Why Barrick Gold Corp. Is on the Cusp of a Bull Market

Description

The last five years for **Barrick Gold Corp**. (TSX:ABX)(NYSE:ABX) have been—without a doubt—the worst in the company's history. Not only have shares plunged 84% since 2011, but Barrick saw its dividend reduced from US$0.20 per share in 2012 to US$0.02 per share today.

Barrick's horrible performance can largely be attributed to two factors: declining prices of gold and major operational and financial mistakes on behalf of Barrick that made the debt load balloon. In 2011 Barrick spent $7.3 billion on a copper acquisition because it decided to diversify away from gold, and Barrick ended up writing down the value of the mine by $3.8 billion two years later due to repeated difficulties.

At the same time, Barrick was attempting to develop its large Pascua Luma mine in South America, and due to a decision to handle development work in house, Barrick had to halt work in 2013 due to rapidly rising costs. These errors cost Barrick over $15 billion and, at the same time, Barrick was dealing with gold prices that were plunging.

At the end of 2013, Barrick was generating negative free cash flow of $1.1 billion despite gold prices averaging $1,400 per ounce and, at the start of 2015, it claimed to require $1,300 per ounce prices just to break even (above current prices).

Gold may be entering a new bull market

Two major things have changed for Barrick. The first (and perhaps the least important) is the outlook for gold. George Soros recently made the news for buying Barrick and increasing his exposure to a popular gold ETF.

Gold should have some good tailwinds going forward. The first tailwind is the supply/demand outlook. It is widely expected that gold mine supply has peaked in 2016, and it is likely that mine supply will be entering a period of decline in 2017 and 2018. While this development may not necessarily reflect immediately in the price of gold (which is moved by many different factors), it is supportive of a higher long-term price of gold, which is important for determining the net asset value and therefore the share price of gold miners.

In addition to supply/demand, gold prices are also affected by interest rates and economic performance. George Soros's recent decision to buy gold was likely based on a bearish economic outlook and the knowledge that the current stock market recovery in the U.S. may be nearing its peak (the current recovery has lasted 86 months compared to the average bull market length of 51 months).

Many believe the current expansion has been fueled largely by monetary policy, and with interest rates at rock-bottom levels, central banks will have less ability to fight the next slowdown. With low yields on bonds globally, analysts at **Morgan Stanley** see gold returning as a key safe haven asset, replacing high-rated government bonds, and, as a result, they see gold prices rising to $1,400 per ounce.

Barrick is in the middle of a major transformation

After years of poor performance, Barrick is now in the middle of a massive transformation that will see a complete change of focus for the company. On a basic level, Barrick is shifting its focus from being a company that is simply chasing production growth to one that is focused on being smaller, leaner, and focused on per share free cash flow growth.

The company has set several ambitious targets, including reducing debt from $10 billion in 2015 to $5 billion over the medium term ($2 billion of which will be achieved this year), reducing all-in sustaining costs to $700 per ounce by 2019 (from $831 per ounce in 2015), achieving a free cash flow breakeven this year of $1,000 per ounce and maintaining a minimum production of 4.5 million ounces of gold annually through at least 2020 (this is slightly down from current levels, but it has plenty of upside potential).

Barrick has already reduced its debt by $3.1 billion last year and succeeded in both lowering its free cash flow breakeven substantially and reducing its mine footprint. Going forward, Barrick's low breakeven economics, falling debt load, and large leverage to rising prices should lead to a sustained run in prices.

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