Major Gold Producers ‘Bruised’ But ‘Not That Bad’ After Price Ups, Downs Of Last 5 Years

By Allen Sykora of Kitco News
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(Kitco News**) -** The world’s largest gold-mining companies are “bruised” but still standing after a tumultuous half decade that saw gold prices soar to record highs but then tumble by more than a third.

This left some companies backpedaling, trying to maintain profitable output after initially racing to increase production when prices were soaring. Commodity and labor costs climbed during the boom years and are now an added challenge in a tougher price environment.

The five largest gold producers back in 2009 were Barrick Gold Corp. (TSX:ABX)(NYSE:ABX), 7.4 million ounces; Newmont Mining Corp. (NYSE:NEM), 6.5 million; Anglogold Ashanti Ltd.(NYSE:AU), 4.6 million;Gold Fields Ltd. (JSE:GFI), 3.9 million (although Gold Fields has since unbundled some South African mines to Sibanye Gold); and Goldcorp Corp. (TSX:G)(NYSE:GG), 2.4 million.

From left to right: Jeffrey Wright, H.C. Wainwright & Co.; Dan Denbow, USAA Precious Metals and Minerals Fund; Thomas Winmill, Midas Management Corp.

“I would say collectively, while their valuations and individual stock prices have certainly been beaten and bruised, if you look at other metrics of corporate health, they’re not that bad,” said Jeffrey Wright, managing director of equity research at H.C. Wainwright & Co.

“You have companies that have been paying down long-term debt. Now, they’re doing adequate and necessary planning for the future that should have been done all along, but they didn’t do. I don’t want to leave the illusion that companies are in their last gasp. That’s not the case. You have strong companies that have the ability to not only service their debt, but pay back their debt, and companies with stable production to growing to modestly growing production profiles with projects that were invested in many, many years ago that are now showing the fruits of their labor.”

As of early-October interviews for this story, Wright pointed out that Goldcorp shares were down roughly 40% over roughly five years. Others fared worse, with Barrick down 60%. Some said companies initially put too much emphasis on trying to ratchet up output rather than efficiency.

“They basically were taking the higher gold prices and running it through their plans, instead of actually running the companies to be the most efficient,” said Dan Denbow, portfolio manager with USAA Precious Metals and Minerals Fund. “You might even put some blame on investors themselves,” he added, in reference to pressure to focus on ounces produced.

There probably should have been more emphasis on factors such as how much it cost to produce each ounce, Denbow said. While companies have pledged to cut back spending, he feels they have not done enough.

“If you start modeling at $1,200 (gold) or below, these companies need to do much more in terms of making hard decisions,” he said.

Wright commented that the efforts several years ago to ramp up production, whether by acquisitions or organically through their own projects, ended up being a “misstep” in some cases since planning seemingly did not take into account potential for a sharp pullback in prices.

“There’s a lot of projects out there that make sense at $1,500-$1,600 gold prices but there’s no way to make money at $1,200 gold,” Wright said.

Once companies embark upon projects, it can take a decade to develop a gold mine, Wright said. That created dilemmas when the price of gold fell back sharply.

“To sustain their growth, because they are so large, they had to commit capital to projects with decreasing, marginal returns on equity,” said Thomas Winmill, president of Midas Management Corp. “If you think about it, there are only so many huge mine projects around the world that would provide a huge mining company the ability to grow and replace ounces every year.”

In some cases, projects that did not pan out as expected cost mining chief executives their jobs, observers pointed out.

Now, one trend is major producers looking to divest non-core assets, Wright said. For instance, he pointed to Goldcorp’s and Barrick’s divesture of their interests in the Marigold Mine in Nevada earlier this year.

“There is less appetite now to go out and buy exploration projects for the sake of adding ounces or potential construction down the road,” Wright said. “If it’s a small acquisition that makes sense within a geographic area where it has synergies to projects in close proximity, that’s something that the majors will look at. But they are not as enticed to make big bets, given the quick run-up in gold and the quick downturn in gold.”

Meanwhile, companies have taken an extra hit because they are still saddled with higher costs after prices fell back.

“A lot of it was planning for gold at $1,900,” Denbow said. But, “some of it (high costs) is not their fault.”

For instance, he said, at the same time gold was soaring, there was a commodity boom that also drove up prices of base metals. This led to shortages for skilled labor. “When you have that skill

shortage, you end up having to pay more for people and you end up paying the same rate for a ‘C’ (quality) engineer that you are paying for an ‘A’ engineer.”

Meanwhile, labor deals cannot be undone easily even if gold prices fall.

“I’ve never met anybody who wants to take a pay cut,” Wright said. So, to get labor savings, companies have to try to cut jobs when possible, he continued.

Firms operating in South Africa also faced rapidly rising power costs, Denbow added. Further, many of these operations had lower grades and were mining deep under the ground.

Wright noted that most major companies are trying to pare debt. Winmill commented that he would focus on the balance sheets of producers, favoring those that have not borrowed too much.

“As a doctor, the patients I would focus on for the long term have little leverage and low operating costs,” Winmill said.

Observers acknowledge companies’ need to cut spending, but also point out this could be a problem down the road when they need to replace mined output.

Denbow said he feels overall that intermediate-sized companies have handled the downturn in gold prices better than the major producers.

“And even in the intermediate space, a lot of them are still hoping that gold prices are going to rescue them down the road,” Denbow said. “The mistake they’re making across the board, and the big guys are doing it as well, is that some of the capex and some of the cost-cutting is good. (But) some of it is very short-term focused and it’s going to lead to companies hampered two years down the road because they’re cutting their exploration and development.”

They may be hoping to ramp this back up when prices recover, but instead could end up with bare cupboards, Denbow continued.

“They need to be making harder choices in terms of right-sizing organizations, looking for profitable ounces and actually closing some of this production,” he said. “They’ve made modestly hard choices but nobody has made the really hard choice, which is to totally close production.”

Winmill said companies are talking about returning capital to shareholders and reducing overhead costs. But he still has some reservations about the course of some producers, including mining the best, most economical ore right away, thereby selling it at reduced prices.

“I would say there is a certain amount of capital allocation suicide going on just to show the market they can continue to produce ounces. It’s probably not the best thing to do in terms of long-term capital allocation,” Winmill said.

Goldcorp Seen As Stronger Survivor

Goldcorp was cited as the top-five company that has perhaps fared the best over the last five years. The stock performance reflects this, some added, pointing out that Goldcorp has lost less ground than others. Winmill also spoke favorably of Randgold Resources.

"Goldcorp probably had the biggest advantage because they didn't come into this period as bloated as some of the guys who have been around longer," Denbow said. Much of its growth and production is newer, such as Peñasquito in Mexico, helping them with a cost structure better suited for the current environment.

Wright commented that Goldcorp had fewer mines, meaning it could adjust more quickly when prices turned against the industry. This also helped some of the mid-tier companies, such as Agnico-Eagle, he added.

Goldcorp also didn't have any large setbacks in its mine portfolio, as Barrick had with the Pascua-Lama project on the border of Argentina and Chile, Wright pointed out. After Barrick spent billions on a major project with reserves of 15 million ounces, development was suspended last year due to a number of factors, including demands and organized opposition from indigenous communities.

"It (Goldcorp) has limited political exposure," Winmill said, pointing out that key mines are in Canada, Mexico and the U.S. This reduces the political risk of sinking capital into countries that may not end up being friendly mining jurisdictions.

Denbow described Barrick and Newmont as "not in ICU" but still seemingly searching for strategies and structure. This is especially the case with Barrick after a new management regime announced this summer that included the departure of its chief executive, with the company to be run by co-presidents, he added.

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