(BN) Gold Miners Come Clean on Costs After Lost 6 Years: Commodi ties

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By Liezel Hill

Feb. 27 (Bloomberg) -- The gold-mining industry, which has underperformed the precious metal for each of the past six years, is pledging to report costs more accurately as part of its efforts to win back investor confidence.

Barrick Gold Corp. and Goldcorp Inc., the two biggest producers by market value, have begun reporting “all-in sustaining costs” for the first time. The new measure averaged $941 an ounce between the two companies in the fourth quarter. That’s 50 percent higher than the $626 average so-called cash cost they disclosed in the preceding three months.

The largest gold companies are seeking to lure investors back to the $300 billion industry after a string of money-losing multibillion-dollar takeovers and over-budget projects. Barrick and its competitors are vowing to focus on margins and to get a grip on soaring production costs, rather than boosting output.

Gold producers “have really done themselves a huge disservice by effectively walking around for the last 12 years promoting the gross margin as opposed to the net or the operating margin,” said Joseph Wickwire, the Boston-based manager of Fidelity Investments’ $2.9 billion Select Gold Portfolio fund. “The managements and the boards of the gold companies really have no one to blame but themselves for some of the negative sentiment and disappointment.”

Earnings statements had previously carried so-called cash costs, based on a standard developed in the 1990s that excludes expenses such as exploration and waste-rock removal.

Margin Compression

The 55-member S&P/TSX Global Gold Sector Index trailed gold each year in 2007 through 2012. The index declined 6.9 percent during that period while gold futures more than doubled. Gold fell 0.5 percent to $1,606.90 an ounce at 7:54 a.m. in New York.

Gold has advanced for 12 successive years, driven at least in part by demand from investors looking for a store of wealth amid concern about inflation. Despite benefiting from that rally, gold producers’ margins have come under pressure from rising prices for labor, equipment and raw materials.

The average cash cost of 10 of the biggest gold miners was $694 an ounce in the third quarter, 49 percent higher than in the same period two years earlier, according to data compiled by Bloomberg. The average gold price rose 35 percent in the same comparison.

“Everyone was trying to run through the funnel of building these new projects as big as you can, as fast as you can,” Kinross Gold Corp. Chief Executive Officer J. Paul Rollinson said in an interview Feb. 13. “There was huge competition for people, competition for steel, competition for tires and spare parts.”

Ballooning Budget

Barrick's gross margin, expressed as a proportion of sales, was 47 percent in 2012, while its operating margin was 39 percent, according to data compiled by Bloomberg.

"The costs of running this business are higher than it looks and that's how we need to manage this business going forward," Barrick CEO Jamie Sokalsky said at a Jan. 29 conference in Toronto.

Sokalsky has been expounding his strategy since taking charge in June, when Barrick fired his predecessor Aaron Regent, citing a disappointing share-price performance. The Toronto- based company saw the cost estimate for its Pascua-Lama mine balloon to as much as $8.5 billion in 2012, from as much as $3.6 billion in 2011.

Fired CEOs

Regent was among at least six CEOs of North American gold producers to either announce their departure or be fired in the past year. Kinross, which fired Rollinson's predecessor Tye Burt in August, has taken more than $5.5 billion of writedowns on Mauritanian assets the Canadian company acquired as part of its
C$8 billion ($7.8 billion) takeover of Red Back Mining Inc. in 2010.

As gold miners pursued additional ounces at the expense of profit margins, investors instead plowed billions of dollars into gold-backed exchange traded funds. The weight of gold behind those ETFs, which include the $64.9 billion SPDR Gold Trust, has quadrupled to 2,530 tons since the start of 2007, according to data compiled by Bloomberg.

The boom in ETFs may now be at an end, with physical holdings poised for the biggest monthly decline since 2008. The gold cycle has probably turned as the recovery in the U.S. economy gathers momentum and investment holdings shrink, Goldman Sachs Group Inc. said in a Feb. 25 report. Still, it's not yet clear whether gold miners will benefit from the change in sentiment.

Predictability, Rigor

"I don't think the industry has done anything to persuade some of those investors that hold, for example, gold ETFs to buy gold shares instead," said Neil Gregson, who manages about $5 billion in natural resources equities at JPMorgan Asset Management in London. "Our allocation to gold equities is now down to 20 percent, which is the lowest we've been certainly since I've been here in the last 2 1/2 years."

To be sure, while the gold industry has traditionally emphasized cash-cost figures, the other components of all-in costs were available in financial reports, Gregson said. Gold companies have diverged since the 1990s in terms of which cost items they included, Goldcorp CEO Chuck Jeannes said in a Feb.
25 interview.

"What we are trying to do is bring back some predictability and rigor," he said.

There's still no universal agreement on the new all-in costs. Members of the World Gold Council, a London-based industry group, are working on issues such as how to treat byproduct revenue, interest expenses and profits on energy hedges, said Agnico-Eagle Mines Ltd. CEO Sean Boyd.

More Realism

Mining companies are hoping that it's governments and not just investors who pay attention to the new all-in costs, Gold Fields Ltd. CEO Nick Holland said in a Feb. 4 interview. Gold more than quadrupled in the last 10 years and reached a record
$1,923.70 an ounce in September 2011, encouraging some countries to seek a greater share of profits.

The Dominican Republic's congress said last month it will review and may change a contract with Barrick over the development of a $4 billion mine. Burkina Faso is among countries that have amended royalty and tax regimes.

"It could be positive for getting more realism into governments about how much tax they really should be levying on us," Holland said. "There's not the super profits that you'd have them believe you're making."

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