Does Barrick Gold Corp.'s (TSX:ABX) Latest News Make it a Buy?

Description

Since reaching a 2018 high of over US$1,356 an ounce, gold has pulled back sharply to be trading at around US$1,190 per ounce, below the psychologically important US$1,200 an ounce mark. A stronger U.S. dollar, rising interest rates and lower geopolitical risk have all contributed to gold's latest weakness.

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Despite softer prices, senior miner **Barrick Gold Corp.** (TSX:ABX)(NYSE:ABX) has elected to buy **Rangold Resources Limited** for just over US$6 billion in stock to create the world's largest gold miner. The news caused Barrick's stock to rally, gaining 10% over the last month compared to gold, which has remained relatively flat.

Now what?

The combination of Barrick and Rangold will produce a formidable industry leading gold miner and be conducted on an all-stock basis that will see Barrick shareholders owning 67% of the new entity and Rangold investors the remaining 33%.

The deal will add Rangold's risky African assets, which have considerable exploration upside and development potential to Barrick's portfolio of more stable gold mining operations focused on the Americas.

The combined entity will have impressive reserves of 78 million gold ounces and over six million ounces of gold production with total cash costs of US$538 per ounce of gold produced.

While cash costs don't fully reflect the overall expenses associated with a gold miner's operations, they do give a good indication as to the profitability of existing producing assets.

Such low consolidated cash costs underscore just how profitable the combined entity will be amid an operating environment where gold is trading at around US$1,200 an ounce. The combined company is expected to have an impressive EBITDA margin of 48% or greater.

The new entity is well positioned to expand its gold reserves and production. Barrick has one of the deepest project pipelines in the gold mining industry, currently developing four-feasibility level projects that are expected to contribute one million ounces to total production by 2021. Three of those projects are in the mining friendly jurisdiction of Nevada, while the fourth is in Peru.

Meanwhile, Randgold is in the process of advancing the Massawa gold project in Senegal with a range of brownfield exploration activities underway in Mali, Democratic Republic of Congo and Cote de Ivoire. As these activities progress, they will add to the combined company's gold reserves and production, further bolstering its net-asset-value and earnings.

From a valuation perspective, the new Barrick appears very attractive. Based on 2017 results for Barrick and Randgold, the new entity has some appealing valuation metrics, including an enterprise value of a mere 5.1 times adjusted EBITDA and a price of seven times cash flow. These are some of the lowest among the major gold miners, emphasizing the appeal of the combined entity.

So what?

Barrick has seen its market value tumble since the start of the year to be down by almost 25%. This can be attributed to gold's latest weakness and the subdued outlook for the yellow metal. Higher interest rates are also not helping.

Not only are they a negative for gold, but they also increase the cost of capital, which for a heavily indebted miner like Barrick operating in a capital-intensive industry will cause finance expenses to expand and make it costlier to raise new capital.

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Nonetheless, the combined entity is attractively valued and possesses considerable potential when the quality of its assets is considered. It also alleviates the need for Barrick to ramp up spending on exploration and mining development to maintain its gold reserves and production. There is every likelihood that gold could rally again before the end of 2018 because geopolitical and economic risks abound.

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