Will a Shift in Barrick Gold's Corporate Governance Send the Stock Higher?

Description

Barrick Gold (TSX: ABX, NYSE: ABX) is a case study in bad corporate governance. For years the company's founder and co-chairman Peter Munk was accused of building an empire at shareholders' expense. But investors have had enough and are joining forces to combat the bourgeoisie…er…board.

Shareholders of the world, unite!

It's been a rough year at Barrick. Last quarter the company wrote off $12 billion in assets as the industry struggles with increasing production costs, weak gold prices, and project delays. But much of Barrick's woes are self-inflicted. The company has been criticized for ego boosting acquisitions, a lack of independent boardroom members, and extravagant compensation.

Barrick's financial performance has been terrible. Between 2003 and 2012, the mining giant's gold production per share has fallen 28%. Between 2007 and 2012, executive and board compensation has totalled nearly $300 million. During the same time investors have paid $2,311 million into the company. And this year Barrick's share price is down 50% – one of the worst performers in the industry.

But shareholders aren't going to take it anymore – someone please cue the Twisted Sisters. Earlier this year, a group of pension funds took issue with the company's decision to pay more than $17 million to the company's co-chairman John Thornton. A majority of shareholders did not approve his compensation, voting against it and other multimillion dollar pay packages to board members.

Now a small U.S. hedge fund wants to break Barrick up arguing that its collection of mining assets are spread over too broad of a geographic area. Mike Morris, co-founder of Two Fish Management, published a 78- page presentation detailing exactly what the Toronto company needs to fix. His key recommendations include:

1) Revise executive compensation to reflect return on invested capital and shareholder returns.

2) Appoint new independent board members including at least one mining engineer and geologist.

3) Sell off non-core assets and refocus Barrick's operations on North and South America.

Morris argues that Barrick's share price doesn't reflect the real value of its assets because the company's operations are geographically diverse and lack focus. It's the ol' conglomerate discount. He estimates that a remodeled Barrick, consisting solely of North and South American assets, could be worth between $40 and $50 per share – versus $19.11 where the stock closed trading on Friday.

Morris further explains that Barrick is reinvesting too much of its capital into low return projects. The company's Pascua Lama mine in Chile – which is behind schedule and over budget – is a case in point. Rather than focus on growth, shareholders would be better served if the company issued dividends or bought back stock.

Viva la Revolution!

The good news for shareholders is that Barrick's management is finally taking concrete steps to address shareholder concerns. In August, the company announced that it plans to either sell, close, or curb production at its highest cost mines, cut 30% of its corporate staff, and slash capital expenditures.

More importantly, Barrick is finally looking into corporate governance. The company admitted last week that it plans to add independent directors to the board and review its management compensation practices. Full details of the changes are expected to be released later this year. If Barrick follows through on these changes, it will be a major victory for shareholders and potentially a big catalyst for the stock.

Barrick isn't the only company making adjustments. Other miners have finally started to respond to falling gold prices and rising production costs. **Kinross Gold** – Canada's third larger gold miner – announced this summer that it has reduced its capital budget, closed its Vancouver office, and laid off staff at its Toronto headquarters. Kinross shares are up about 10% since the new plans were announced. **Yamana Gold** has also pledged to cut production targets in an effort to corral costs.

Foolish bottom line

The lesson from Barrick is clear – with the right amount of heft, and persistence, shareholders can have an impact on how companies are run. As retail investors, we may not have the financial muscle to influence policies, however, we can benefit if we recognize potential situations where bad governance is poised to turn. These kinds of special situations can lead to very shareholder friendly returns.

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Fool contributor Robert Baillieul doesn't own shares in any companies mentioned. The Motley Fool doesn't own shares in any companies mentioned.

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