Finding Value in Canada's Beaten-Down Gold Mining Sector

Description

To put it mildly, it's been a tough year for gold investors and miners alike. Profits in this sector are under extreme pressure given the decline that has occurred in the commodity, and share prices have reacted accordingly, bringing investor sentiment down with them.

The share prices of many companies have touched new lows since the price of gold came crashing back to Earth — and with a number of potential bargains hidden among Canada's gold mining sector, it's a good time to survey the industry.

A note on evaluating mining stocks

Investing in gold miners is essentially a leveraged play on the price of gold. For mining equities to outperform bullion, gold mining companies will need to show strong free cash flow generation. To do this, gold miners need to sustain high levels of production, while keeping costs at rock-bottom levels. There are two ways that production costs for gold miners are measured: total cash cost per ounce and all-in sustaining cash cost per ounce produced.

The former is the most popular and widely used measure in the industry, but it only includes direct production costs per ounce of gold produced. The latter has recently been introduced as a more comprehensive means of measuring the cost of production; it measures all costs incurred by a company over the lifecycle of its mines. This measures not only direct production costs but also indirect costs including sales, general and administrative expenses, mine exploration and development expenses, as well as rehabilitation and asset retirement expenses.

Who looks cheap?
Of the gold miners that have seen their price plunge, three have managed to sustain solid production while keeping costs at rock-bottom levels, making them an appealing play on gold. They are: the world's largest gold miner, **Barrick Gold** (TSX:ABX, NYSE:ABX); relative newcomer to the fray, **Yamana Gold** (TSX:YRI, NYSE:AUY); and small-cap **New Gold** (TSX:NGD).

As the chart below illustrates, each of these miners has a total cash cost of under $600 per ounce and an all-in sustaining cost per ounce of under $1,000, making them far lower cost producers than many of their peers.

Company	Enterprise Value	Q1 2013 Production KOz	Q1 2013 Total Cash Cost P/Oz	Q1 2013 All In Sustainin Cost P/Oz
Barrick Gold	$28B	1,797	$561	$919
Eldorado Gold	$4.6B	164	$567	$1,010
Gold Corp	$22.4B	615	$710	$1,135
New Gold	$3.5B	0.95	$485	$875
Newmont	$19.5B	1,165	$755	$1,086
Yamana Gold	$8.1B	291	$383	$856

Source data: Barrick Gold, Eldorado Gold, Gold Corp, New Gold, Newmont and Yamana Gold Financial Filings Q1 2013.

Even at the current depressed gold price, all three are making a healthy margin on their gold production and are well-positioned to remain profitable should the price fall further. Let's look at the three a bit more closely.

Barrick Gold

As the world's largest producer, Barrick Gold offers investors a unique combination of geographically diversified mine assets, low costs, and economies of scale and a promising exploration program. Even with these qualities, Barrick's stock has declined by about 50% this year.

This decline is more reflective of the challenges Barrick has faced. Cash costs have risen an a further write-down of the value of its Pascua-Lama project on the border of Chile and Argentina looms.

Yamana Gold

Yamana Gold is a far smaller player than Barrick but packs a heavier punch for investors. It has a diversified portfolio of mines across Latin America, with its primary gold production in Mexico, Chile, Argentina, and Brazil. It also has one of the lowest all-in cash costs per ounce in the industry; it's capable of generating a margin of $439 per ounce even at the current gold price. This means that the company remains extremely profitable.

Even so, since the start of the year its share price has plunged 38% as the gold price has tumbled.

The company is also focused on reducing costs even further and increasing production at its mines in an effort to generate further economies of scale and compensate for the lower revenue per unit sold.

New Gold

The last of the bunch is mid-cap miner New Gold, which has a globally diversified portfolio of assets in Canada, the U.S., Mexico, and Chile. Like Yamana, it has a particularly low all-in cash cost per ounce, which for the first-quarter 2013 was $875 per ounce of gold produced. This gives New Gold a healthy margin of $420 per ounce at the current gold price. But even so, negative market sentiment toward the gold sector has sent its share price lower by 37% since the start of 2013.

New Gold is also in the process of focusing on increasing production and reducing costs, allowing it to access economies of scale and strengthen its margins. These activities will also leave the company well positioned to take advantage of any rebound in the price of gold.

Foolish takeaway

The gold mining sector has taken a pounding on the back of the significant weakening in the price of gold. But there are signs that gold is stabilizing at its current price, which means that those producers able to generate high levels of production at a relatively low cost will still be able to generate solid margins.

If that thesis holds, we'll see a rebound in the share prices of the low-cost high margin producers — as investors realize they have thrown the baby out with the bath water.

While the gold sector may be poised for a bounce, one resource that is potentially on the verge of a major move higher is uranium – the key ingredient for nuclear power. **Click here now** to download our special **FREE** report "**Fuel Your Portfolio With This Energetic Commodity**". We think you'll be surprised at how bright the future is for uranium, how far these 2 stocks have fallen, and how quickly they could rebound. **Click here now** for the nuclear ride of your life!

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TICKERS GLOBAL

1. NYSE:AUY (Yamana Gold)
2. NYSE:B (Barrick Mining)
3. TSX:ABX (Barrick Mining)
4. TSX:NGD (New Gold Inc.)
5. TSX:YRI (Yamana Gold)

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