Which Gold Miner Belongs in Your Portfolio?

Description

A new report released by **Citigroup**, as reported by *The Globe and Mail*, advises investors not to be "tempted" by gold mining stocks, even though they may seem cheap after a rough couple of years. The report makes some good points. The industry tends to "burn cash in good or bad markets," has a short-term mindset, and has a very poor record of creating shareholder value.

Interestingly, the report did identify two stocks you should consider "if you have a strong stomach". Below we take a look at those two companies, as well as a third alternative.

1. Barrick Gold

Barrick Gold (TSX: ABX)(NYSE: ABX) is the poster child for every problem facing gold miners today. Operational mishaps, overaggressive expansion, and a slumping gold price have all hit the company hard — its share price has fallen by about two-thirds since late 2011. Yet oddly it was one of the two companies recommended by the report. So are the shares cheap enough for you to buy?

To answer this question, let's take a look at 2013. Excluding $2 billion spent (wasted) on the idle Pascua Lama project, Barrick made about $700 million in free cash flow last year. This is not a big number for a company valued by the market at nearly $20 billion. And this $700 million was made in a year when gold prices averaged over $1,400 per ounce. Today, gold trades at just over $1,250.

Barrick seems to have made some improvements. Costs are down, governance has improved, and most recently the company struck a deal with opponents of the Pascua Lama project. But this is still a very expensive stock, even for those with a strong stomach.

2. Goldcorp

The other company recommended by the report was **Goldcorp** (TSX :G)(NYSE: GG), a company with a much better track record than Barrick. As a result, its share price did not suffer to the same degree, falling (only) 44% since late 2011. So where does that leave the company now?

Goldcorp spent nearly $2 billion on mining interests last year, resulting in negative free cash flow. But the company did identify its all-in cash costs at $1,031 per ounce. At today's gold price, that means the company would have made $222 (pre-tax) per ounce. When multiplying this by last year's production, you get about $600 million in earnings power. And the company is valued by the market at about $21 billion.

So like Barrick, Goldcorp is still a very expensive stock.

3. Yamana Gold

Yamana Gold (TSX: YRI)(NYSE: AUY), like Goldcorp, is well-respected by the investment community, mostly because it never got carried away like Barrick. Its stock price has fallen by about half since late 2011.

So are the shares any cheaper than Goldcorp's or Barrick's? Well, like Goldcorp, Yamana had negative free cash flow last year. But the company did produce 1.2 million ounces of gold at an average cost of $924. At today's prices, that would translate into earnings power of about $400 million, again pre-tax. And Yamana is valued by the market at nearly $7 billion.

So like the other two companies, Yamana is still quite expensive, at least when looking at the company on a cash flow basis. If you want to bet on the price of gold, you're better off just buying a gold ETF.

CATEGORY

1. Investing

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

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Date
2025/09/13
Date Created
2014/05/30
Author
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