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More gold-sector M&A expected; no-premium deals gain in popularity

(Kitco News) - Mergers are likely to continue in the gold-mining industry, although there is a trend toward no-premium acquisitions, fund managers and analysts said.

"A lot of larger global shareholders of these mining companies for a while have been advocating for consolidation," said William Winmill, analyst with the Midas Fund (MIDSX). "So I would not be surprised if a number of these companies listen. And we have seen that."

Two mega-mergers – Barrick Gold Corp.-Randgold Resources Ltd. and Newmont Mining-Goldcorp – occurred during the last couple of years. However, companies with smaller market capitalizations are also getting in the act.

In its Gold Focus 2020 report released Wednesday, the consultancy Metals Focus reported that M&A activity in the gold sector nearly doubled last year to $24.7 billion, although half of this was the $12.3 billion Newmont-Goldcorp merger. The number of transactions remained almost the same as the previous year at 106.

Joe Foster, portfolio manager of VanEck International Investors Gold Fund (INIVX), said he looks for M&A activity to continue, particularly between midtier and junior-mining companies. He also looks for more “mergers of equals” in which producers do not pay a premium to acquire another company, but in which mining firms instead partner up with another with the goal of creating a stronger company.

“Mergers of equals have been very far and few in between historically,” Foster said. “They do happen occasionally, but not very often.”

Over the years, mergers usually occurred when one company paid a premium to buy another.

“In the past, we’ve seen many times where companies have overpaid for an acquisition,” Foster continued. “Even though companies do a considerable amount of due diligence on their acquisition targets, it’s very hard to know exactly what you’re buying until you have the asset and start working and mining the asset. Sometimes you find it’s not as robust as you thought it was, and it doesn’t deliver like you thought.”

Thus, the returns are not as great as envisioned.

“I think there is a concerted effort to keep that from happening again, either refraining from M&A activity or doing a friendly merger of equals,” Foster said.

Winmill commented that the no-premium mergers are “a contrast from the last [gold bull-market] cycle 10 years ago where companies were borrowing to buy out other companies. So perhaps it’s safer acquisitions this time around.”

With no-premium deals, bigger and stronger companies potentially can attract a broader shareholder base. So-called “generalist” investors “like to come into companies with a certain size,” Winmill said.

A larger company in turn might be able to take advantage of other opportunities that arise around the world, Foster continued.

“You don’t get a big premium up front, but you’re creating value in the longer term,” he said.

As an example, he cited the no-premium mergers in recent years between Barrick and Randgold, as well as the Equinox Gold Corp. and Leagold Mining Corp.

“The market saw the benefits of those mergers of equals, and their short prices performed very well immediately after the mergers,” Foster said. “In some of these mergers, it takes a while to play out and you see the value develop over time.”

Still, Winmill cautioned that no-premium mergers may not always create increased value for shareholders. For instance, two companies that are not healthy to begin with may not be able to prop one another up. Further, producers that already have lean management teams have reduced potential savings from a merger.

The bottom line is some combinations “make more sense than others,” Winmill said. As an example of one of the successful ones, he cited the Nevada joint venture between Barrick and Newmont that allowed the two gold-mining giants to cut costs, such as reduced expenses in trucking ore across the state.

Large companies seen focusing on organic growth

Foster said he does not expect much M&A activity from the largest gold-mining companies in the near term.

“The majors seem to be content with their organic [growth] opportunities,” Foster said.

However, another trend that may well continue is China becoming more active in mergers, going after junior developers, in particular, he said.

“That is a change in this cycle,” Foster said. “In past cycles, we’ve seen North American and Australian companies doing more M&A activity with junior developers. So far in this cycle, it’s been the Chinese that have been happy to snap up some of these companies.”

The interest was probably always there on the part of Chinese firms, but now they are acting, Foster said.

“We’ve known for a long time that the Chinese are very interested….I think the increase in gold prices has prompted them to act on it,” Foster said.

Winmill said another trend is for Australian companies to acquire producers in other parts of the world. Australian producers “have been a real success story,” the analyst said, noting that the trend in the Australian dollar has boosted their profitability.

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