Don’t Be Fooled by Barrick Gold Corporation’s Size

Description

Size isn’t everything, and **Barrick Gold Corporation** (TSX: ABX)(NYSE: ABX) is a case in point. Yes, it is the world’s largest gold producer and most recognizable amongst investors. But it has also been one of the worst performers.

In late 2011, gold prices peaked at approximately $1,900 per ounce, and have since retreated steadily to levels of over $1,200 per ounce at the end of 2013. Early in the year, we saw renewed strength in the price of gold, but more recently the price of gold has fallen to below $1,200 per ounce again.

The one positive in an environment of weakening commodity prices is that out of necessity, companies begin to look more closely at operational efficiencies and the expense side of the equation. Simply put, since revenues are declining, they must focus on reducing expenses in order to preserve the health of the company.

Let’s look at where Barrick stands in its quest to be profitable despite gold price weakness by performing a SWOT analysis.

Strengths

After years of overspending and poor returns, Barrick has been getting serious about improving operational efficiency and financial performance. The company is targeting annual cost savings of $500 million, divesting itself of underperforming mines, and has come to the market with an equity issue recently in order to improve its balance sheet.

Barrick has made great strides in reducing its cost structure and now expects all-in cost per ounce of $900 to $940 in 2014.

Weaknesses

The company’s production profile is weak, with production declining 3.4% in 2014, and expected to continue to decline going forward. Part of this decline is due to management making the necessary decision to delay projects that do not have a high enough IRR.

Although Barrick has improved its balance sheet, debt to total capitalization is still high, at 45%. This limits its financial flexibility and especially at a time of weakening gold prices, it will present the company with challenges.

I mentioned in the strengths section that Barrick divesting of underperforming mines is a good thing. But there is a flipside, which is that the company is divesting of these assets when assets are selling on the cheap due to the weakness in the gold market. So, really, this is something the company has to do; it does not have the luxury of timing. And the timing is certainly not good.

Opportunities

Barrick’s Cortez mine in Nevada, which represents 15% of production, is among the lowest-cost gold mines in the world, coming in at a cash cost of $401 per ounce. This is 31% lower than the company’s average cash cost per ounce of its portfolio of producing assets. While the mine is currently having operational difficulties, if the company can improve its operations and follow through with its expansion plans, this would be very positive for the stock.

Further cost improvements are likely for other mines in Nevada, such as the Goldstrike mine.

Threats

Barrick’s overextended balance sheet threatens the company’s ability to turn things around.
The gold price is a big threat and a big uncertainty. Analysts are forecasting a declining gold price environment. Estimates are in the range of $1350 per ounce in 2014 and $1300 per ounce in 2015, going even lower longer term. This compares to a $1,669 gold price in 2012 and $1,900 in 2011.

The gold industry is coming off a period of record production and declining demand. The fundamentals would point to weakness in the gold market for the foreseeable future. However, should the economy weaken, investors would gravitate toward gold for its safe-haven status.

Bottom line

The fate of gold prices is highly dependent on many factors, including the health of the global economy, physical demand, and production levels of the metal. But at least at the company level, we are starting to see things such as a renewed focus on improving efficiencies and cost structures that investors like. As for Barrick Gold, I remain on the sidelines, as this SWOT analysis demonstrates too many risks inherent in this company.

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