too is an unusually large project in a safe jurisdiction: a big value-add considering that location risk is even more pronounced for copper projects than for gold.

So the NovaGold thesis is clear: an all-in bet on a massive, high-grade mine that still has to be developed, **just the type of high-risk miner the market has hated in recent years.** And the volatility on this one is not for the faint of heart: the stock can move 10 percent in a day. But things look much better for the company than in 2012, when it traded at $13 before collapsing to as low as $2. Despite this possible downside, NovaGold has a lot going for it. There's the category-busting nature of the Donlin asset itself. There's the fact that Barrick is now fully on board. And there's the fact that the company's top shareholders have stayed faithful through the fluctuations of its very volatile stock price. These include legendary value investor Seth Klarman of Baupost, the third-largest holder of NovaGold stock. And not to be underestimated is the fact that unlike most other gold mines in its league in terms of size and quality, Donlin is (as noted above) located in the world's safest geopolitical jurisdiction: the United States of America. This means that if and when Donlin goes online, people who've bought stock in NovaGold don't have to worry about a coup and a subsequent surprise nationalization of the mine. It will stay in the hands of NovaGold and NovaGold's shareholders, a fact which one day may justify a safety premium.

Last but by no means least is the stock's absolutely phenomenal leverage to gold. At current prices of $3.90 per share, including the company's cash balance and a discounted value of $200 million for its stake in Galore, the share price seems to discount a gold price of $1,200 in perpetuity. This includes no additional upside from exploration, a bearish scenario. But our model suggests that should gold make a move to $1,400, at a five percent discount rate the value of the Donlin project hits almost

$3.5 billion, giving an NAV for NovaGold including its cash of $5.68. At the $1,890 price where gold peaked in 2011, Donlin is worth $7.17 billion and NovaGold's NAV climbs to $11.18. At a doubling of the gold price to $2,400, Donlin would be worth almost $10.9 billion, producing a value of $16.77. **At the zero percent discount rate gold miners traded at before hard times for the metal set in, a move in gold to $2,500 would result in Donlin's value increasing more than four times, from $6.2 billion to $29.6 billion, or $44.77 per share**. It's also worth noting that in bull markets for gold stocks, they often trade at premiums and even multiples of NAV, especially ones with great exploration potential and low regulatory risk like Donlin. And if we want to get totally blue-sky here and follow what Kaplan told us he thinks is the low end of an equilibrium price for gold, at $3,000 our stock valuation soars to **$23.34 at a five percent discount rate and $57.20** at a zero percent discount rate. Powerful stuff.

So there you have it. NovaGold looks like a cheap ticket to a fancy party for the roaring bullion bulls out there. Plenty of reason to consider a play on the massive and rich Alaskan asset it's bet big on. And you don't even have to strap on your snowshoes or heft a pickaxe to do so.

Richard Hurowitz is founder and publisher of The Octavian Report*. Sam Munson is managing editor of* The Octavian Report*. The writers of this piece may own shares in some of the companies mentioned.*

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