This Gold Stock Is Far Too Cheap Due to the Coronavirus

Description

Gold is traditionally a safe haven asset during times of trouble. As investors flee riskier assets like stocks, massive amounts of capital gets diverted into bonds, precious metals, and cold hard cash. This downturn has been a bit different.

Over the last few months, gold prices have been roughly flat. Gold mining stocks, meanwhile, have been crushed. Even the highest quality miners are being pressured.

Investors are clearly worried about access to capital. While gold prices may be stable, mining operations are capital intensive. Higher financing costs will hurt profitability. For highly indebted operators, financing may disappear completely.

If you want to make money with gold stocks, find miners that are generating high levels of free cash flow. The mining industry is notoriously terrible at capital allocation, so you don't have many choices. But one stock in particular sticks out. This gold miner has been unfairly punished even though it could ultimately *benefit* from the downturn.

Poised for success

Kirkland Lake Gold Ltd. (TSX:KL)(NYSE:KL) has been my favourite gold stock for years. Last January, I covered why 2019 will be Kirkland's best year on record.

"Since its current management team took over, Kirkland has consistently posted higher assets, profits, reserves, and cash flow, allowing it to initiate a growing dividend and a share-repurchase program," I explained. "In an industry rife with a 'growth-at-all-costs' mindset, Kirkland's management is a breath of fresh air."

In 2019, Kirkland stock rose by 60%. What specifically drove this performance? Three things: growing reserves, production, and free cash flow.

Reserves are the foundation of any mining operation. While production generates revenues, reserves are the money in the bank. In 2018, Kirkland had 5.7 million ounces of gold reserves. By the end of 2019, that number had ballooned to 20.5 million.

What's most impressive is that Kirkland has expanded its reserve base efficiently. You can see this in production costs. In 2016, all-in production costs were $930 per ounce. By 2018, all-in costs had fallen to $685 per ounce. Last year, they fell again to $564 per ounce.

Dramatically increasing reserves and production while driving down costs is a perfect recipe for free cash flow. That's exactly what happened. Free cash flow in 2016 was $114 million, an already impressive figure for the industry. Free cash flow generation grew each year since, topping $460 million in 2019.

Even with a dividend and operational growth, Kirkland has seen its cash pile more than double over the last 12 months.

Own this gold stock

This is where it gets interesting. Capital scarcity will disrupt the capital-intensive mining industry. But not Kirkland! As we've seen, this stock can finance its operations and growth purely through internal cash flow generation.

Industry's woes can be an *opportunity* for Kirkland. Year-to-date, shares are down 30%, even though business will barely be impacted, giving management an opportunity to buy low.

The company has repurchased eight million shares since mid-2017, but the market correction has accelerated the value in buying back more stock. Executives just authorized repurchasing 20 million shares over the next 12 to 24 months. All of these buybacks come in addition to the rising dividend, which has tripled in value since the start of 2019.

Most companies execute stock buybacks in terrible fashion. They buy shares when markets are rising to new heights. When asset prices dip, these buybacks may ultimately *destroy* shareholder capital. Buying low is the key, but few management teams reserve the cash to do so, nonetheless take the risk.

As mentioned, Kirkland's management team is different. They're some of the best capital allocators in the business. Buying back stock, or even struggling competitors, will be a great way for Kirkland to create long-term value during the pullback.

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