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Gold mining sector shining again

by LEE Yanru

In the midst of a bearish economic outlook, financial markets were surprised by highly favorable financial results last week. The S&P 500 Index ended the week on a high note after the release of better than anticipated US non-farm payrolls. Global stocks moved higher together with the rise in oil prices, improvement in US manufacturing data and optimism over Chinese economy. On Monday, the Chinese central bank boosted liquidity and provided stimulus to the slowing economy.

The prices of precious metals have also increased. Since the end of last year, silver prices have risen by 11.9% to USD 15.51/Oz, while platinum prices have surged by 9.88% to USD 978.80/Oz. Gold, on the other hand, was the best performing precious metal, an irony despite being often seen as a safe haven for investors in times of financial turmoil. Gold price reached USD 1258.95/Oz last Friday and has risen 18.6% so far this year. While analysts may disagree on the factors driving the recent surge in gold price, some common explanations included the resurgence of US inflation expectations, and the ever-low benchmark deposit rates in Europe and Japan, which indicate a lower opportunity cost of investing in gold.

This upward trend in the price of gold has played a significant role in improving the credit outlook of the overall gold mining sector. The top 10 gold miners have benefitted from the rise in gold prices as the sale of the precious metal deposits account for 80% of their overall revenue. The improvement in credit profiles of these companies can be seen in the decline of the aggregate RMI-CRI 1-year Probability of Default (PD) in Figure 1, which is a simple median of the top 10 gold mining companies. The aggregate RMI-CRI 1-year PD has decreased from its recent peak of more than 40bps in August to 9.25bps last Friday, in tandem with the increase in gold price.

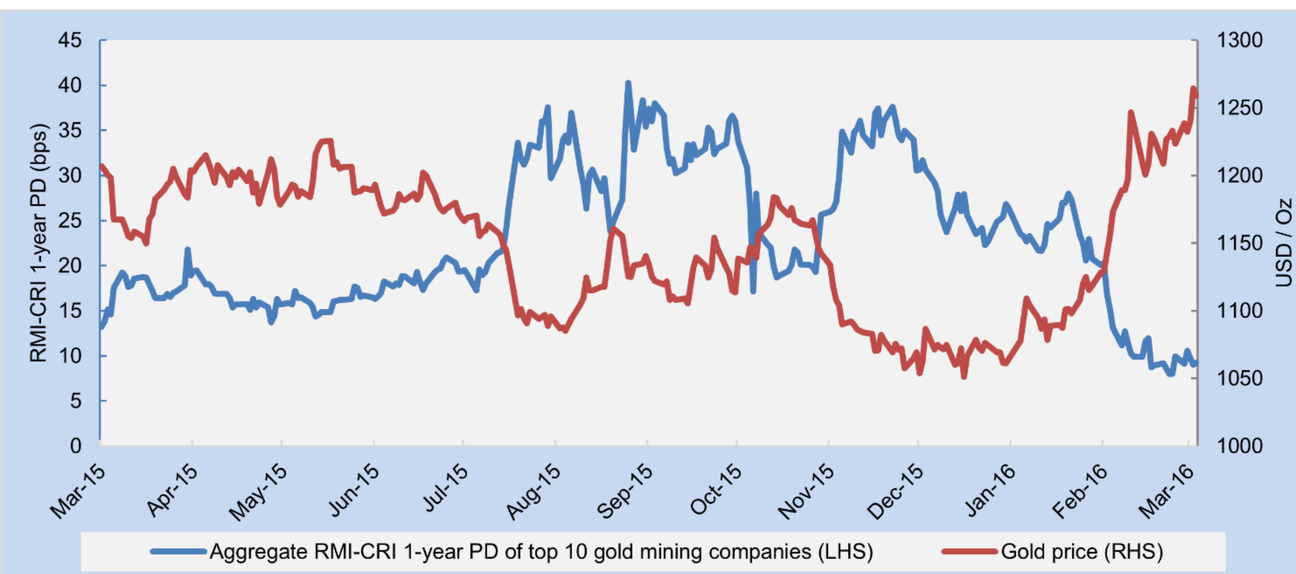

Figure 1: RMI-CRI 1-year aggregate Probability of Default (PD) for top 10 gold mining companies (by production) and gold price/ Oz
Source: RMI-CRI, Bloomberg

Table 1 displays the credit performance of individual gold companies. As shown in the table below, the RMI-CRI 1-year PD of most of these companies' has declined by more than 50%. These firms also witnessed a substantial gain in their market cap, which increased by at least 30% for all these firms and by more than 100% for a few of the firms in 2016.

	RMI-CRI PD (31/12/2015)	RMI-CRI PD (4/3/2016)	% decline in PD	% increase in market cap
Barrick Gold Corp	45.76	7.96	82.60%	85.27%
Newmont Mining Corp	15.07	4.49	70.21%	45.14%
AngloGold Ashanti Ltd	187.04	68.06	63.61%	108.92%
Goldcorp Inc	23.11	10.54	54.39%	30.91%
Kinross Gold Corp	49.71	12.76	74.33%	76.50%
Newcrest Mining Ltd	2.84	1.42	50.00%	35.13%
Gold Fields Ltd	69.16	39.92	42.28%	62.64%
Polyus Gold International	23.7	21.16	10.72%	45.63%
Agnico Eagle Mines Ltd	7.09	3.53	50.21%	31.09%
Sibanye Gold Ltd	29.89	5.41	81.90%	154.96%

Table 1: RMI-CRI 1-year Probability of Default (PD) and stock price of top 10 Gold Mining companies ranked by production. *Source: RMI-CRI, Bloomberg*

Notably, the three largest gold mining companies have exhibited significant improvements in their credit profiles. Barrick Gold Corp (Barrick) has been streamlining operations since 2013 by selling assets, cutting jobs and investing in more efficient methods of production. After making an ill-timed decision to purchase Equinox in 2011, Barrick has recently decided to adopt a more conservative stance towards the acquisition of other companies, despite ample opportunities available in the market right now.

Similarly, Newmont Mining Corp (Newmont) has also announced its intention to reduce its current position of net debt from 1.4 times its earnings before interest, taxes, depreciation and amortization to a ratio of 1 in the next few years. According to the company, the firm's free cash flow is likely to increase by USD 350mn for every USD 100 gain per ounce of gold. Newmont will use excess earnings to strengthen its balance sheet.

AngloGold Ashanti (AngloGold)'s strategy of investing in cost-efficient production had enabled it to tide through the arduous challenges of plunging gold prices over the past few years. With major improvement in cost-efficient methods, Anglo Ashanti reported that operation costs declined by 9%. The company also cut down its net debt by 30% last year.

A snapshot of the financial statements of these companies is shown in Table 2. The cash ratio of these companies have increased significantly, suggesting better liquidity and stronger capability to repay short-term debt. The Total Debt to Asset of these companies have also been generally declining over the last few financial quarters, suggesting a lower degree of leverage.

	Barrick			Newmont			AngloGold		
	Q2 2015	**Q3 2015**	**Q4 2015**	**Q2 2015**	**Q3 2015**	**Q4 2015**	**Q2 2015**	**Q3 2015**	**Q4 2015**
Total Debt to Asset	39.6	38.58	37.89	24.59	24.85	24.76	42.3	37.19	37.58
Cash Ratio	0.82	0.99	1.33	1.42	1.77	1.98	0.55	0.4	0.69

Table 2: Selected financial data for top 3 largest gold mining companies. *Source: Bloomberg*

Presently, many analysts differ in their views over the direction of gold price in the near future. Deutsche Bank is more optimistic about investing in gold due to an uncertain global economic outlook. Société Générale, on the other hand highlighted that gold price is overvalued and has yet to incorporate the potential Fed rate hike in this year. Other analysts pointed that potential monetary easing by the European Central Bank, as well as concerns over Britain's exit from the European Union could drive up gold price to greater heights. If gold price can continue its upward trend, or at least maintain its current high price, then it is highly likely that the gold mining companies can hold on to their glittering moments.

Credit News

Hong Kong residential sales plunge 70% as slowdown intensifies

Mar 07. Hong Kong residential home sales plunged 70% in February from a year earlier to a 25-year low, as falling prices and economic uncertainty deterred buyers. Property prices have declined 10% from their September highs amid uncertainty over the economy at home and in China, possible interest rate increases, and plans by the government to boost housing supply in the next five years. The slowdown is prompting some Hong Kong developers to slash targets. (Bloomberg)

China plans securitization to tackle banks' bad debt burden

Mar 03. China plans to bundle together billions of dollars' worth of non-performing loans and eventually sell them to global investors. Chinese media has reported that the regulator has granted a total of RMB 50bn for the first wave of products. This campaign would whittle back debts at Chinese banks and move some of the risk outside the domestic financial system. According to official figures, such debts at the banks have reached RMB 1.27tn (USD 194bn), while analysts estimate the real number is likely to be many times higher. The packaged bad loans would be backed by collateral and have other means of producing cash flow as assets are restructured or liquidated. The products will not be rated by the international rating agencies. (FT)

US life insurers shaken by rock-bottom rates

Mar 02. Shares in the leading US insurers, which help millions of Americans through retirement, have been anything but stable in recent weeks. Titans of the industry have been hit almost as hard as scandal-hit lenders in this year's stock market rout. The biggest worry is rock-bottom interest rates, which pushed up the value of the insurers' liability and made it a struggle for them to generate adequate returns on their vast investment portfolios. Rating agencies are concerned insurers are tempted to turn to riskier asset classes to deal with the problem. Stock market volatility, energy sector fragility and regulatory uncertainty have added to the pressure. (FT)

Moody's sees junk defaults reaching highest since 2009

Mar 02. Global junk-bond defaults will rise to the highest level in seven years in 2016 as a prolonged downturn in commodity prices continues to wreak havoc on company profits and balance sheets, according to Moody's Investors Service. The default rate for all of Moody's-rated corporate issuers is estimated to rise to 2.1%, also a post-financial crisis high, from 1.7% last year. The metals and mining sector had the highest default rate in 2015, at 6.5%, followed by oil and gas, at 6.3%. Global high-yield borrowing costs are hovering near the highest levels in four years, as the debt has declined 1.1% so far this year after plunging 2.1% in 2015. (Bloomberg)

Slater & Gordon shares plunge 45% on solvency fears

Mar 01. The stock price of Slater & Gordon, the world's first listed law firm, plunged after it reported a nearly USD 1bn half year loss as a result of a USD 876mn write-down, an amount three times larger than the sum of its profits since its listing. The company has lost more than 95% of its value since April 2015. The sell-off could be attributed to solvency concerns over whether the company can reach an agreement with its banks or fail to repay its debt of USD 800mn by next year. (Sydney Morning Herald)

Brazil's GDP shrinks 3.8% (FT)

US imposes 266% duty on imports of steel from China (Bloomberg)

China credit outlook cut to negative from stable by Moody's (Bloomberg)

Regulatory Updates

China streamlining IPO rules said to be unlikely this year

Mar 06. Lawmakers in December granted the China Securities Regulatory Commission (CSRC) a two-year window to install a registration-based system for IPOs, which would end CSRC intervention in pricing and allow companies to go public faster. Huatai Securities Co. says it's not likely to happen until 2017 as the regulator allays investor concerns about a more market-reliant process that may damp IPO returns. Some 220 companies completed IPOs in 2015, compared with 128 in 2014 after a yearlong suspension of new sales as the securities regulator drafted rules aimed at curbing fraud and beefing up protection for investors. (Bloomberg)

Banks' hands tied as Basel tightens rules on operational risk

Mar 04. The Basel Committee on Banking Supervision has proposed a standardized approach to measure operational risk, with the aim of delivering consistent results across banks and jurisdictions. The existing rules dictate three methods for calculating a bank's capital charge of operational risk, as well as permitting the use of internal models subject to supervisory approval. Respondents have until June 3 to provide feedback to the proposal. (Bloomberg)

Bank-crisis losses can be avoided with higher capital buffers: IMF (Business Times)

Danish mortgage banks gird for tougher rules as Basel dominates (Bloomberg)

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