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Global Gold Stocks May Catch Bullion as Costs Fall
(Update1)

By Jesse Riseborough

June 25 (Bloomberg) -- Gold stocks have failed to keep up with bullion prices this year. As mining costs slow and as the companies find more gold that can be mined at a profit, the shares have every reason to rebound.

Mining costs, which have doubled in the past seven years, are starting to moderate as some producers focus on larger, higher-grade mines in countries where operating expenses are lower. Average total cash costs for North American producers are forecast by National Bank Financial Inc. to fall 1.9 percent in 2008

after gaining by more than a fifth this year.

Goldcorp Inc., Canada's second-largest gold producer, and Agnico-Eagle Mines Ltd., the country's No. 4, are among companies increasing reserves, a measure of gold in the ground that can be extracted profitably. Gold companies are also selling fewer forward contracts to lock in higher prices, suggesting they expect bullion to climb.

"I will be particularly interested in those companies that have got prolific reserves and then are blessed with a very low production cost," said Alfred Wong, who helps manage \$16 billion at UOB Asset Management Ltd. in Singapore. He has bought shares of Agnico-Eagle of Toronto, Eldorado Gold Corp. and Goldcorp, both of Vancouver, in the past month.

Agnico-Eagle and Goldcorp are National Bank Financial's top picks. Eldorado's cash costs are set to fall 27 percent and output will increase almost threefold by 2009 after opening mines in China and Turkey, according to a June 7 report by Credit Suisse Group.

Higher Prices

The Amex Gold Miners Index, a measure of global gold stocks, has risen 5.7 percent since its low for this year in January. Still, the index is down 3 percent in 2007, while the price of gold has gained 2.5 percent in the period. The metal, which advanced for six consecutive years, last year rose to a 26-year high of \$730.40 an ounce before falling.

Gold for immediate delivery fell as much as \$1.75, or 0.3 percent, to \$652.55 an ounce and traded at \$652.95 at 4:47 p.m. Sydney time.

The price of gold may rise back above \$700 an ounce by the end of the year, according to forecasts issued by JPMorgan Chase & Co. and ABN Amro Holding NV in the past three weeks.

Gold will reach \$800 an ounce by 2010 and then \$1,400 by 2015, analysts from Credit Suisse Standard Securities Inc., led by David Davis, said in a report this month.

Costs of producing gold have been rising as mining companies compete with each other for equipment and workers at the same time as fuel and power have become more expensive.

Bottom Line

Now so-called cash costs -- costs directly related to mining -- for some producers are starting to ease. Companies are finding higher grades of gold that require the removal of less waste ore. At the same time, producers such as Eldorado and Peter Hambro Mining Plc are tapping new gold mines in China and Russia, nations where labor and power are cheaper but where political uncertainty had discouraged exploration before.

Cash costs for North American gold producers covered by National Bank Financial averaged \$330 per ounce produced in the first quarter. Average cash costs for those producers have risen from \$164 an ounce in 2000, the bank said in a May 25 report. Costs are expected to average \$324 an ounce this year and fall to \$318 next year after averaging \$265 last year, the bank said in a June 5 report.

“Costs have reached a level that is certainly controllable, so any increase in the gold price pretty much goes to the bottom line,” said Michael McCormick, who helps manage the equivalent of \$318 million at Leyland Private Asset Management

in Sydney. He owns Denver, Colorado-based, Newmont Mining Corp., the world's No. 2 producer, and Papua New Guinea-based Lihir Gold Ltd.

Inflation

Barrick Gold Corp., the world's biggest producer of the metal, produced at an average of \$313 an ounce in the first quarter as grades increased at its mines including Lagunas Norte in Peru, Veladero in Argentina and Goldstrike in the U.S.

The Lagunas Norte mine is one of the company's lowest-cost operations and will produce about 850,000 ounces this year at cash costs of \$140 to \$155 an ounce, Barrick estimates. Agnico-Eagle is seeking to develop its Pinos Altos project in Mexico due to the country's low operating costs, the company said.

To be sure, a rise in gold stocks depends on the price of gold rising faster than it has so far this year. Gold may drop to \$625 by the end of 2007 and remain at similar levels throughout 2008, the Commonwealth Bank of Australia forecasts.

“By and large international inflation will be contained by central banks so the demand for gold as a hedge against inflation is likely to be fairly moderate,” said David Moore, Sydney-based commodities strategist at Commonwealth Bank.

Low Costs, Increased Production

Gold producers able to contain costs while increasing production are most attractive when gold prices rise, said James Holt, who helps manage the equivalent of \$5.3 billion at Zurich Financial Services Ltd. in Sydney. Goldcorp, which operates mines in North and South America, has among the lowest cash costs among gold companies in the world, said Holt.

“Just having that leverage to the gold price is the critical, critical thing for us,”

said Holt, who holds Newmont, Barrick, Goldcorp, Johannesburg-based Gold Fields Ltd., Africa's second-largest producer, and Meridian Gold Inc. of Reno, Nevada.

Producers outside the biggest four by output may provide the best returns, UOB's Wong said. Some smaller producers are turning to China and Russia, countries with lower costs than Canada and Australia. Wong also owns Peter Hambro Mining, Russia's second-largest gold producer.

Leyland's McCormick favors gold companies that are looking to start new mines, such as Equigold NL and St. Barbara Ltd., both based in Perth, Western Australia.

New Frontier

Goldcorp has said it will announce an increase in reserves at its Penasquito project in Mexico. Agnico-Eagle expects to lift reserves at projects in Finland, Mexico and Canada to as much as 20 million ounces of gold by the end of 2008.

Miners reduced their hedges against lower gold prices by almost 10 percent in the first quarter, the biggest decline in nine months, Mitsui Global Precious Metals said in a report May 4. This allows the companies to get the full benefit of bullion prices that have more than doubled over the past six years.

China, Russia and a number of African nations represent the new frontier of gold production, said Ralph Aldis, who helps manage \$1 billion of precious metals stocks for the U.S. Global Investors World Precious Minerals Fund. The fund has gained 29 percent in the past year, with Goldcorp its largest holding.

"You have to do considerably more due diligence before investing in a project where the political risk is difficult to quantify, but you can find interesting opportunities in both" Russia and China, San Antonio, Texas-based Aldis said.

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