Warning: More Equity Issues Are Coming

Description

Last week, **Barrick Gold** (TSX: ABX, NYSE: ABX) announced plans to issue at least $3 billion in Canada's largest equity issue since 2009. The move signals that company's scramble to repair its balance sheet after gold prices plunged this year. But is this an isolated incident or a warning of things to come in the mining industry?

Cash crunch for gold miners
For anyone following the trails at Barrick, last week's announcement probably didn't come as much of a surprise. This spring, the company had only $2.3 billion in cash by which to finance a combined $25 billion debt load and capex budget. According to estimates provided by **Deutsche Bank** earlier this year, Barrick would have had to raise $9.8 billion in equity if it were to maintain the dividend and original project plans at current gold prices.

Initially, Barrick responded by cutting costs, slashing its dividend, selling assets, and scrapping mines. Unfortunately, even this wasn't enough. Last week the company announced a $3 billion equity issue at $18.35 per share — significantly diluting shareholders' stake in the company.

The situation is even worse at **Osisko Mining** (TSX: OSK). This summer, the company had only has $110 million in cash by which to finance $220 million of scheduled debt repayments over the next year. Osisko was able to renegotiate the terms of these loans thereby buying the company time. However, this deal was only made possible by issuing potentially equity dilutive warrants.

But if you think this problem is limited to Barrick and Osisko, think again. Two years ago, many analysts were using $1,300 per ounce gold rates as the ultimate bear case scenario and gold miners structured their balance sheets assuming much higher commodity prices. Today, spot rates are hovering only slightly above that threshold.

Who's next?
With gold trading at roughly $1,300 per ounce, most of Canada's largest producers should be able to scrape by through cost cuts and asset sales alone. But if gold prices were to fall another $100 to $200 per ounce, many miners will be forced to raise equity to bridge funding gaps until they can restructured

their businesses.

Last week, Standard & Poor's lowered its credit rating for **Newmont Mining** (TSX: NMC, NYSE: NEM), citing the impact of lower commodity prices on its business. While Newmont is in OK financial position today, the company is saddled with $15.3 billion in liabilities relative to a $12.9 billion market capitalization. If gold prices tumble to $1,200 an ounce, the company's debt-to-EBITDA ratio will surpass 2.5 — roughly where Barrick is today.

Equity dilution is also a risk at **Kinross Gold** (TSX:K, NYSE:KGC). The company only has only $5.5 billion in market capitalization by which to manage a $4.4 billion debt load. In order to protect its balance sheet, Kinross suspended its dividend and further delayed the Tasiast project. But if gold prices take another leg downward, the company may not be able to generate enough cash to finance its liabilities and current capex spending.

Fortunately, these companies are at least able to raise cash, albeit at a high cost. Junior miners have been completely cut off from the equity market. Many can't even raise enough funds to keep the lights on let alone fund exploration and development.

Foolish bottom line
Gold investors should examine the holdings in their portfolio and determine which ones can survive in the current low-price gold environment. Otherwise, more Barrick-like surprises may be in store.

Disclosure: Robert Baillieul has no positions in any of the stocks mentioned in this article.

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Date
2025/09/10
Date Created
2013/11/06
Author
rbaillieul