Kinross Writedown Warning Shreds Stock

Ballooning Costs

By Peter Koven, Financial Post
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Gold-mining companies with the best growth profiles are usually the ones that are most attractive to investors. But thanks to soaring industry costs and risk aversion in the market, Kinross Gold Corp.'s aggressive growth strategy has had the opposite effect.

Shares of the Toronto-based miner plunged 21% Tuesday after it warned its three key development projects will likely be delayed and that it will take a "material" goodwill charge on the Tasiast mine in Mauritania, its biggest source of production growth.

Kinross wants to spend more time reviewing its projects to ensure it spends capital as efficiently as possible as its costs continue to run higher.

"We don't want to repeat some of the problems that are legendary in the mining busi-ness in terms of projects that have gone sideways and costs that have gone out of control. So we wanted to act early, and that's what we've done," chief executive Tye Burt said in an interview.

But investors took the news as further evidence the company will struggle to build its new mines, especially Tasiast, on a reasonable budget. Those concerns have been in place for months, and Tuesday's sell-off just added to months of poor stock performance.

Kinross made a series of aggressive acquisitions over the past several years, most notably the US$7.1-billion takeover of Red Back Mining Inc. in 2010 that brought it the Tasiast project. Those deals boosted the company's resource base from about 25 million ounces to more than 100 million, giving it a much healthier pipeline of projects.

Cost creep reduces the value of undeveloped projects and makes them more challenging to build.

In the case of Tasiast, a non-cash goodwill charge is being taken to reflect the change in carrying value since it was acquired. The mine had a book value of US$7.1-billion as of Sept. 30, of which US$4.6-billion was goodwill.

The other projects facing likely delays are Fruta del Norte in Ecuador and Lobo-Marte in Chile. Kinross recently agreed to pay a wind fall profits tax to the Ecuadorian government and is trying to negotiate better terms for its investment.

In addition to the increases in construction costs, Kinross provided operating-cost guidance for 2012 that was higher than expected. The com-pany expects cash costs of between US$670 to US$715 per gold equivalent ounce this year, up from about US$600 in 2011.

The concern for some analysts Tuesday was that Kinross's balance sheet could be stressed by the increased costs. Greg Barnes of TD Securities wrote that he would not be surprised if one of the three growth projects was "significantly delayed."

Mr. Burt denied the balance sheet is an issue. Kinross plans to spend US$6-billion to US$7-billion over the next three or four years, which Mr. Burt expects to fund through operating cash flow, the existing US$1.7-billion cash balance, and unused credit lines and project financing.

However, ***Veritas Investment Research*** analyst ***Pawel Rajszel*** said there could be balance-sheet issues if gold prices decline. "This is the only company in my coverage that has trouble below US$1,400 gold in terms of free cash flow," he said.

Despite the poor performance of the stock, Mr. Burt maintained that the acquisitions of Tasiast, Fruta del Norte and Lobo-Marte were critical to building value in the company in the long term. "The nature of the mining business is you deplete your assets the moment they start production. It is an inescapable fact of life that the gold ounces have to be replaced and supplemented and grown to move the company forward," he said.

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