Why Is New Gold Inc. Being Targeted so Heavily by Short Sellers?

Description

What: Canadian small-cap miner **New Gold Inc.** (TSX:NGD)(NYSE:NGD) continues to attract considerable short interest. Two weeks ago, when the **TMX Group** published its *Top 20 Largest Consolidated Short Position Report*, almost 7% of its total float was being shorted, making it the fifth largest short position on the TSX. This indicates that the market believes the stock is about to fall and this is no surprise given the headwinds the company is now experiencing.

So what: New Gold is among the lowest-cost gold producers, with all-in-sustaining-costs (AISCs) of US$779 per ounce of gold sold for the full-year 2014. This is well below the company's 2014 guidance of US$815 to US$835 per ounce and below what many of its peers spend. Many investors would think this makes New Gold an attractive way to invest in gold.

However, it is easy to see why New Gold is attracting such significantly short interest. The company is highly reliant upon copper and silver as a means of generating revenue and both metals have seen their prices soften significantly in recent months.

The outlook for copper remains pessimistic because of headwinds being experienced by the world's single largest user, China. China's slowing economy, diminishing construction activity, and lower industrial output are weighing heavily on copper prices and are expected to do so for some time yet.

Another problem is that its AISCs are expected to rise because of a combination of lower copper prices and the company's reliance on boosting gold production from its higher-cost mines in order to grow total production.

Finally, the outlook for gold continues to grow pessimistic, with a stronger U.S. dollar continuing to apply pressure to the price of the lustrous yellow metal. In recent days gold's price has softened by almost 8% from US$1,300 per ounce to near US$1,200 per ounce and it is expected to fall further.

Investment bank Goldman Sachs predicts that gold will end 2015 at US$1,190 per ounce and fall even lower in 2016 to average US$1,050 per ounce over that year. This outlook certainly doesn't bode well for the financial performance of gold miners, with the small and mid-tier miners like New Gold being the most vulnerable.

New Gold also continues to carry a mountain of debt totaling US$874 million, and with its cash flow vulnerable to softer gold, silver, and copper prices, its degree of leverage will rise as metal prices fall.

Clearly, each of these factors will have an impact on New Gold's bottom line and it is easy to see why the market holds such a bearish outlook for the company's share price.

Now what: What should the reaction of investors be in light of New Gold's circumstances?

Clearly, new investors would be best advised to avoid New Gold, as it faces a range of headwinds that will negatively impact its operations. For existing investors, deciding to bail out and take a loss is a far tougher decision. As a long-term investor, I like to buy and hold for the long term, yet it is always prudent to weigh the fundamentals of any investment, and where they pull up short, be willing to accept a loss. In the case of New Gold, now may just be the time for investors to consider employing their capital elsewhere.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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