Update Edition

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EARNING INCOME FROM GOLD

By Gordon Pape, Publisher and Editor

One of the hottest market sectors this year has been gold. As of the close on April 28, the S&P/TSX Global Gold Index was up 14.73% year-to-date. Only the tiny information technology sector was doing better.

Gold has been on a roll for the past several months despite rising interest rates, which normally are a headwind for the precious metal. The price has been fluctuating around US$2,000 an ounce and some experts predict it will continue to rise over the summer, due mainly to big purchases by central banks.

But most income investors aren't participating in the gold surge. That's because gold doesn't pay interest or dividends. It just lies in a vault like a lump of inert metal (which it is). Not only does it not generate income, but it costs money to keep it safely stowed. Criminals are always happy to take it off owners' hands, as we were reminded by the recent $20 million heist at Toronto's Pearson Airport.

But financial engineers have devised a way to have your gold and live off it too. They've launched exchange-traded funds (ETFs) that invest in gold miners and generate income by selling covered call options against some or all of the portfolio. Investors who hold these ETFs are currently receiving attractive yields as well as capital gains. Here is a look at two Canadian-based entries. Prices are as of April 28.

CI Gold+ Giants Covered Call ETF (TSX: CGXF)

Type: Exchange-traded fund
Price: $11.69
Annual payout: $0.948 (trailing 12 months)
Yield: 8.1%
Risk: High
Website: https://funds.cifinancial.com/en/funds/daily-prices?ssf=CGXF

Comments: This ETF invests in a portfolio of at least 15 leading gold producers (as measured by market capitalization) listed on North American exchanges. About 59% of the holdings are in Canadian stocks, with 13% in the US and 28% international. Top holdings include Gold Fields Ltd., AngloGold Ashanti Ltd., Kinross Gold Corp., Endeavour Mining, and B2Gold Corp.

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The managers write covered call options against the securities in the portfolio to generate income, which is paid to investors on a quarterly basis.

The ETF was launched in June 2011 and has about $167 million in assets under management. The management expense ratio (MER) is 0.71%.

Recent performance has been impressive. The fund was up 24.2% for the six months to the end of March. Based on the trailing 12-months distributions, the yield at the current price is 8.1%.

But a word of caution. These results are outliers. The average annual compound rate of return since inception is -1.2%. In other words, if you bought units when they were launched, you'd be out of pocket right now – not by much, but still a loss. Over the past10 years, the fund has made profits four times and lost money on six occasions.

Horizon Gold Producer Equity Covered Call ETF (TSX: GLCC)

Type: Exchange-traded fund
Price: $27.33
Annual payout: $2.533 (trailing 12 months)
Yield: 9.3%
Risk: High
Website: https://horizonsetfs.com/ETF/glcc/

Comments: The principle here is the same. The fund holds a portfolio of top gold producers and actively writes covered call options against them. The top names are somewhat different from those in CGXF, however, and include Agnico Eagle Mines, Barrick Gold, Franco-Nevada, and Newmount Corp.

Like CGXF, this fund was also launched in 2011, but it's been more successful in attracting investor interest, with $261 million in assets under management. The MER is 0.79%. This fund makes distributions monthly, currently at a rate of $0.22 a unit.

The patterns between these two funds are similar. Both have been strong recently – this one was up 26.88% in the six months to March 31. But the average annual compound rate of return since inception is -1.76%.

In short, neither of these funds should be considered a long-term hold. They are only suitable for opportunistic investors, who can tolerate risk and are prepared to sell quickly if gold prices turn down.

We will add the Horizons fund to our recommended list and monitor it on a regular basis.

Follow Gordon Pape's latest updates on Twitter: http://twitter.com/GPUpdates

ENERGY STOCKS CONTINUE TO PAY OFF

By Gordon Pape

Oil prices have softened a little recently, but our mid-size energy recommendations continue to generate nice returns for investors. Here are updates on three of them. (Prices are as of April 28.)

Gibson Energy Inc. (TSX: GEI, OTC: GBNXF)

Type: Common stock
Current price: C$22.99, US$16.91
Originally recommended: Oct. 14/21 at C$23, US$18.44
Annual payout: $1.56
Yield: 6.8%
Risk Rating: Higher risk
Website: www.gibsonenergy.com

Comments: Gibson Energy is a Calgary-based liquids infrastructure company. Its principal businesses consist of the storage, optimization, processing, and gathering of liquids and refined products. The company's operations are focused around its core terminal assets located at Hardisty and Edmonton, Alberta. Gibson also has a facility in Moose Jaw, Saskatchewan, and an infrastructure position in the US.

The company's results for the fourth quarter and full year 2022 were released recently and the results were encouraging for investors.

Gibson reported revenue of just over $11 billion for the full year, which included $2.5 billion in the fourth quarter. The 12-month total was an increase of $3.8 billion or 53% over 2021. The company said the jump in revenue was mainly due to higher commodity prices.

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Net income was $223 million for the full year, including $64 million in the fourth quarter. That was a year-over-year increase of $78 million or 54%.

Distributable cash flow for 2022 was $356 million, up $65 million (22%) over 2021. The dividend payout ratio on a trailing twelve-month basis was 60%, which is below the company's 70–80% target range.

As we noted in our last review, we expected this to result in a dividend increase early this year, and that's what happened. The company announced a 5% dividend hike to $0.39 per quarter ($1.56 per year), beginning with the April payment. Combined with a small pullback in the share price, that increases Gibson's yield to a very attractive 6.8%.

The company also continues to buy back shares. Gibson repurchased 2.5 million shares for an aggregate $59 million in the fourth quarter. That brought the total for 2022 to six million shares for an aggregate $146 million, representing over 4% of outstanding shares.

Action now: The stock is a Buy for investors who can handle above-average risk and who are looking for high yields.

Keyera Corp. (TSX: KEY, OTC: KEYUF)

Type: Common stock
Current price: C$31.88, US$23.54
Originally recommended: July 21/04 at C$6.03 (split-adjusted)
Annual payout: $1.92
Yield: 6.0%
Risk rating: Higher risk
Website: www.keyera.com

Comments: Keyera is primarily in the natural gas and natural gas liquids (NGL) business, providing such services as gathering, processing, fractionation, storage, transportation, and marketing. It does not do any exploration or production.

The company reported a fourth quarter loss of $82 million that was caused by a non-cash impairment charge of $180 million primarily related to its Simonette gas plant. For the full 2022 fiscal year, Keyera showed a profit of $328 million, up slightly from $324 million in 2021.

Distributable cash flow (DCF) was $104 million for the fourth quarter, down from $207 million in the same period of 2021. For the full year, DCF was $654 million compared to $669 million in 2021. The company said the decrease was due to higher maintenance capital spending.

The company ended the year with net debt to adjusted EBITDA of 2.5 times, at the low end of its target range of 2.5 to 3.0 times.

Although the 2022 numbers weren't as encouraging as we had hoped, the company is building out its core infrastructure, which should increase revenue and profits going forward. The company has acquired an additional 21% working interest in the Keyera Fort Saskatchewan complex, adding significant and immediate capacity that offers meaningful synergies with its integrated platform. It said the construction of its $1 billion KAPS pipeline is 99% complete and announced it has approved a 40 million cubic feet per day capacity expansion at its Pipestone gas plant at a cost of $60-$70 million. The project is expected to be completed by the first quarter of 2024.

Keyera did not announce a dividend increase for this year but is planning to move from monthly to quarterly payments in June. Unless there is a change in the dividend rate between now and then (unlikely), the new quarterly payment will be $0.48 a share.

Action now: Hold.

Freehold Royalties Ltd. (TSX: FRU)

Type: Common stock
Current price: $14.75
Originally recommended: Oct. 28/21 at $12.10
Annual payout: $1.08
Yield: 7.3%
Risk: Higher risk
Website: www.freeholdroyalties.com

Comments: Freehold is an oil and gas royalty company based in Calgary. It has assets in five provinces and eight US states. Its primary focus is to acquire and actively manage royalties, while providing a lower-risk income vehicle for shareholders. Freehold has land holdings totaling more than 6.4 million gross acres in Canada and 0.9 million gross drilling unit acres in the United States.

Fiscal 2022 was a good one for Freehold, with record performances on several fronts. These include revenue, funds from operations (FFO), production, and wells drilled.

CEO David Spyker said the results were due to "the significant work done over the last three years to

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establish the company as a premier North American energy royalty company. Our expansion and optimization efforts have resulted in a 'new look' Freehold, with the scale and asset base that will enable sustainable, long-term value creation for our shareholders.

"By targeting plays across North America, our asset base, development inventory, and revenue generation is underpinned by exceptionally high-quality payors in many of the top tier operating areas across North America. Freehold's fourth quarter and full year 2022 results reflect this quality."

Royalty and other revenue totalled $393 million for the year, up 88% over 2021. Higher production volumes and a strong commodity price environment were the main drivers. Revenue from the US, which has been the target of the company's recent expansion, accounted for 37% of the total.

Funds from operations for 2022 came in at $316.5 million ($2.10 per share), up 67% from $189.6 million ($1.39 per share) in 2021.

Dividends paid per share almost doubled year-over-year, to $0.94 in 2022 compared to $0.45 in 2021. The payout ratio was 45%, a significant increase from 33% in 2021. But the dividend appears to be sustainable as long as oil prices stay near current levels. Freehold raised the dividend twice in 2022.

Total production was 14,101 boe/d (barrels of oil equivalent per day) in 2022, up 19% from 11,844 boe/d in the prior year.
During 2022, $190.8 million was allocated to portfolio reinvestment The focus of the 2022 acquisitions was on the continued enhancement of the US portfolio, with transactions completed in the Permian and Eagle Ford areas.

Proved and probable oil and natural gas reserves totalled 54.5 MMboe as of Dec. 31, 2022, up from 49.8 MMboe on Dec. 31, 2021. Freehold replaced 160% of proved reserves and 190% of proved plus probable reserves.

Action now: The stock is a Buy for aggressive investors. But be aware that Freehold has a history of quickly adjusting its dividend, up or down, if there is a significant change in oil prices.

YOUR QUESTIONS

GIS puzzle

Q – I'm a bit confused on what counts as income for guaranteed income supplement (GIS) calculations. Money Sense has an article that reads: CPP, interest, and RRSP withdrawals are all counted dollar for dollar, so these items will cost you $0.50 per $1 received.

How can this be? It's impossible to be dollar for dollar and also $0.50 on the dollar. Which is correct?

Dividends will cost you $1.40 per dollar so should we avoid dividends? – Joe

A – Bureaucracy can be confusing at times, and this is an example. What it really means is that any income you receive from the sources you named (plus others like RRIFs, EI benefits, Old Age Security, etc.) is included at the full amount in calculating your income for purposes of determining GIS eligibility.

So, $1,000 worth of RRSP withdrawals adds $1,000 to your total income – dollar for dollar.

As for dividends, you have to use the grossed-up amount of any such payments in your calculations, which is where the $1.40 number comes from. That may not seem fair but it's the law.

I should note that withdrawals from a Tax-Free Saving Account do not count as income for GIS purposes.

For every dollar you receive as income, your GIS eligibility is reduced by $0.50. That means if your total income from all qualified sources is $10,000, your GIS payments would be reduced by $5,000.

The maximum monthly GIS payment for a single person in 2023 is $1,026.96 but remember that will be reduced by $0.50 for every dollar of other income you receive. To qualify, a single person's income cannot exceed $20,832. – G.P.