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Tumbling gold prices add to miners' miseries

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As the cost of producing gold gets closer to the selling price, some companies are 'swimming naked as the tide falls'

The free fall in gold prices spells more bad news for an industry already fighting cost overruns, asset writedowns and project cancellations.

Gold dropped to its lowest price in two years on Monday, reaching $1,361 (U.S.) an ounce, driving the Toronto Stock Exchange gold index down nearly 10 per cent as shares of major producers sank to 52-week lows.

The crumbling gold market is raising fears that industry profits will be extinguished as the price of gold closes in on the cost per ounce required by many companies to produce the metal and replace their reserve base.

"Costs are rising faster than gold and if gold isn't rising, then producers are in trouble," said ***Pawel Rajszel***, an analyst with ***Veritas Investment Research Corp.*** in Toronto, who calculates the all-in, sustaining costs of producing gold at around $1,100 (U.S.) an ounce on average.

"It's the story of the decade and nobody noticed because gold prices were going up," ***Mr. Rajszel*** said. "Now that gold prices are going down, you see who's swimming naked as the tide falls."

As gold prices soared over the past decade, production costs were marching higher as well. Prices for equipment, materials, labour and energy soared as mining and energy firms competed for the same resources and supplies amid an industry frenzy of mine construction and expansion. While much of that cost burden lingers, the selling price for gold is in sharp retreat.

Barrick Gold Corp., the world's largest gold producer, projects all-in costs of $1,000 to $1,100 per ounce for 2013. The all-in cost, or sustaining cost, reflects a company's cash operating costs plus the estimated spending to replace reserves. Kinross Gold Corp. had all-in costs of about $1,100 per ounce for 2012 and forecasts that the figure will rise to between $1,100 to $1,200 per gold ounce sold this year. Mid-size producer Agnico-Eagle Mines Ltd. expects all-in costs this year of about $1,075 per ounce.

For Iamgold Corp., the all-in cost already outweighs the gold price, according to ***Mr. Rajszel***. He estimates that all-in costs for Iamgold, a Toronto-based company with half its mines in Africa, are $1,417 an ounce. Iamgold said it doesn't have an all-in cost available because it is still working to define final guidelines on how it should be calculated.

Gold prices have plunged amid reports that Cyprus's central bank would sell 10 tonnes of its gold to satisfy creditors in the country's bailout package, sparking worries that other countries could follow suit. Société Générale de Belgique SA and Goldman Sachs Group Inc. also forecast a plunge in gold prices.

Barely a year ago, Tye Burt, then chief executive officer of Kinross, told investors at the company's annual general meeting in Toronto that Canada's third-largest gold producer might have to slow spending if gold hit $1,200 an ounce.

At the time, investors took little notice because gold was trading at $1,600 and the expectation was that it would trend higher again, with a three-year outlook at the time of around $1,750 an ounce and expectations that economic and political crises across the planet would help it remain the safe haven of choice for investors.

Fast-forward a year and a month, and $1,200 gold does not look so far away.

In a study published on Monday, RBC Dominion Securities Inc. predicted "Significant Pain at $1,300 gold."

"We would expect all the gold producers in our coverage universe to cut all discretionary expenses, cut capital spending sharply, defer new capital development programs and in some cases cut dividends," the bank said in the report looking at producers to assess exposure to falling prices at price levels ranging from $1,500 an ounce to $1,200 an ounce.

At $1,200 per ounce, the bank said, companies such as Barrick, Kinross and Newmont Gold Co. could be downgraded to non-investment-grade levels.

In the falling gold price environment, the bank said, companies with big projects on the go may require additional debt to complete plans.

Goldcorp Inc., New Gold Inc., Yamana Gold Inc. and Agnico-Eagle are among the miners best able to withstand lower prices because they have lower costs, lower levels of debt and have recently completed new mine development. Miners with a higher proportion of gold production from underground mines are also in better shape because they can change plans to access higher-grade, lower-cost ore, the bank report said.