



2 More Key Ratios for Valuing Gold Miners

Description

In my last article I took a closer look at a [key ratio that allows investors to comparatively value](#) a gold miner on the basis of their gold reserves. This was calculated by dividing their enterprise value by the ounces of gold categorized as reserves.

However, gold reserves aren't the be-all and end-all of valuing gold miners. Because of the industry's complicated and capital-intensive nature, enterprise value as a multiple of EBITDA — a key indicator of a miner's core profitability — and price as a multiple of cash flow are important indicators of value.

Enterprise value to EBITDA

EV as a multiple of EBITDA is a key indicator because it allows investors to make apples-to-apples comparisons about the value of gold miners. This is because it's unaffected by a company's capital structure, unlike the price-to-earnings ratio.

It also reflects the capital-intensive nature of the industry by taking into account a miner's level of debt, including the cost of paying off that debt. This gives investors a more accurate feel as to the financial health of a miner and whether it is undervalued in comparison to its peers.

In the earlier article I focused on **Kinross Gold** ([TSX: K](#))([NYSE: KGC](#)), which many pundits are calling undervalued because of its low price-to-book value of 0.73, indicating that it is trading 27% below the book value of its assets.

Kinross has an EV of six times EBITDA, which is low for a gold miner. It is significantly lower than many of its peers, with the exception of **Barrick Gold** ([TSX: ABX](#))(NYSE: ABX), which has an EV of five times EBITDA. Kinross's EV to EBITDA is lower than **Newmont Mining's** ([NYSE: NEM](#)) EV of 10 times EBITDA, **Yamana Gold's** ([TSX: YRI](#))(NYSE: AUJ) 12 times EBITDA, and **Goldcorp's** (TSX: G)(NYSE: GG) nine times EBITDA.

It is also significantly lower than those of the two main precious metal streaming companies **Silver Wheaton** (TSX: SLW)(NYSE: SLW) and **Franco-Nevada** ([TSX: FNV](#))([NYSE: FNV](#)), which have EVs of 13 times and 19 times EBITDA respectively.

These figures show that the market has not fairly valued Kinross on the basis of its core profitability.

Price-to-operating cash flow

This ratio measures the price of a company relative to how much operational cash flow it is generating. It is a particularly important comparative valuation measure for gold miners because of the capital-intensive nature of the industry.

It is superior to using earnings multiples such as P/E or price-to-book because it is far harder to manipulate cash flow through accounting practices. It is also not impacted by non-cash expenses, thus providing a more accurate picture of the financial health of the company. Studies have shown the price-to-cash flow ratio to be the most reliable indicator of long-term returns.

So let's take a closer look at Kinross to see how it compares to its peers. It has a price of six times its operating cash flow per share, which is lower than Newmont's eight times, Yamana's nine times, and Goldcorp's 12 times, but still higher than Barrick's five times.

Again, Kinross's multiple is lower than the lower-risk precious metal streaming companies, being less than half of Silver Wheaton's 16 times operating cash flow per share and lower than Franco Nevada's seven times.

This shows that Kinross is undervalued by the market in comparison to the majority of its peers — with the exception of Barrick, which remains undervalued after a spate of bad news in 2013 dented market confidence in the company. It also supports the theory that a low price-to-book multiple is quick and dirty measure of whether a company is undervalued and offers value for investors. However, the story doesn't stop there. In the next article, I will take a closer look at a range of multiples that allows investors to measure risk.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:ABX (Barrick Mining)
2. TSX:FNV (Franco-Nevada)
3. TSX:K (Kinross Gold Corporation)
4. TSX:WPM (Wheaton Precious Metals Corp.)
5. TSX:YRI (Yamana Gold)

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