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Investing for a world of change

Notes from the road: Why investors should take heart from a 'sober' gold-sector gathering

POSTCARD

Denver Gold Forum, Colorado Springs

Gold is at record highs. Yet attendance at the biggest annual gold-industry conference was well below average and the mood was subdued. This says something useful about the mindset in the gold sector – and what investors can expect from here.

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Before becoming a portfolio manager, George worked in the natural resources sector. He began his career in operations at British Steel Strip Products.

The Denver Gold Forum in Colorado Springs is a great barometer of the health of the gold-mining sector. With a record gold price driving strong performances by gold stocks, this year’s conference offered a timely opportunity to get a first-hand perspective on what to expect in the months ahead.

The annual event, now in its thirty-sixth year, is attended by all the world’s largest gold businesses. Over four days this September, I met with 27 gold companies one-to-one and enjoyed chatting to many more informally. Attendance was actually considerably down on previous years. But I think that says something useful about the mindset in the gold sector, and what investors can expect from here. In fact, I left Denver far more positive about the outlook for gold stocks than when I arrived. Even with the gold price hitting new peaks, there seems to be plenty of upside remaining for gold companies.

Record prices, low interest

Back in 2011, when gold was also touching new highs, companies were in an ebullient mood. The precious metal had been going up for a decade and increasing production was the only agenda item for miners and investors. There followed a steep fall in the gold price and four years of severe, and in many cases self-inflicted, pain for gold producers and investors alike.

Gold is again at new highs, and almost a decade has passed since the lows of late 2015. But the mood in Denver could not have been more different to 2011. The Forum usually averages 1,500 attendees, but this year there were only about 900. Generalist investors were largely absent, and even specialist investment teams and gold companies had sent fewer people. The mood could best be described as ‘cautious’. You can also see that in asset flows: despite the rises for gold and the gold-equity index, investment in this segment has been subdued, especially into gold stocks.

This is not a buy, sell or hold recommendation for any particular security.

Why the hesitancy? One reason is that many of the investors who came into this segment during COVID in 2020 experienced losses as gold companies suffered three years of massive cost inflation. A lacklustre sector performance was exacerbated by lower production as miners caught up on stripping and mine development, which had fallen behind during the pandemic. Some investors bought gold itself rather than gold stocks, but muted exchange-traded fund flows suggest most just stayed away. Further limiting gold-equity participation, the growth of technology and some other equity sectors means the representation of gold stocks in broad equity indices is now minimal.

As any active investor knows, opportunities can arise when everyone else has lost interest. Consequently, low attendance was the first thing to catch my attention at this year's Gold Forum.

Changing fortunes for gold companies

The performance of the NYSE ARCA Gold Miners Index is about in line with the gold price this year (to end-September), although it has actually delivered double the return of the physical metal since the end of February. This somewhat underwhelming year-to-date performance (gold equities would typically be expected to outperform gold in a rising market, and underperform in a falling market) has not gone unnoticed by the industry and many investors. But there are signs things are changing.

COVID disruptions and Russia's invasion of Ukraine have cast long shadows over the gold sector, which was hit not only by a spike in energy prices, but also by higher costs of other inputs due to logistics bottlenecks and wage inflation as skilled workers were in strong demand across the natural resources sector. But as 2024 has progressed, these headwinds have reversed, or at last stabilised. Diesel prices are down and labour availability has improved, with the falls in lithium, nickel and iron-ore prices freeing up many workers, particularly in Western Australia, as operations to produce these commodities have been shuttered or cut back. Consequently, the recent rises in the gold price have not been consumed by cost increases, but are showing through in higher cashflows and profitability.

Focused on costs and returns

My conversations highlighted that, while management teams are clearly very happy with the current gold price, they remain cautious on their growth promises, not least because capital-expenditure inflation has been rising in recent years (higher interest rates make it more expensive to invest). Many told me they are focusing on using the higher gold price to increase free cashflow and returns to shareholders, rather than boosting capex budgets.

As gold executives believe their equity valuations are too low, many are looking to do this via buybacks, usually adding these on top of a basic dividend. As one company noted, its free cashflow in the past quarter was six-times what it was a year ago. Encouragingly, a good number of companies are also growing production volumes, even if just to recover what was lost in the COVID disruptions.

As for dealmaking, while mergers and acquisitions are not entirely off the table, companies are very cautious and asset deals seem more likely. For example, Newmont is selling assets after its purchase of Newcrest Mining. I think this adds up to a positive backdrop for investors, who can take comfort that the excesses of the previous gold boom are not being repeated.

Potential for upside surprises

Rumour has it that the Gold Forum will broaden its scope to mining generally. But don't take that as a sign that the gold sector is losing its shine. As I say, I left Denver more optimistic than when I arrived. The sober mood, poor attendance and cost focus reinforced my view that companies' results are likely to surprise to the upside over the next two quarters. There were signs of an uplift in Q2 2024 results, and the subsequent price moves in gold (up) and oil (down) should help performance in the coming quarters.

In terms of positioning within the sector, I currently favour Australian gold companies as the cost/volume improvements have been more dramatic as skilled labour has become more available. Longer term, the clear desire of many companies to improve returns and not just volumes bodes well for a sector that has a lot to prove, but that will attract more investment if company results improve.

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