Despite Gold's Plunge, New Gold Inc. Delivering Promising Results

Description

By Matt Smith

With increasing volatility in the price of gold and an uncertain outlook, investors have exited the gold mining sector in droves. But it has also had the effect of making low-cost miners king in such an uncertain industry.

The Canadian market is dominated by gold miners, which has created a plethora of opportunities for contrarian investors, particularly those with a bullish sentiment toward the precious yellow metal seeking to take advantage of the recent spike in the gold price. One of the most promising among Canada's low-cost gold producers is small-cap **New Gold** (TSX: NGD).

Good second-quarter results
New Gold reported strong second-quarter results despite net operating cash flows being negative. Gold production was up by 8% year over year to 102,000 ounces, while total cash costs had fallen by 9% year over year to $430 per ounce produced. The key driver of this was the contributions of New Gold's new low-cost New Afton mine.

Despite this growth in production, New Gold's bottom line declined. Net earnings were down by almost 38% year over year to $15 million, because of weaker gold prices. New Gold's all-in sustaining costs also rose by 17% year over year to $931 per ounce of gold produced, a result of lower by-product revenues and the mining of lower grade ore at New Gold's Cerro San Pedro, Mesquite, and Peak Mines.

Production cost per ounce is one of the lowest in the industry
With an enterprise value of 10 times EBITDA, New Gold does not appear particularly cheap, even in comparison to its larger competitors. This includes Canada's largest and second largest gold miners, **Barrick Gold** (TSX:ABX) (NYSE:ABX) and **Goldcorp** (TSX:G)(NYSE:GG). Barrick has an enterprise value's that is a mere four times, while Goldcorp's enterprise value is nine times EBITDA. (More on these two later.)

But what makes New Gold attractive in comparison to its peers is its low production costs per ounce.

This becomes even more important for investors when considering the uncertainty in where the price of gold is going. New Gold’s total cash cost per ounce of $430 and all-in sustaining costs per ounce of $931 in the second quarter places it well below the estimated industry average, as the chart below illustrates.

gold mining

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Source data: Financial filings for all companies listed.

New Gold’s total cash cost per ounce is one of the lowest in the industry and lower than either Barrick or Goldcorp. It’s all-in sustaining cost per ounce produced is also one of the lowest in the industry and is lower than Goldcorp, but marginally higher than Barrick. But it is these low production costs that will allow New Gold to sustain solid margins even if the price of gold were to fall further. New Gold’s ability to increase production allows it to take advantage of any unexpected spikes in the gold price.

Strong project development pipeline
Another appealing aspect of New Gold is the company’s strong project development pipeline, including the recent acquisition of the Rainy River Resources. This acquisition has boosted New Gold’s gold reserves by more than 40% and, more importantly, the project is located in the stable and lower-risk operating environment of Canada. New Gold also has two other projects in development stage: Blackwater (also located in Canada) and El Morro (in Chile).

The El Morro project has proven particularly troublesome for New Gold and Goldcorp. Like the larger Pascua-Lama project located in Chile and operated by Barrick, it has run into considerable opposition from local environmental groups. El Morro’s environmental permit was suspended in April 2012, and there’s no clarity on when it will be reinstated, effectively stopping development.

But while New Gold owns 30% of the project, it is Goldcorp that is carrying the majority of the risk as both 70% owner and operator. New Gold is only obliged to repay the loans received from Goldcorp, which allowed it to participate in the project from the cash flows that it receives from El Morro. This effectively mitigates any downside risk/impact that the delays have had on the project for New Gold.

Foolish Final Thoughts
With its low production costs and steadily increasing production, New Gold is well-positioned to weather any further volatility in the price of gold. Its strong portfolio of development projects — with the majority located in the lower-risk environment of Canada — along with minimal exposure to the problematic El Morro project indicate that it has a bright future ahead.

Even still, the market right now has certainly priced in the upside that New Gold offers investors, with larger peers such as Barrick trading at cheaper multiples.

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Matt Smith does not own shares of any companies mentioned.

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