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Gold Miners Find Little Solace in Cheaper Oil

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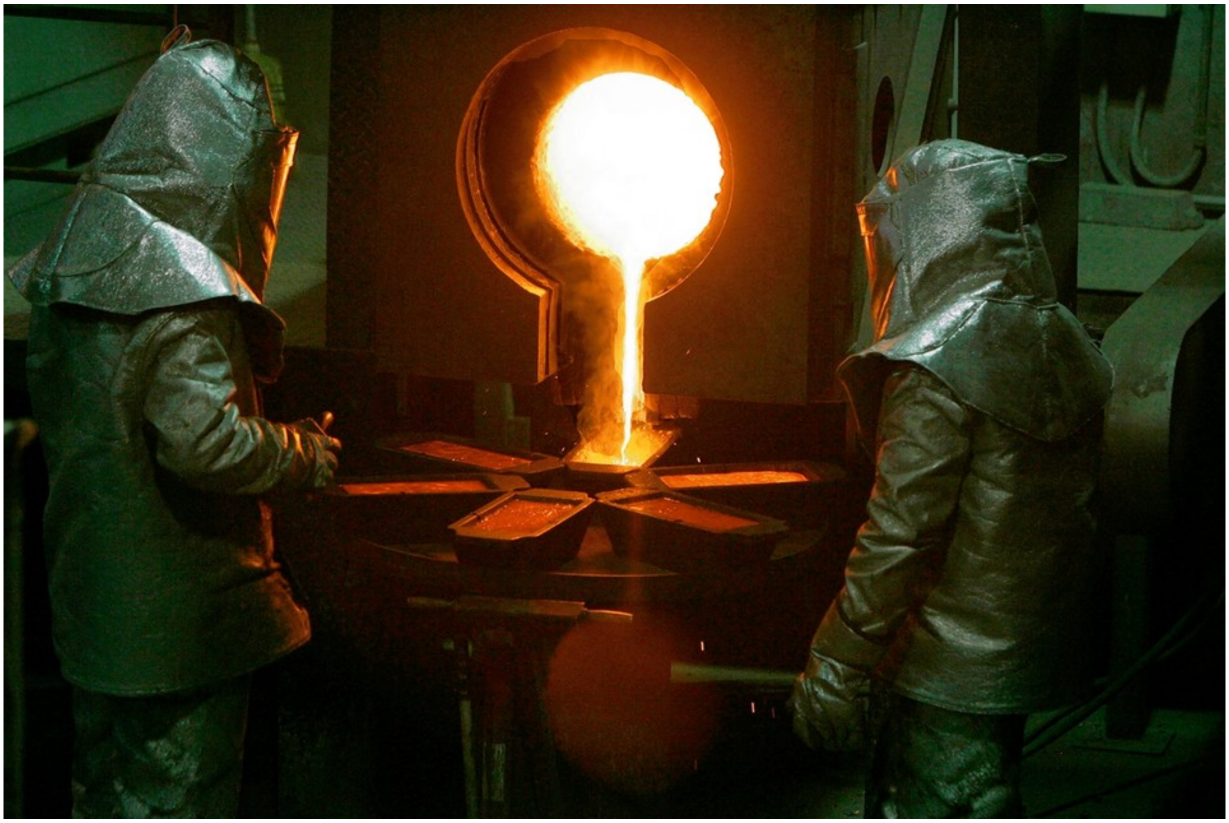
Pressed by Falling Gold Prices to Cut Costs, Some Are Getting Creative



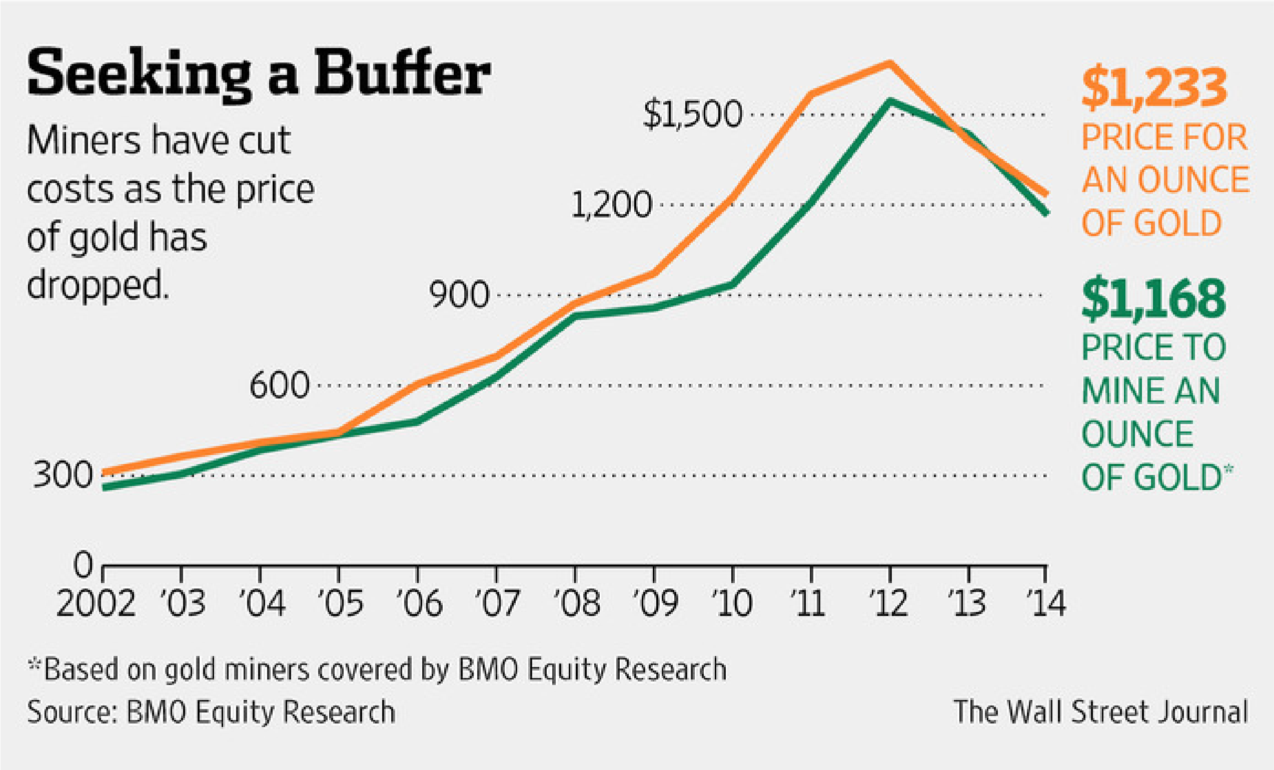
Workers at Yamana Gold's Minera Florida mine in Alhue, central Chile, in 2009. Toronto-based Yamana—pressed like its competitors to cut costs—plans to spin off some assets. *REUTERS*

Falling oil prices have made it cheaper to mine gold, but the yellow metal's own three-year price decline is pressuring miners to come up with new, sometimes creative ways to cut costs and restructure.
Among other things, miners are drawing up plans to spin off assets and share administrative functions between companies.

As measured by the Market Vectors Gold Miners Index, the gold sector has rallied almost 19% since Nov. 4, buoyed by a 7% gain in gold and by cost reductions stemming from falling oil and a rising dollar. But analysts and investors say the biggest savings have already been reaped, and that to keep stock prices rising miners need to do the one thing they are not doing: merge with each other.

Gold prices are still down 37% from their 2011 highs, mainly as inflation, against which gold is traditionally a hedge, has remained low and investors have moved into securities that offer yields. That decline has spurred a yearslong scramble to cut costs. Miners have shaved an average of 20% off the cost of producing an ounce of gold in the past year, according to Dundee Capital Markets. That is mainly due to cuts in capital expenditure.

But with gold prices nearing break-even levels for many miners, some are seeking new solutions in a sector already reshaped by a three-year downturn. “The low-hanging fruit, on the cost side, has been picked,” said ***Pawel Rajszel***, an analyst at ***Veritas Investment Research***. ***Mr***. ***Rajszel*** said that in recent earnings reports, growth in savings has slowed.



Energy Intensive

Gold mining is an energy-intensive industry, which is why HSBC Securities calculates that a 20% fall in oil could reduce miners’ overall costs by 2% to 6%. But not all miners will feel the full benefits. Around half of Barrick Gold Corp. ’s exposure to oil is hedged at $86 a barrel. Some mine mainly underground, which uses less fuel than open-pit mining, where trucks ferry the rock around.

Analysts also point out a flip side to declining oil: It damps the inflation that boosts gold.

Another macroeconomic benefit has been the rising dollar, which lowers costs in countries where miners operate. Yamana Gold Inc. —which mines in Canada, Brazil, Argentina and Chile—says that for every 10% devaluation in these countries’ currencies, its mining costs fall by $40 to $50 an ounce. Yamana’s costs averaged $807 an ounce in the third quarter.

“The dollar and oil, it’s a nice win,” said Steve Letwin, chief executive of Iamgold Corp. “But you have to continue to make sustainable cost cuts, given how volatile gold and oil are.”

Given this, miners are looking at other ways to cope with a lower gold price.

Some miners are considering spinoffs. Yamana announced on Wednesday that it would place some of its Brazilian assets into a new company that could be spun off to its investors. Yamana sees this as a way to separate higher-risk assets from the rest of its portfolio while allowing investors the option of still owning them.

Underscoring potential difficulties, the world's largest gold producer, Barrick, considered spinning off some of its mines but is currently not pursuing this option, say people familiar with the matter. Barrick's failed merger attempt with Newmont Mining Corp. in April envisaged a spinoff, and executives continued to look at the idea after talks collapsed. One problem cited was the difficulty of deciding how much Barrick debt the new company would take on, one of these people said.

'You have to continue to make sustainable cost cuts, given how volatile gold and oil are'

—Steve Letwin, chief executive of Iamgold

Some bankers say companies are increasingly discussing forming joint ventures to share costs—such as power generation, geologists and regional offices—for mines that operate near each other. But recent precedent isn't good. Barrick and Newmont looked at this in Nevada, but talks have so far gone nowhere.

Sharing operations without combining companies is difficult. "Each company is going to have its own interest at heart," said Patrick Chidley, a mining analyst at HSBC Securities.

Some miners are looking at a limited form of such sharing, hoping to combine administrative functions where there is geographic overlap, rather than actual mining operations. Mr. Letwin said Iamgold has had very preliminary discussions with Newmont about sharing community- and government-relations functions, as well as some legal work in Suriname.

Such savings might not be significant enough, say analysts. Instead, they say, investors want to see more aggressive moves, such as full-scale mergers and shutting down unprofitable mines.

High Expectations

The long-expected consolidation in gold has yet to materialize. While the values of gold miners have fallen, the expectations of their owners have not.

Kirkland Lake Gold Inc. operates in an area of Ontario that has more than a dozen peer miners, many of which have just one asset but corporate offices and teams, said George Ogilvie, the company's CEO. Few are looking to merge, he said. "Sometimes it takes a little bit of time to sink in past a mentality of 'it is my company, maybe we can manage this,' " he said.

If gold prices fall further, consolidation will become inevitable, Mr. Ogilvie and others say.

"With gold at $1,100 it becomes miserable for some miners, and consolidation is inevitable," said Doug B. Groh, a fund manager at Tocqueville Asset Management LP, which owns gold stocks. "This is the point of no return."

—Ben Dummett contributed to this article.

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