



## Why Barrick Gold Corp. Could Still Have Almost 50% Upside

### Description

The end of summer has not been kind to shareholders of **Barrick Gold Corp.** ([TSX:ABX](#))(NYSE:ABX)—shares are down about 25% since the start of August. However, a combination of seasonality factors, a strong fundamental backdrop for gold prices, and a healthy valuation all point to the recent downward move in Barrick being a buying opportunity.

Before looking at why Barrick has upside, it is important to answer the question of why Barrick shares sold off beginning in August. Firstly, gold prices have fallen about 5% from August highs of \$1,370 per ounce to current levels of \$1,310 per ounce as of the last close. Secondly, Barrick missed consensus EPS estimates slightly for Q2 2016 (EPS of \$0.12 versus consensus expectation of \$0.14).

Barrick shares rallied over 200% from January to its August peak, and a pullback is to be expected. Both of the factors that caused the pullback are temporary.

The weak EPS was primarily due to lower sales volumes, and beneath these results were several extremely encouraging developments, including five consecutive quarters of free cash flow, a lowered cost guidance, and excellent progress towards its goal of reducing debt to US\$5 billion (from \$15.4 billion in 2013). Barrick is now at US\$9 billion, and asset sales/free cash flow should close the gap in 2017.

### Rising gold prices will be the main driver of Barrick's returns

Like any commodity company, the number one driver of returns will be the performance of the underlying commodity. The price of gold is currently \$1,310 per ounce, and there is a strong case to be made that gold is currently in a bull market with prices of \$1,400 or even \$1,500 an ounce likely in 2017 and 2018.

**Royal Bank** is one of the latest names to revise upward gold prices; the bank now expects gold prices of \$1,500 per ounce in 2017 (this agrees with Bank of America's and Credit Suisse's forecasts). **TD** and **Bank of Nova Scotia** expect \$1,400 per ounce gold in 2017.

This upward move in gold prices could occur sooner rather than later. Gold shows fairly predictable

seasonality—March through August is typically the weakest period for gold prices, and prices usually pick up from September through February. Emerging markets (India in particular) are a source of this seasonal bias.

This largely has to do with Indian wedding season. Gold is often a centerpiece of traditional Indian weddings. Ten million weddings are held in India each year, and with India accounting for one-third of gold demand and jewelry being half of this demand, the seasonal-demand increase is significant.

This normal seasonal trend will be amplified this year due to the fact that India is expecting larger than normal crops this year due to a very healthy monsoon season. The end result is that farmer incomes are elevated. Gold is likely to be a beneficiary of higher farm incomes due to its cultural importance (in weddings and other ceremonies) as well as its investing importance, since gold is seen as a store of value by farmers who may have limited access to other investment opportunities.

This seasonal strength occurs along a broader trend of extremely low global interest rates (0.67% average global government bond yield), which decreases the relative cost of holding gold.

### **Barrick is set to benefit**

These underlying factors should support gold prices into 2017. Currently, Barrick is expected to earn cash flow per share of \$2.66 in 2017 if gold prices are \$1,400 per ounce. This gives Barrick a current price-to-cash flow ratio of 6.5.

In early August, Barrick traded at 8.1 times cash flow, and its peer group traded at 9.5 times cash flow. Analysts at Bank of Nova Scotia and TD Bank see 8.5 to 9.5 as a reasonable target for Barrick (and also in line with the 10-year average of about 8.5). Barrick trading at this level would have a share price of US\$22-25.27, leading to a return of between 27% and 46%. Should prices climb to RBC's forecast of \$1,500 per ounce, this upside is even higher.

### **CATEGORY**

1. Investing
2. Metals and Mining Stocks

### **POST TAG**

1. Editor's Choice

### **TICKERS GLOBAL**

1. NYSE:B (Barrick Mining)
2. TSX:ABX (Barrick Mining)

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