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Precious Metals

Gold Mining Long And Short

Thomas Winmill, Midas Funds 10.13.09, 7:00 PM ET

Buy: Barrick Gold Corp.

Barrick recently entered into an agreement to purchase a 70% interest in the El Morro copper gold project in northern Chile for $465 million from Xstrata. Total proven and probable reserves for El Morro are estimated at 6.7 million ounces of gold and 5.7 billion pounds of copper. The project may offer construction and operating synergies with other nearby Barrick projects, such as Pascua-Lama.

An extensive $70 million project feasibility study was completed almost two years ago, estimating annual production (70% attributable to Barrick) of about 300,000 ounces of gold and 350 million pounds of copper over a 14-year mine life. The study assumed then-current construction and operating costs (labor, fuel, materials, equipment); it required capital investment of $2.5 billion, which could be materially lower at today's price, but would generate an internal rate of return of over 14%, using gold at $625 per ounce and copper at $2.80 per pound.

Plugging in today's gold price ($1,060) and copper prices ($2.77) makes the economics all the more compelling. One year of cash flow attributable to Barrick could exceed the purchase price for the project. Another company, New Gold, has a right of first refusal on Barrick's potential 70%, expiring Jan. 11, 2010. New Gold has a market cap of $1.6 billion and cash on the books of $147 million, compared to Barrick's $35 billion market value and $2 billion in cash. In my judgment, New Gold will not exercise its right.

The bottom line is that Barrick is a top-quality company offering a reasonable valuation, and its earnings could grow more than expected with this high-return project.

Sell: NovaGold Resources

The perception of value in NovaGold for many investors is probably based on expected returns from its 50% interest in the Donlin Creek gold mining project in Alaska. NovaGold's other mining projects are unlikely to be economically feasible at current metal prices. The other 50% of the Donlin Creek project is owned by Barrick. The project does have a positive feasibility study, but even assuming a 15% reduction in the $4.5 billion in estimated capital costs, the project has a four-year payback.

For the quarter ending May 31, 2009, NovaGold reported a net loss of $4.8 million, or $0.03 per share in Canadian dollars, notwithstanding a foreign exchange gain of $16.1 million Canadian, due to salaries, fees, selling and general administrative, and corporate development costs. As of the end of the quarter, the company held approximately $56 million Canadian in cash and equivalents and $49 million in working capital.

With El Morro now a possibility, Barrick is less likely allocate its capital to developing this project, and NovaGold doesn't have the capital to do it. After the recent run-up in its share price, to survive until operating cash flows from Donlin Creek can become a reality, NovaGold may be tempted to sell many new shares to raise money. Sell the shares before the company does.

Thomas Winmill is portfolio manager of the Midas (MIDSX) fund. Currently Midas Fund owns shares of Barrick and no shares of NovaGold. Winmill owns shares of Midas Fund, but no shares of either Barrick or NovaGold. Neither Midas nor Winmill currently has or seeks to do business with Barrick or NovaGold.

http://www.forbes.com/2009/10/13/sell-novagold-resources-personal-finance-investing-ideas-barrick-gold.html