Gold Fields Tries to Divide and Conquer

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November 29, 2012 – The Wall Street Journal

Gold Fields is going short on South Africa and long on irony. The miner said Thursday it will spin off a new entity called Sibanye Gold. "Sibanye" means "we are one" in the Xhosa language—which is about as far away from capturing the underlying rationale for the move as possible. Still, it at least hints at the fact that Gold Fields' fundamental problems are shared by gold miners everywhere.

Sibanye houses two old, declining South African mines. After it is gone, South Africa will account for just 13% of Gold Fields' output, down from 47% today.

Cutting exposure to South Africa is a no-brainer in valuation terms. The three big miners there—Gold Fields, Harmony Gold MiningHAR.JO -0.49% and AngloGold AshantiANG.JO +0.81%—trade at an average forward price/earnings multiple of 7.3 times, a 39% discount to the Philadelphia Gold and Silver index. Besides this year's violent labor unrest, that gap also reflects structurally higher costs for older, labor-intensive mines there. Wages account for 53% of South African cash costs, compared with a global average of 25%, according to Credit SuisseCSGN.VX -0.05% .

So for all the underlying message of togetherness, Gold Fields wants to diversify.

More important, this move is the latest manifestation of a shake-up in global gold. All miners are grappling with a major problem: how to sell themselves to indifferent investors. Once you get past the disclaimers, the first slide in Gold Fields' presentation explaining the spinoff shows how gold prices have more than doubled since the start of 2006, while gold-mining stocks have gone nowhere.

Increasing costs have eroded the miners' leverage to rising gold prices, traditionally the core of their appeal. Poor discipline on spending has destroyed value, raised debt levels and limited dividends. Meanwhile, the rise of exchange traded funds has given gold investors an easy alternative.

Miners have been shaking up executive ranks and trying various strategies to win back investors' favor. Apart from Gold Fields, Barrick GoldABX.T +0.20% has spun off African assets into a separately listed company. It is now in talks to sell its remaining majority stake in African Barrick GoldABG.LN -0.90% to state-owned China National Gold. Indeed, given their hunger for global resources and low cost of capital, such entities could end up being natural buyers of Sibanye and any other South African assets that fall loose.

These are steps in the right direction, but the pressure on miners looks likely to increase. High gold prices encourage more output, the same as any other commodity. Surveying major gold miners representing nearly half of global output, ***Pawel Rajszel***, analyst at ***Veritas Investment Research***, says their aggregate production forecasts add up to growth of 8% a year out to 2016.

Such an increase would undermine the gold price, even as cost inflation squeezes margins from the other direction. In that respect, the miners are all in the same boat.