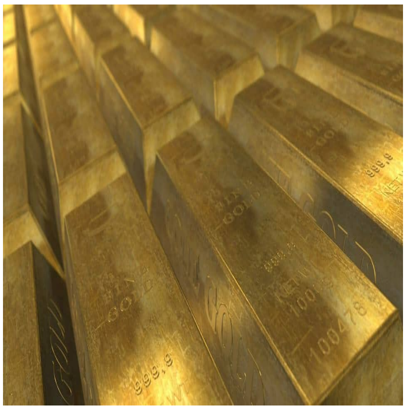

Can This Beaten-Down Gold Miner Ever Recover?

Description

It has been a tough year for investors in intermediate gold miner **New Gold** (TSX:NGD)(NYSE:NGD). The miner which once held so much promise has seen its market value collapse, shedding 78% over the last year compared to the 10% decline in the value of gold.

Most of that loss occurred in the wake of New Gold releasing its troublesome second-quarter 2018 results in late July. This can be blamed primarily on the poor start-up results from New Gold's Rainy River mine, lower-than-expected production, and cost blowouts.

Now what?

New Gold owns four operational mines with two located in Canada, one in the U.S., and the other in Mexico. All those jurisdictions have proven themselves to be mining friendly and to have relatively low political risk. New Gold has gold reserves of 14.6 million ounces, most of which or 56% are contained in its Canadian Blackwater gold project in British Columbia.

Because of the issues relating to its operations, notably at Rainy River, New Gold announced poor and disappointing results for the second quarter, which are responsible for the substantial decline in its market value. While quarterly gold production soared by an impressive 17% year over year to almost 109,000 ounces, New Gold reported a US$302 million net loss compared to a US$23 million net profit a year earlier.

This can be attributed to a range of factors, the key being a blowout in costs, which saw all-in sustaining costs (AISCs) rise by a worrying 32% year over year to US$877 per gold ounce produced. That can be blamed on lower-than-expected production at New Gold's troublesome Rainy River operation caused by lower-than-forecast ore grades and recoveries.

The issues being experienced at Rainy River forced New Gold to record an after-tax impairment charge of US$282 million, which was the main cause of the hefty loss that it reported for the second quarter.

Because of those complications and the impact this is having on its overall operational and financial performance New Gold was forced to revise downward its 2018 guidance. This forced the miner to reduce forecast gold production shaving 19% off the top end of its original annual guidance to a forecast maximum output of 480,000 ounces for 2018.

Another disconcerting aspect of the revised guidance is that estimated AISCs were increased by a startling 25% and are expected to be somewhere between UUS$1,080 and US$1,120 per gold ounce produced. It was this revision that contributed to the market savagely marking down New Gold's stock.

However, the significant decline in New Gold's share price appears overbaked and has created an opportunity for investors. Its gold reserves, using an assumed price of US$1,200 per ounce and after deducing extraction costs as well as long-term debt, are valued at $2 per share, which is roughly double New Gold's market price. This highlights the considerable upside that exists should new Gold resolve the problems afflicting its Rainy River mine, reduce costs, and bring the Blackwater project online within forecast specifications.

So what?

New Gold is a difficult stock to like. The shortcomings of the Rainy River mine are weighing heavily on its stock and have caused the market to lose confidence in the miner. The miner does, however, own some very attractive assets, and the market reaction to the failings at Rainy River is overbaked.

The recent sell-off has created an opportunity for risk-tolerant investors to gain exposure to gold, which is poised to rally, but it should be remembered that this is a high-risk investment.

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mattdsmith