Gold Fields Ltd.: Declining Gold Prices Add To The Woes Of South Deep Operations

Summary

- Gold Fields Ltd. is technically all set for a rebound, and analysts also recommend a buy.
- However, a decline in gold prices and a stronger USD will limit stock price growth.
- Gold Fields Ltd. is highly responsive to gold price fluctuations.
- The impact of weak Q2 results and restructuring of the South African mine is partially offset by increased CAPEX.

In my previous article on Gold Fields Ltd. (NYSE:GFI), I suggested that the stock may witness further decline during FY 2018. That article included an overview of the company's business and my reasons for a potential decline in stock price that was expected to persist during FY 2018.

Figure 1

Investor Takeaway

At the time of writing this article, GFI last traded at $2.50 and had lost ~33.33% since June 2018. Additionally, the stock has lost nearly half of its value during the past 12 months, and I think it may edge slightly lower. At current prices, I believe the stock is a good buy that promise long-term growth.

This article will incorporate certain headwinds that may act as a barrier against share price growth in the short term. Since the South African mining operations posted a major setback for the company and the USD has strengthened against unsteady gold prices, the chances of a stock price recovery are remote, at least in the current FY.

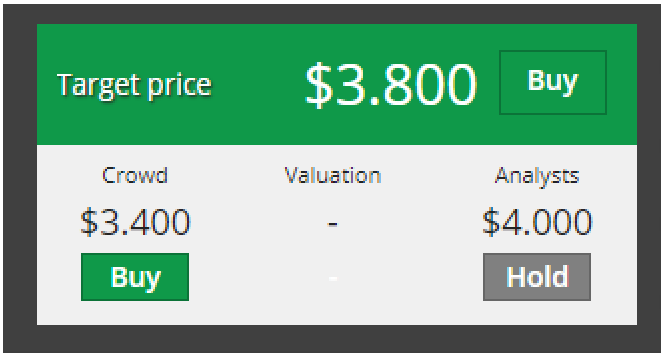
GFI is technically set for a rebound, and analysts also recommend a buy

In my opinion, there are two obvious factors that indicate share price growth going forward. First, have a look at the technical chart (Figure 2) indicating that the stock is trading at support levels.

Figure 2

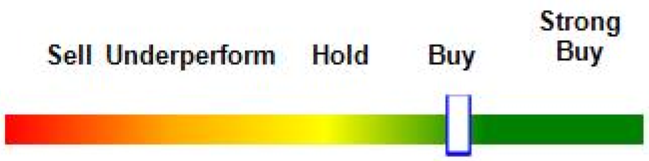
Second, analysts also recommend a buy at current prices, with a target price set at ~$3.80/share (Figure 3). Based on analyst opinion, GFI seems to have ~50% upside from current prices.

Figure 3



Moreover, Nasdaq analysts also recommend buying the stock. Their rating of this stock lies between "Buy" and "Strong Buy" (Figure 4).

Figure 4



I shall add that it's a good buy at current prices, but those holding the stock might have to wait for some time because the FY 2018 outlook for the company is not very appealing.

However, a decline in gold prices and stronger USD will limit stock price growth

Having discussed the obvious reasons for a rebound, let's move to the facts that indicate otherwise. I think a gold market bull is less likely to come around, but if it does, it will be a savior for the stock.

Figure 5

If you look at gold's six-month price movement (Figure 6), you will notice that gold bears have dominated for the majority of the period and gold had dropped from ~$1,350/oz to ~$1,176/oz.

Figure 6

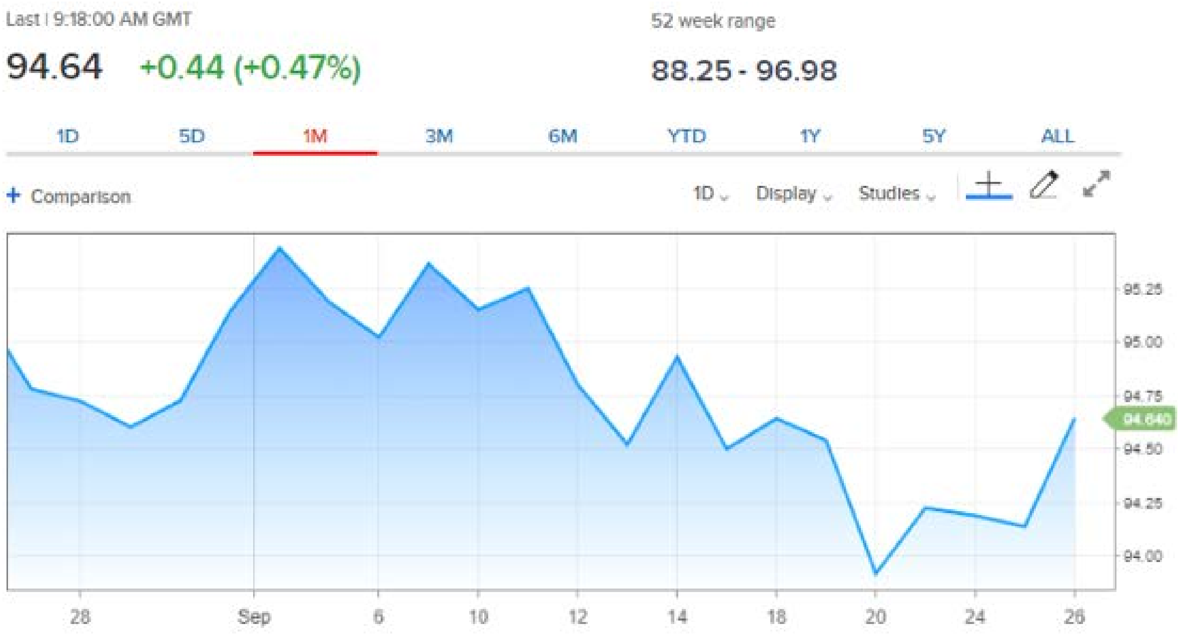
Although gold prices witnessed some recovery during the past one month and edged near the $1,195-1,200/oz range (Figure 7), but it looks as if the rally may be short-lived.

Figure 7

Could there be a sustained recovery in gold prices?

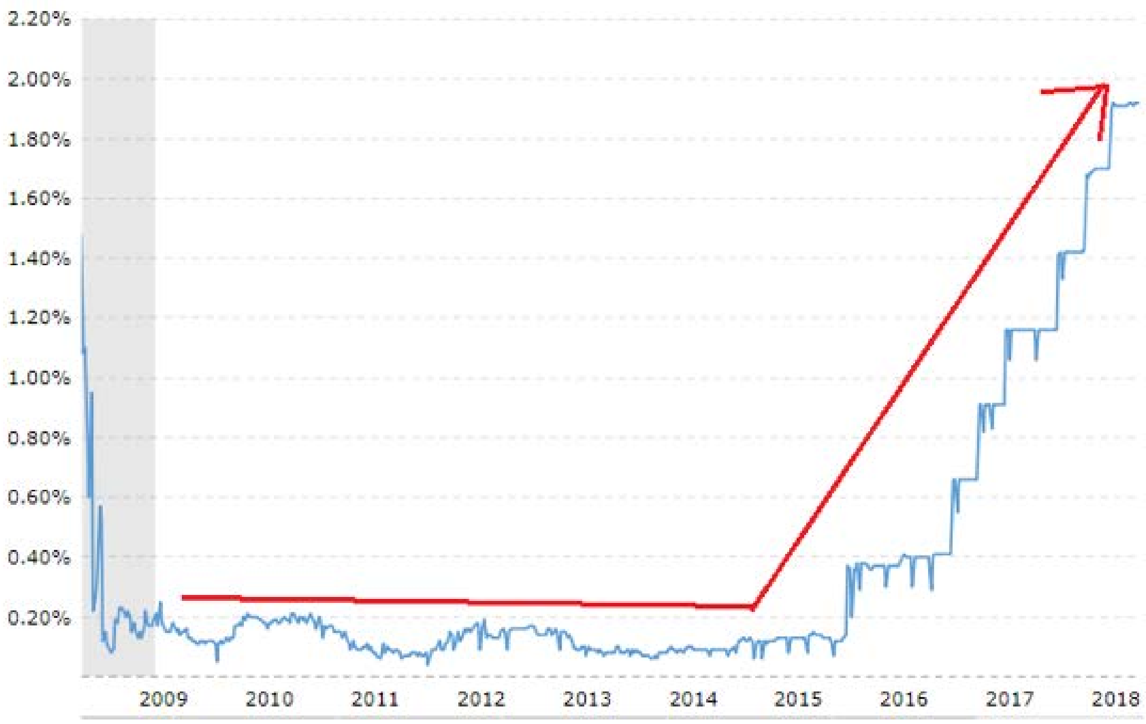
It looks difficult at the moment, because the dollar has strengthened against gold one more time, and this is evident from the DXY US Dollar Currency Index. Figure 8 shows that the USD index had lost ~1% during the past 30 days (from $95.44 to $94.64), but it's recovering.

Figure 8



Moreover, the Fed funds rate has been on an upward trajectory during the past 10 years (Figure 9), and if the rate exceeds the 2% mark, then the dollar would become stronger and gold prices may witness another round of collapse.

Figure 9



A healthy US economic outlook has improved the chances of a revision in interest rates. If gold goes into crisis, then we can easily imagine the impact on GFI stock price (and that would also hold true for any other gold miner).

Could there be a favorable case for gold?

Nevertheless, we may propose a case in favor of gold prices. As discussed in some detail in this article, declining gold prices were not exclusively due to the normal demand-supply equilibrium. Rather, the prices were thrashed by a series of intense short-selling of gold futures during the past three months. However, the chart below (Figure 10) indicates that gold futures had witnessed an increase during the past week. This indicates an expectation of increasing gold prices going forward. But it would be too early to predict the magnitude of any such increase.

Figure 10

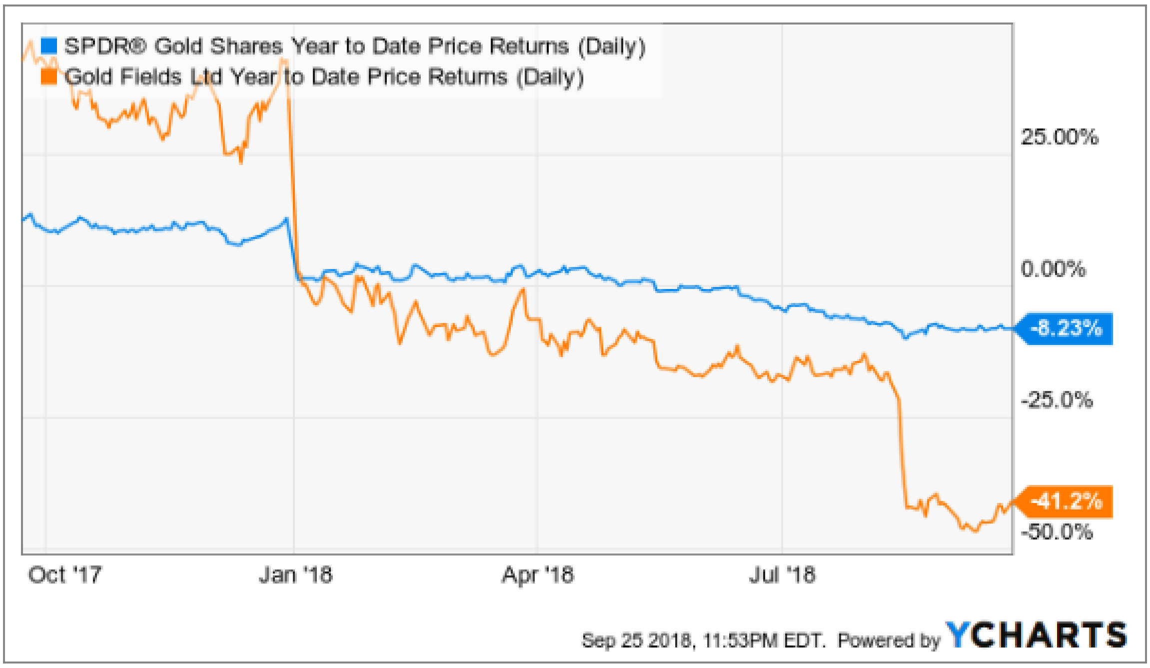
Since the past decline in gold was significantly influenced by short-selling of gold futures, an upward shift in gold futures would mean that those short-sellers of future contracts will initiate "buy" contracts to close out their positions. I believe that such intense buying may support gold prices going forward.

GFI is highly responsive to gold price fluctuations

The chart in Figure 11 indicates that GFI is more sensitive to gold price fluctuations than gold ETFs. For analysis, I have compared GFI's Year-to-Date Price Returns (Daily) against the SPDR Gold Trust ETF (NYSEARCA:GLD). The graph indicates that when GLD's returns were ~10% during the periods October 2017 to January 2018, GFI's returns were ~30-40%. Similarly, when GLD's price returns fell to a negative 8% recently, GFI fell as low as 41%

(negative). These numbers establish a ~4x correlation factor between GFI and GLD.

Figure 11



Based on the above discussion, it could be argued that in case of a 10% recovery in gold prices, GFI may respond by an increase of ~30-40%. On the other hand, if gold prices go down from current levels, then GFI will see a far greater downside.

The impact of weak Q2 results and restructuring of South African mine is partially offset by increased CAPEX

GFI's H1 2018 results were far from impressive. H1 EPS stood at $0.08, while revenue stood at ~$1.35 billion, up ~4% Y/Y. As indicated in Figure 12, the unremarkable performance was due to an increased AISC (read: All-In-Sustaining Cost) Q/Q, from $955/oz in Q1 to ~$973/oz in Q2. The declining gold prices also added to the downside and limited the positive impact of increased gold production Q/Q (from ~490,000 oz in Q1 to ~504,000 oz in Q2). In simple words, the greens (as indicated in Figure 12) were outnumbered by the reds.

Figure 12

GOLD FIELDS

H1 2018 salient features

	H1 2018	H1 2017	Q2 2018	Q1 2018
Attributable gold equivalent production (koz)*	994	1,022	504	490
All-in sustaining costs (US$/oz)*	965	967	973	955

However, problems emanating from the SD (read: South Deep) mine in SA (read: South Africa) added to the company's woes. GFI currently engages 5,554 workers (including full-time employees and contract workers) at the SD mine because the mine's operations are largely labor-intensive. The company recently announced a restructuring plan that includes laying off ~30% of the permanent workforce and ~24% of contractual staff. It also plans to reduce equipment fleet and CAPEX and scale the mining operations. This measure looks imperative because so far SD operations had only created troubles for the company. Here's how:

During Q2 2018, SD production was ~49 Koz and resulted in a *cash burn* (or negative operating cash flow) of ~R295 million. During Q1 2018, mine production stood at ~48 Koz with a *cash burn* of ~R361 million. The negative numbers from SD added to GFI's cost metrics. For instance, the company's *all-in-costs* during H1 2018 rose by 6% Y/Y, from $1,103/oz to $1,169/oz. A comparison of the *all-in-costs* with the current gold price (in the region of $1,200/oz) does not indicate healthy profitability in *per ounce of gold production*. In my opinion, the above situation justifies GFI's decision to restructure SD operations in SA. At least it could control *cash burns* and also control costs to some extent. Nevertheless, the company may expect to encounter more trouble going forward from its SD operations.
It looks as if neither the South African authorities nor NUM (read: National Union of Mineworkers in South Africa) is contented with the layoff announcement. The SA Minister for Mineral Resources, Mr. Gwede Mantashe, expressed his concerns over the layoff plans that would further aggravate the 27% unemployment rate in South Africa. Not a sizable impact on unemployment rate though, but the overall employment outlook in the economy will deteriorate further. NUM spokesman Livhuwani Mammburu also criticized the company's plan by stating:

"We feel that this is a bloodbath of job losses in the industry, mine workers have become the sacrificial lamb in the name of profit."
That said, it appears that the overall picture of SA mining operations does not look good for GFI. The SA government has recently incorporated a new mining charter that provides guidelines for resource miners in the country. These guidelines cover *black ownership* in mining companies, beneficiation (I

think this one is a positive by definition), employment equity (that one could affect foreign investors' interest in SA) and procurement selection. In my opinion, *employment equity* and *black ownership* appear to be the tools that the SA government could use to protect the interest of *black people* and adversely affect the interests of foreign investors. Moreover, the South African general elections are scheduled in 2019, and we do not know how the coming government will approach the problems of the SA mining industry. The next government might manipulate the problems or otherwise.
Whatever their approach might be, the overall mining picture in SA does not look good for GFI. This is supported by the numbers specific to the SD mine. GFI previously estimated that SD would reach annual production target of ~500 Koz by 2022. But as we have seen during H1, the mine has only produced ~100 Koz in the first two quarters, and full-year production may be projected at ~200 Koz only. That is far from the production target set for FY 2022, and given the added troubles previously discussed, it looks like SD will never be able to meet that production target.

Even though SD has rich resource potential and is capable of producing for ~70 years, and GFI's CEO was confident that the mine holds value for shareholders:

"We believe there is more in it for the shareholders by continuing at this stage than not continuing and actually throwing away all the money we spent."
I believe the facts suggest otherwise. In my opinion, GFI may not generate any real profitability from SD unless it successfully converts this mine into a largely mechanized and deep underground mine.

CAPEX for Peruvian mine
Nevertheless, the negative impact of restructuring in the SD mine is somehow mitigated through GFI's planned CAPEX to extend the life of the Cerro Corona mine (in Peru) through 2023 to 2040. GFI will spend ~$240 million on engineering and consulting activities to consider technologies that will extend mine life. The Cerro Corona mine contributed ~5.1 million grams (~180 Koz) of gold production during FY 2017, and if GFI could increase the life of mine, then that would increase production potential of the company and partially offset the impact of lower-than-expected production from the SD mine.

Conclusion
Considering the technical price charts, GFI may be well-positioned for a rebound. However, a fundamental analysis of the company's troubles in its South African operations indicates that the stock may not have significant upside at least by the end of the year - not until the company has shared FY 2019 projections for the SD mine. Nevertheless, the extension of mine life (through 2023 to 2040) for the Cerro Corona mine in Peru partially alleviates GFI's problems by promising prolonged resource production from one of its mines.

The other major problem seems to be shaky gold prices that tend to get weaker against the US dollar. We shall wait and see where the Fed Funds rate goes. If it moves above 2%, then expect more downside in gold prices and, consequently, in GFI stock price.

Overall, I think the stock may edge slightly lower falling within the $2.3-2.35 range, and it would be a good buy at those prices.

Disclosure: I/we have no positions in any stocks mentioned, and no plans to initiate any positions within the next 72 hours.
I wrote this article myself, and it expresses my own opinions. I am not receiving compensation for it (other than from Seeking Alpha). I have no business relationship with any company whose stock is mentioned in this article.