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Why Gold Stocks Still Suck

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It is a bit hard to fathom but nearly three years have lapsed since I penned a rant called **"Why Gold Stocks Suck"** (**Mercenary Musing, April 30, 2012**) after a Cambridge House conference in Calgary.

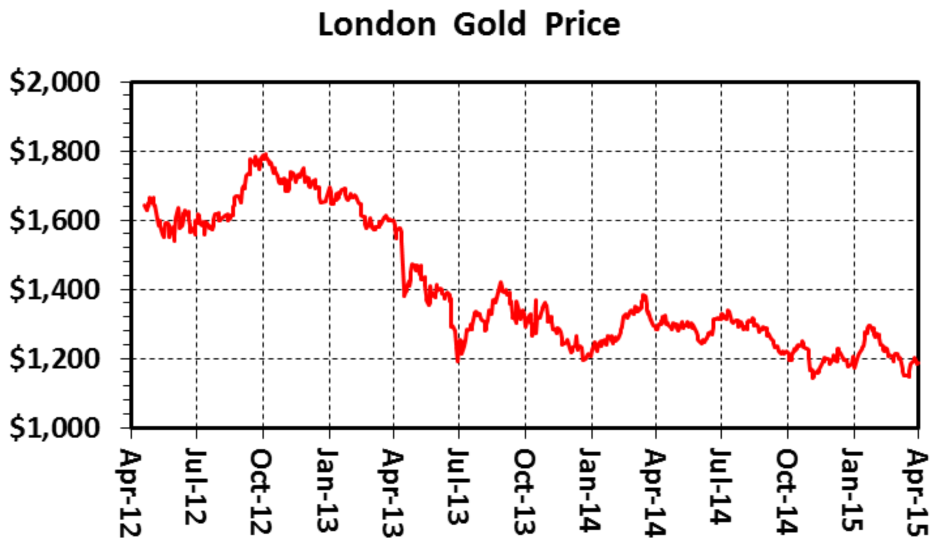
At that time, I had little inkling that the bear market for gold exploration and mining companies would continue into its fifth year and be deeper now than in the spring of 2012.

The Toronto Venture Exchange Index, which serves as a good proxy for the overall health of the junior resource sector, is down an additional 51% since my last musing addressed this particular subject:

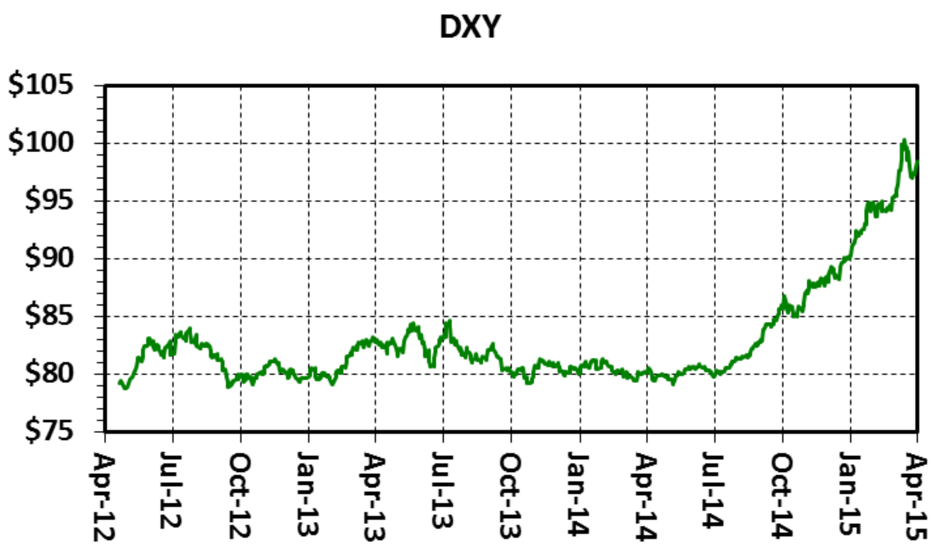
Since closing at 2440 immediately prior to the PDAC in March 2011 and given yesterday's close of 683, the TSXV Index has lost 72% of its value. That folks, is one mother of a bear market and it continues unabated.

There are several new reasons why gold stocks still suck. To wit:

- Gold underwent two corrections in April and June of 2013. On April 20, 2012, the gold price was $1642; it closed yesterday at $1202 for an overall drop of 27%:



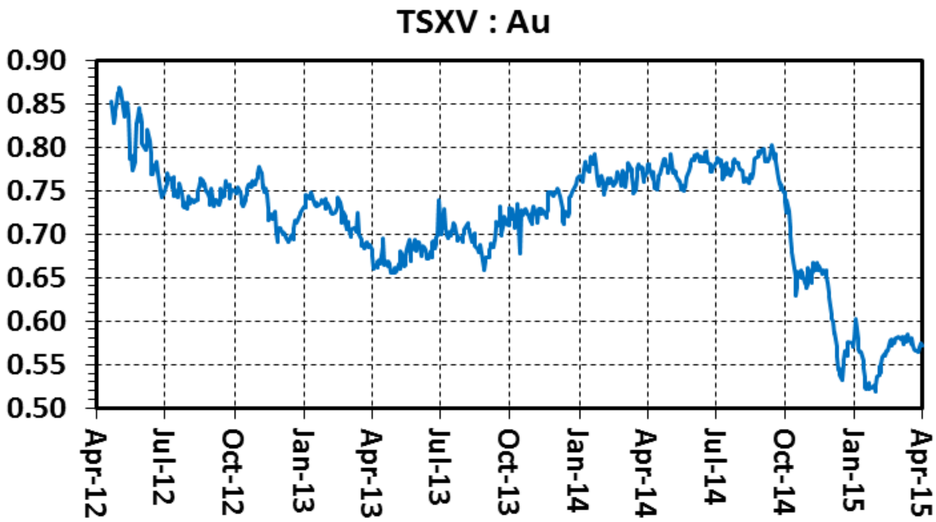
- The US dollar, as measured by DXY, has gained 24%, from 79 to 98. That said, the price of gold has actually increased in many currencies since mid-July 2014 when the US dollar started its meteoric rise from the 80 level:



- The number of companies classified as "mining" on the Toronto Venture and Toronto Stock Exchanges has dropped 13%, from 1716 to 1471 at the end of February.

- Back in the early days of the downtick in 2012, most junior explorers and developers were still viable concerns. That certainly is not the case now. Based on research by Vancouver-based CPA Tony Simon, 589 of these companies (40%) currently have negative working capital and thus are subject to regulatory delisting for not meeting the minimum requirement of $50,000 in cash reserves.

The continuing demise of the junior exploration and mining sector is aptly illustrated by the TSXV:Au ratio. It fell from 1.71 in early March 2011 to 0.85 on April 20, 2012 and currently stands at 0.57:



My 2012 missive documented the dismal performance of the junior gold sector during the bull market run for gold and related equities from early 2009 to 2011. Retail speculators and institutional investors alike were never rewarded, left the junior gold market, and have not returned.

Compounding the problem, work by Cipher Research has shown that seven major gold miners were not profitable from 2003-2013 despite a gold price that escalated over 250% (**Mercenary Musing, February 2, 2015**).

To quantify its evaluations, Ciphers utilized a methodology called the Adequacy Ratio, which is a simple measure of a company's inflows of cash divided by the outflows of cash. For mining companies, the Adequacy Ratio is defined as Revenues divided by OPEX + IMP + debt repayments + dividends paid.

A ratio >1.0 is healthy (in **black** below); a ratio <1.0 (in **red** below) over an extended period means that the company has continuously raised money from outside sources in order to fund its operations:

Adequacy Ratio = Revenues / (Operating Costs + IMP + Debt Repayments + Dividends Paid)

	2013	2012	2011	2010	2009	2008	2007	2006	2005	2004	2003	Avg
Avg Gold Price ($)	1,411	1,669	1,572	1,225	972	872	695	603	445	410	363	1,052
Agnico Eagle	0.81	0.80	0.94	0.50	0.49	0.29	0.59	1.10	1.04	0.97	0.76	0.75
Barrick	0.60	0.82	0.96	1.02	0.60	0.84	0.91	0.70	0.84	0.80	1.03	0.83
Eldorado	0.83	0.76	1.08	0.94	1.29	1.20	0.78	0.42	0.22	0.50	0.74	0.80
Goldcorp	0.65	0.82	1.05	0.93	0.71	0.62	0.60	0.82	1.05	0.77	0.97	0.82
Newmont	0.80	0.74	0.83	1.07	0.78	0.52	0.63	0.89	0.88	1.05	0.72	0.81
Randgold	1.06	0.94	1.06	0.82	0.82	0.93	1.03	1.02	0.85	0.49		0.90
Yamana	0.73	0.77	1.15	1.13	0.70	0.84	1.00	0.33	0.23	0.92	1.08	0.81
Average AR	0.78	0.81	1.01	0.92	0.77	0.75	0.79	0.75	0.73	0.79	0.88	0.82

This telling table illustrates that none of the seven gold miners generated sufficient revenues from operations to sustain their existing business models over the 11-year run of high gold prices. In only one year, when the gold price hit its all-time high in 2011, did the companies have a cumulative ratio of 1.0.

Because the major miners did not reward shareholders during the bull market for gold, investors also fled the large cap mining sector.

Now we are in a situation where venture capital money is no longer flowing to the junior explorers so few and fewer deposits are being discovered and advanced. Concomitantly, with investors no longer attracted to the major gold miners, their share prices suffer and capital budgets, including the usual kitties for strategic alliances, joint-ventures, and M&A activities, are significantly pared down.

Because of poor performance at both ends of the spectrum, the small to mid-cap gold miners and developers are having difficulty accessing capital for advancement of their projects. In a normal and healthy market, these are the companies that become acquisition targets for the majors.

Simply put, gold stocks still suck. In fact, they suck way more than when I first wrote about this issue three years ago.

That said, as a trained and experienced scientist, give me a problem and I will diligently work to provide a solution.

In the case of gold stocks, I think this solution is relatively simple. In my opinion, three things must happen to kick-start the business again:

- Junior resource companies that do not pay their bills should no longer be allowed to trade shares on the public market. The Toronto Venture Exchange must follow its own regulations and delist the hundreds of zombie miners that are in violation of minimum listing requirements. Eliminating the scams, shams, and scofflaws in the mining business is a logical first step in convincing retail speculators to reenter the marketplace.

- The major gold miners must focus on producing high margin ounces versus the paradigm that ruled the previous 13 years of growth for growth's sake. Gold mining is a value industry and corporations should adopt this core philosophy of healthy per ounce margins in order to become profitable over the long haul.

- The gold price must rise in real terms versus the US dollar. For the near term, that depends in large part on economic machinations by Old Yeller and the Fed.

Finally, I leave you with this parting thought: *The baddest bears always beget the bestest bulls*.

Stay the course, my friends, and you will be rewarded.

Ciao for now,

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Acknowledgment: Gwen Preston is the editor of **MercenaryGeologist.com.**

The **Mercenary Geologist Michael S. "Mickey" Fulp** is a Certified Professional Geologist with a B.Sc. Earth Sciences with honor from the University of Tulsa, and M.Sc. Geology from the University of New Mexico. Mickey has 35 years experience as an exploration geologist and analyst searching for economic deposits of base and precious metals, industrial minerals, uranium, coal, oil and gas, and water in North and South America, Europe, and Asia.

Mickey worked for junior explorers, major mining companies, private companies, and investors as a consulting economic geologist for over 20 years, specializing in geological mapping, property evaluation, and business development. In addition to Mickey's professional credentials and experience, he is high-altitude proficient, and is bilingual in English and Spanish. From 2003 to 2006, he made four outcrop ore discoveries in Peru, Nevada, Chile, and British Columbia.

Mickey is well-known and highly respected throughout the mining and exploration community due to his ongoing work as an analyst, writer, and speaker.

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