3 Reasons Why the Worst Has Yet to Come for Barrick Gold Corp.

Description

Over the past three years, nothing has gone right for **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX). The company wasted billions of dollars on a failed project, and billions more on a bad acquisition, then had to deal with falling gold prices.

Shareholders in the company have certainly felt the pain; in the last three years, the stock has fallen by 65%.

Thus, it's only natural to believe Barrick has hit rock bottom. Besides, the company is dramatically reforming its ways: costs have been cut; mines are being sold; investments are more focused; the debt load is being reduced. So, is now the right time to step in?

Well, I don't believe so. There are still a bunch of things that can go wrong for Barrick. We take a look at the top three.

1. Downside for gold prices

Gold prices have already fallen quite substantially from nearly US$1,900 per ounce in 2011 to roughly US$1,200 today. Have we reached a bottom?

Not necessarily, for a couple of big reasons. First of all, the U.S. Federal Reserve may raise interest rates later this year. This would raise the value of the U.S. dollar, a big negative for gold. It would also make high inflation much less likely, which diminishes the appeal of gold as an investment.

Second, gold remains expensive by historical standards. Remember, the metal traded for only about US$400 per ounce 10 years ago. Gold also trades above production cost for practically all established miners. A fall to US$1,000 is not hard to imagine.

2. Declines in production

Getting back to Barrick, its new strategy comes with an unfortunate side effect: declining production. After producing 7.2 million ounces last year, the company predicted 6.2-6.6 million ounces for 2015.

And even that number will come down after Barrick sold more than 500,000 ounces of production capacity in the last week.

In the long term, I’m even more worried. Mining is a business that requires lots of upfront investment. Otherwise, mines can get depleted pretty quickly. And Barrick’s spending cuts are pretty dramatic. For example, “mine site expansion” spending is being cut in half. In five or 10 years’ time, this could come back to haunt the company.

3. That looming cloud of debt

Barrick’s US$13 billion debt load may seem large, but there are two factors working in the company’s favour. First, nearly all of the debt has a fixed interest rate. So, even if the Federal Reserve does raise rates, then Barrick’s interest payments won’t rise. Second, only about $1 billion of debt must be repaid before 2018.

In five years though, things could get a lot worse: debt will become due; interest rates could be higher; production might be lower. And if gold prices sink in the interim, Barrick could be in serious financial trouble. I don’t want to be a part of that.

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