Capital Markets Will Remain Brutal To Mining Companies In 2014 – Midas Funds' Winmill

By Debbie Carlson of Kitco News
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(Kitco News**) -**Cash flow will be critical for miners in 2014, with companies that have strong operating cash flow or free cash flow able to ride out what's likely to be another trying year for the sector, said the head of a mining mutual fund.

Tom Winmill, portfolio manager of Midas Fund and Midas Perpetual Portfolio, said the tight-fisted capital markets make it hard for the miners to raise cash. It's especially hard as metal prices are down sharply on the year.

"What we're seeing in the miners is those who can access capital and those who can't. The punishment for those that have difficulty to access capital is really quite severe," he said.

Winmill gave the example of Toronto-based Detour Gold Corp. (TSX: DCG), which has seen its value plummet as the company took on debt as prices fell. The stock price fell sharply in anticipation the firm will need additional equity financing in order to have enough cash to get through their ramp-up to full operations to 2014.

"That shows you how seriously tough it is for a small company to raise capital," he said.

Even a large producer like Barrick Gold Corp. (NYSE: ABX) (TSX: ABX) saw its stock valuations take a hit of about 10% when they announced a deal to raise funds. Winmill noted they managed to raise money, but that it shows the temperature of the capital market is cool to miners.

As such, Winmill said the strategy Midas Fund is pursuing when making new investments is to avoid smaller companies or any companies that need equity financing. Any new investment money is being earmarked to companies that are cash-flow positive he said, naming BHP Billiton (NYSE: BHP), Rio Tinto (RIO), Freeport McMoRan Copper & Gold (FCX) and Goldcorp (GG) among top choices.

"We think that's important for investors to consider until the capital market situation for miners resolves itself," he said.

Cost-cutting has been on the lips of every mining chief executive officer this year, but there's a difference between cutting a mailroom clerk in the home office and making thoughtful cuts with an eye to future growth, Winmill said.

Simple cuts are "just to pat the investors on the head," he said.

What he looks for is whether firms are mindful about the whether the cost of capital produces a return on capital.

"The larger companies that have a good portfolio of projects that are making that type of decision is the type of cost-cutting that we like to see. We like to see them eliminate an entire project where cost of capital is not sufficiently below the return on capital. That's the most import criteria in our opinion, rather than G and A (general and administrative) cuts," he said.

And it's not just looking at balance sheets, either.

"You can look at a balance sheet and see cash on there, but if they're looking at uses of cash to maintain projects or put in development (projects) that exceed what they have currently have available, (then) you have to take a very close look at that company. If they start running into requirements for cash, such as Detour did, that company will take an enormous hit before the market will give it more cash," he said.

The need for cash might mean more miners will have to hedge production next year, he said.

"I think that's very possible, particularly those companies that are higher cost and look to get bank financing to put their crucial projects into production…. There's a whole new dynamic of conservatism in project finance," he said.

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