What Does the Sinking Gold Price Mean for Barrick Gold Corp.?

Description

These days are very troubling for gold investors. The U.S. economy is performing well, its currency is strong, and interest rates may rise soon. This is all very bad for the gold price. No wonder gold has fallen to about US$1,150 per ounce, after reaching US$1,300 in January.

So, what kind of impact is this having on Canada's gold miners? To answer this question, let's take a look at the biggest, **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX).

The basic numbers

First, let's take a look at Barrick's expectations for 2015. The company is targeting production of roughly 6.4 million ounces at an all-in-sustaining cost of US$840 per ounce. If gold prices stay at current levels, that equals profit of about US$1.7 billion.

Unfortunately, this money won't simply flow to Barrick's shareholders. Due to the company's high debt levels, about US$800 million will be paid to creditors. On top of that, about US$150 million will flow to corporate overhead. This brings Barrick's profits down to roughly US$780 million.

There are other costs as well. Barrick is planning to spend roughly US$750 million on exploration, mine-site expansions, and so-called projects. For the sake of argument, let's assume these costs are discretionary.

So, how expensive are the shares?

At the current market price, Barrick is valued at just over US$12 billion. This equals about 16 times the profit number reached above. At first glance, the shares seem reasonably priced. However, when one takes a closer look, it's clear that's not the case at all.

Simply too expensive

Let's start with the obvious: income taxes. Last year Canada's statutory tax rate was 26.5%, and if we apply that to this year's number, then Barrick's profit falls to $570 million. So, now the stock trades at

21.5 times earnings.

Second of all, we must remember that mines are a depleting resource. In other words, companies need to spend money on exploration and expansion just to keep production constant. At least part of the US$750 million that Barrick plans to spend on expansion should be counted as an expense. This makes the shares even more expensive.

Finally, let's take a look at the long term. In 2018, Barrick has to pay back about US$900 million in debt, and another US$900 million in 2019. If gold prices don't recover, Barrick could find itself in a real bind, especially if interest rates have risen by then.

There are better alternatives

Of course this scenario assumes that gold prices stay constant. If they fall further, then Barrick and its shareholders will be in even worse trouble. Meanwhile, the company's stock price is too high to compensate investors for this risk.

Fortunately, there are better options if you want to bet on gold. My recommendation is to keep it simple, and just buy a gold ETF.

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2. Metals and Mining Stocks

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Date
2025/07/22
Date Created
2015/03/11
Author
bensinclair