Kinross Gold Corporation Is up 200% This Year: Time to Sell?

Description

Since the year began, shares of **Kinross Gold Corporation** (TSX:K)(NYSE:KGC) are up nearly 200%. While the stock has been buoyed by rising commodity prices, gold has only advanced by about 21%.

Has Kinross Gold run too much too quickly?

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Impact is magnified

It's perfectly natural for miners to move in larger magnitudes than their underlying commodity exposures. For example, in the past five years, gold prices have fallen by roughly 15%. Over the same time period, Kinross shares have dropped by nearly 50%, even with the latest rebound.

Gold miners move with greater strength than gold prices for a few reasons.

First, small movements in the metals' price can have a magnified impact on a miner's profitability. For example, last year Kinross produced gold at an all-in sustaining cost of US$975 an ounce. At the start of the year, gold prices were about US$1,200 an ounce, resulting in a profit for the company of US$225 for every ounce mined. By the end of 2015, selling prices had fallen to US$1,050 an ounce, a decrease of 12.5%. Kinross's profits, however, fell to just US$75 an ounce, a decrease of 67%.

So, as gold prices have risen over the last few months, investors are expecting Kinross to experience a major jump in profits.

Has the run gone too far?

Kinross is undoubtedly in a better position following the run in gold prices, but that doesn't mean shares haven't overreacted to improving industry conditions. After the run-up, shares now trade at 1.6 times book value, the same level it did back in 2011 when gold prices were about US$1,375 an ounce. Gold prices still have to increase another US$90 an ounce to reach that level.

So, are shares overvalued?

There are a few justifiable reasons why Kinross should trade at a higher valuation than it has in the past. It has expanded its base of producing mines, optimized its chain of production to lower operating costs, and has continually pushed down its cost of production. It has also used its strong financial system to buy up cash-strapped gold miners at attractive prices.

For example, **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) has been selling non-core mining assets to decrease costs and raise cash in an effort to reduce total debt by billions of dollars. Last year, it sold its Bald Mountain mine and 50% stake in its Round Mountain mine in Nevada to Kinross for $610 millionin an all-cash transaction.

The Round Mountain acquisition helps Kinross consolidate its ownership in the project from 50% to 100%. The addition of Bald Mountain helped diversify its operations, increasing its low-risk U.S. exposure. The company estimates the two mines will add 430,000 ounces of gold over the first three years, will lower its average all-in sustaining costs, and help deliver free cash flow to fund organic growth and expansions.

What should you do?

The future price of gold has consistently proved experts wrong over the last decade or more. At the end of the day, Kinross shares will go the way of gold prices. Continue to expect wild swings of big magnitudes, even if gold prices fluctuate by only a few percentage points. If you’re uncomfortable with losing 50% of your investment if gold drops by 10%, it would be best to stay on the sidelines.

CATEGORY

1. Investing
2. Metals and Mining Stocks

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1. Editor's Choice

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2. NYSE:KGC (Kinross Gold Corporation)
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