



Smaller Is Better When it Comes to Gold Miners

Description

When gold was trading for more than \$1,500 per ounce back in 2011, and every sector analyst in front of the television camera predicted \$2,000 by year-end, the biggest gold miners kept on acquiring new mines with breakeven prices that seemed unprofitable. Fast forward to today, and you have massive write downs like the \$8.7 million that **Barrick Gold** ([TSX: ABX](#)) (NYSE: ABX) reported back in August 2013.

The smaller Canadian miners, on the other hand, were much more prudent with their capital allocation. If you are interested in exposing yourself to gold, look to add these three stocks to your portfolio.

IAMGOLD

When you work for a company called **IAMGOLD** ([TSX: IMG](#))([NYSE: IAG](#)), it is hard to deny what your job is. The company is a small gold miner with operations located in South America and Africa. With a market capitalization of only \$1.7 billion, it is much smaller than Barrick Gold's \$21 billion, but its financial leverage is also small at only 1.36 compared to 2.39 for Barrick Gold. A lower financial leverage means IAMGOLD is in a much better position to weather the plunge of gold prices. Unlike Barrick Gold, management was very strict on their acquisitions by placing stringent conditions, both on the quantitative and qualitative aspect of prospective mines.

Management was also clear it would not advance on projects if the long-term economics were not there. It might not sound attractive when gold prices are at \$1,800 an ounce, but at \$1,300 investors can rejoice that IAMGOLD was strict. Even in today's low-price environment, it put up a 34% EBITDA margin last quarter with total cash cost of \$886 per ounce of equivalent gold.

IAMGOLD currently trades at \$4.35 while having a tangible book value of \$7.55 per share.

If you are bullish on gold, this is an excellent margin of safety to help mitigate the political risk associated with operations in emerging markets.

The road to Eldorado

Our second small miner is **Eldorado Gold** ([TSX: ELD](#))([NYSE: EGO](#)), which is one of the lowest cost producers of gold headquartered in Canada with a cash cost of \$757 per ounce of equivalent gold in 2013. This company has an even lower financial leverage of only 1.36 and EBITDA margin of 45%. Last quarter, it reported a net income margin of 10%. Quite an impressive result considering that its competitors are talking about idling mines and rationalizing their workforces. Most of Eldorado Gold's mines are located in Turkey and China and while not the optimal place to operate it is still much safer from a political standpoint than African countries.

Of the three miners, Eldorado Gold is poised to report the best gain in the short term due to its much lower cash cost per ounce of equivalent gold.

Semafo

Our third and final company is **Semafo** (TSX: SMF). With a market capitalization of \$1.4 billion, it is the smallest of our trio and the most volatile. Its financial leverage is at 1.18, also the lowest, but it is not the best operator. Due to its small size, it is not able to benefit from economies of scale to the same extent as Eldorado Gold. Nevertheless, it still posted an EBITDA margin of 34% last quarter, but failed to post a positive net income.

Buying into Semafo is buying into future growth. Being such a small player, it will have to expand in order to achieve a size where economies of scales start to appear. The good thing is that with such a good balance sheet, the company can take its time to execute without worrying about refinancing and lowering leverage.

Additional risk with Semafo is that the bulk of its operations is in Africa and there is a meaningful political risk when operating on this continent. Any investor willing to invest in Semafo needs to take the chance of mass strikes, corruption or nationalization into account.

The sector might be coming back after a couple of rough years, but that does not mean the risk involved with investing in a commodity producer has been completely mitigated. Each company mentioned has specific risks that need to be taken into account before adding them to your portfolio.

CATEGORY

1. Investing

TICKERS GLOBAL

1. NYSE:EGO (Eldorado Gold Corporation)
2. NYSE:IAG (IAMGOLD Corporation)
3. TSX:ABX (Barrick Mining)
4. TSX:ELD (Eldorado Gold Corporation)
5. TSX:IMG (IAMGOLD Corporation)

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