

HUI Gold Stocks

With gold getting a lot of attention in these wild markets, naturally its producers are also attracting interest. And almost silently, gold stocks have emerged from the depths of the [2008 stock panic](#) to be the best-performing sector in the markets. From the November lows to this week, measured by the HUI gold stocks have soared 71% while the S&P 500 has merely ground sideways.

Gold is obviously the guiding light for gold stocks and its [fundamentals](#) remain exceptionally bullish. And with more and more interest in gold a greater amount of speculative capital is naturally going to gravitate toward those vehicles with the ability to leverage gold's fortunes.

But gold stocks reside in such a small market that most folks don't know much about them. The combined market cap of the entire HUI, the 15 biggest and best gold mining stocks, was only \$123b as of the end of January. This is only a tiny fraction of the market cap of the S&P 500 and well less than that of even a single market darling like Microsoft.

Investors new to the gold stock arena can gain exposure to them via the [GDX ETF](#) without knowing much about individual mining companies. But many investors do want to take the next step and trade individual gold stocks. And herein lies the challenge. Where does one start and which ones are the best?

Researching gold stocks is indeed an arduous task if you don't know much about the industry. This is why our [gold stock reports](#) are so popular. They filter the large pool of gold stocks and provide research on the best of the best. But investors willing to do the research on their own do in fact have a place to start. And there is no better place than those stocks that comprise the venerable HUI.

The official name of the HUI is the AMEX Gold BUGS Index. And with BUGS standing for "Basket of Unhedged Gold Stocks" this index is designed to include stocks that have the most exposure to the price movements of gold. As for hedging, it is a practice employed by the majority of commodities producers and simply involves selling all or a portion of future production today.

Whether it is a farmer locking in the sales price of his upcoming wheat harvest or an aluminum miner using a complicated inflation-adjusted formula to establish a long-term sales contract for its bauxite production, hedging is very common. Among its many purposes hedging obviously serves to protect against market volatility, but it also helps commodities producers plan their fiscal calendars and forecast capex.

Hedging can work great in a sideways- or downward-trending market. For example, most of the gold producers that hedged their production in the 1990s

actually turned profits selling forward their gold. But the trouble with hedging is it limits upside exposure. And this is a big problem in a secular bull market.

In the early 2000s many hedgers had a large chunk of their gold production sold forward at prices between \$300/oz to \$400/oz. But when this bull got legs the price of gold drove through these prices and didn't look back. When gold soared to \$600/oz, \$700/oz, \$800/oz, and beyond these hedgers were stuck selling their gold well below spot. This has obviously been devastating to their financials and even more so for shareholders.

For the gold miners that wish to take advantage of a rising gold price environment, it behooves them to engage in minimal or better yet no hedging activity. And in gold's bull thus far it is these miners that have seen their stocks perform the best. If expenses remain stable each dollar that gold rises translates to a dollar of profit. Unhedged producers have seen incredible [profits leverage](#) in this gold bull, and shareholders have been rewarded generously.

So based on the BUGS mantra, HUI components are indeed unhedged. And though most HUI stocks are *completely* unhedged, there is a qualifier in that if a miner's hedgebook amounts to less than 1.5 years of production, by HUI standards it also is considered unhedged.

The HUI is comprised of 15 stocks that are modified equal-dollar weighted, with the larger cap companies tending to represent a larger portion of the weighting. And this method is useful since the market capitalizations of the companies in the HUI range from \$250m to \$27b.

Since the HUI is only balanced quarterly, at any given point in a quarter the weightings can vary based on individual performance. But with the largest weightings going to the larger companies Goldcorp, Barrick Gold, and Newmont Mining combine for over one-third of the HUI's total value at any given time. The rest of the stocks usually range from about 4% to 6%.

Now when researching the HUI stocks there are many different categories to consider and each gold miner has a unique story of its own. Below are small write-ups (in order of largest to smallest HUI weighting) on each of the HUI components that should help potential gold stock investors understand the breadth of research involved in analyzing gold stocks. And believe it or not, even within this group of elites there are those miners that are much better positioned than others.

Goldcorp (GG-NYSE): Goldcorp has long been one of the most popular gold stocks. And its spectacular reputation is well deserved. In the early 1990s Goldcorp had a market cap of just \$50m and was faced with the depletion of its flagship Red Lake mine. But with a foundation built by legendary gold pioneer

Robert McEwen and followed by a string of savvy CEOs, Goldcorp has methodically transformed itself into one of the world's elite senior gold producers.

First a Red Lake revival re-established this historic Canadian gold district as one of the world's premier high-grade gold camps. Then a series of ingenious M&A moves catapulted Goldcorp into the money-making machine we see today. The 2005 merger with Wheaton River Minerals and the 2006 acquisitions of Glamis Gold and a collection of Placer Dome assets gave Goldcorp an incredibly strong portfolio of projects.

The Red Lake complex of mines leads Goldcorp's 10 world-class mining operations and is mining gold reserves with an average grade of *over 20 g/t*. And by 2012 Red Lake should be producing over 1m ozs per annum. Goldcorp also has a robust pipeline of exploration and development projects that will materially grow its production profile. These generative projects are led by the massive Peñasquito project, which will be Mexico's largest mine when it goes live later this year.

Overall Goldcorp's fundamentals are spectacular. This 2.3m-oz producer mines its gold at some of the lowest operating costs in the industry (just over \$350/oz), is long-term-debt free, unhedged, and has an amazingly strong balance sheet.

Barrick Gold (ABX-NYSE): Barrick Gold is *the* largest gold producer in the world. Its incredible portfolio of 27 operating mines, 10 development projects, and numerous exploration projects is spread across a geographically diverse landscape spanning five different continents.

With an annual production volume of 7.6m ozs, Barrick mines 40% more gold than its nearest competitor. And to support this impressive production profile it holds the largest gold reserves in the industry, a whopping *139m ozs*. At gold's current price Barrick is sitting on over *\$125b* of economical reserves.

But even though Barrick is the king of the gold mining industry, its 25-year history hasn't always been rosy. Barrick has had to tackle some serious adversity to gain a top spot in the HUI. In fact, because of its precarious hedging history it is actually one of the newer members of the HUI.

For a long time Barrick employed a hedging policy in which it sold forward about 25% of its reserves. When gold was in the doldrums at the turn of the century this strategy was actually profitable, but once gold got some legs these hedges would prove catastrophic to shareholders.

Barrick's early 2006 mega-acquisition of Placer Dome didn't help its cause either. Now this was the move that vaulted Barrick over Newmont to become the world's largest gold producer, but Placer Dome's notorious hedgebook only added to the pain.

Ultimately whether it was Barrick's underperformance to most other gold stocks or the fact that it was selling a big chunk of its gold hundreds of dollars below spot, Barrick finally came to its senses and closed its production hedgebook by mid-2007.

Though settling its hedges would prove to be quite costly, with a price tag of over \$2b, it was the best move for Barrick Gold shareholders. ABX was added to the HUI shortly after it closed its production hedgebook and is now one of the highest-weighted HUI components.

Newmont Mining (NEM-NYSE): Newmont Mining is probably the most recognizable gold stock to mainstream investors. Not only does it have a rich history that dates back to the early 1920s, it is the only primary gold stock listed on the S&P 500 index. This Colorado-based behemoth operates dozens of mines on five different continents and has long been one of the HUI's highest-weighted components.

Though Newmont has always employed a no-hedging stance, it hasn't always been unhedged thanks to its massive 2002 acquisition of Normandy Mining. Normandy brought over a nasty hedgebook that took Newmont nearly five years to close. But based on the strength of its collective global operations and huge reserve base of over 80m ozs, these hedges didn't compromise HUI guidelines.

Until Barrick Gold's acquisition of Placer Dome, Newmont was the long-standing world-number-one gold producer. But as the now number two, Newmont is still a force in the gold mining industry. After a bumpy last couple years Newmont is on the up-and-up once again. 2009 production is forecasted at about 5.5m ozs at cash costs just over \$400/oz. And with its massive 1m-ozs-per-year Boddington project in Australia coming online later this year, Newmont will shrink the production gap with rival Barrick.

IAMGOLD (IAG-NYSE): While IAMGOLD does have a peculiar name, its production growth over the years is far from peculiar. With just under 1m ozs of gold produced in 2008 it had quadrupled production volume from 2000. Now 2009 production is going to be down as IAMGOLD loses volume from its two Canadian mines, but thanks to a strong pipeline of development and exploration projects it hopes to reach 1.8m ozs by 2012.

When it comes to M&As IAMGOLD has of course swung around its cash from profitable gold production over the years, with the acquisitions of Gallery Gold, Cambior, and Orezone of recent, but its most memorable M&A activities are those deals that didn't happen.

In 2004 IAMGOLD and Wheaton River Minerals announced a merger that was subsequently shot down by IAG shareholders. Golden Star Resources then

attempted a hostile takeover that failed. Then after this IAG announced a reverse takeover with Gold Fields that was eventually shot down by Gold Fields shareholders.

After all this bustling here we are today with IAMGOLD as a stand-alone company quickly advancing through the ranks of the mid-tier gold producers. IAMGOLD currently is either joint-ventured in or owns seven gold mines. Five are located in Africa with the other two in Suriname and Canada. And its growth in the coming years will come from organic expansions along with new projects located in Burkina Faso, Canada, Ecuador, and French Guiana.

Harmony Gold (HMY-NYSE): Harmony Gold is one of the top-ten largest gold producers in the world with fiscal 2008 production of 1.6m ozs. And the lion's share of this gold is mined from the bowels of South Africa's rich Witwatersrand Basin. This incredible geological structure has been host to *over 1.5b ozs* of gold production (nearly half the gold mined in the history of the world) since its discovery in the late 1800s.

The gold in Witwatersrand Basin is present in gold-bearing reefs that knife vertically into the depths of the earth. And following these reefs downward has created the deepest mines in the world. Harmony owns 10 of these underground mines, with its Elandsrand operation extending to a depth of *over two miles*. In addition to its South African operations Harmony is also involved in a JV with Newcrest Mining in Papua New Guinea.

While Harmony's gold production has been trending down in recent years, following South Africa's greater trend, it does have several development projects and operational enhancements that it expects to reverse this decline. Along with increasing the average grade of its underground gold Harmony plans on growing annual production to 2.2m ozs by 2012. And while Harmony is unhedged, its cash costs (>\$500/oz) are in the higher quartile of the industry average and need to come down.

Yamana Gold (AUY-NYSE): Yamana Gold is determined to become Latin America's premier gold producer. And like many of the larger gold mining companies Yamana used the M&A ladder to ascend to its heights. Provocatively Yamana wasn't even a producer in 2003. But after several Brazilian acquisitions and the subsequent acquisitions of RNC Gold, Desert Sun Mining, Viceroy Exploration, Meridian Gold, and Northern Orion Resources, Yamana is well on its way to senior producerdom.

Now not just any company can go on the M&A warpath in such fast and furious fashion and achieve immediate success, but Yamana Gold has done so. Led by a spectacular management team, Yamana has methodically developed operations to become one of the most profitable gold miners with cash operating costs at under \$375/oz. And over the next four years it expects to double GE

(converting silver production into **Gold Equivalent** ozs) production to over 2m ozs annually.

One thing you worry about when a company achieves such fast growth via M&As is the cost of doing so. But Yamana has done a fine job managing the financial implications of such activities. Its debt is well under control and investors haven't seemed to notice the massive dilution from the share-based acquisitions. Though its total common shares outstanding have more than quintupled from mid-2005 to the end of 2007, AUJ's share price quadrupled over this same period of time.

Eldorado Gold (EGO-AMEX): Eldorado Gold has one of the neatest names in the entire gold mining industry. And many folks new to the gold stock scene would immediately understand EGO's affinity to gold based on its namesake, the fabled South American "City of Gold". Though EGO's principal focus is in Turkey and China, not Latin America, its gold projects are still something to behold.

Eldorado is one of the world's premier mid-tier gold producers. And its flagship Kisladag mine pulls gold from one of the biggest and best gold deposits in Eurasia with over 5m ozs of reserves. But as shareholders are well aware, geopolitical crises in the mining industry can crop up unexpectedly.

Just after Kisladag had ramped up to full commercial production it received a court-ordered injunction to shut down operations due to a legal challenge of its environmental permits. Eldorado had to acquiesce to this injunction and in mid-2007 shut down as ordered. In short, a well-funded anti-mining group clogged up Turkey's inept legal system and forced this shutdown.

These claims were of course unfounded and the case was eventually thrown out, but Kisladag remained closed for *seven months* before it recommenced gold mining. This of course hurt Eldorado's stock, but knowing the mine would reopen it was quickly bid back up. Ultimately this goes to show that no company in the mining industry is immune from geopolitical risks.

Speaking of geopolitics, Eldorado's other major operation is located in China of all places. And with its Tanjianshan gold mine going live in late 2006, EGO has the proud distinction of being the first North American gold miner to produce Chinese gold.

Overall even though Eldorado's geopolitical risk is a bit higher than others, its smashing fundamentals cannot be overlooked. Its 2009 unhedged gold production of 340k ozs, at cash costs under \$300/oz, will feed an incredibly strong balance sheet.

Gold Fields (GFI-NYSE): South African-based Gold Fields is the fourth largest gold producer in the world with annual production of nearly 4m ozs. It operates

nine mines in South Africa, Ghana, Australia, and Peru with about 60% of its volume coming from its four remarkable South African mines.

Most impressive of these is the prolific Driefontein mine. Driefontein is a 1m-oz-per-year gold producer that has mined 100m ozs in its history. Gold is currently being extracted from greater than two miles below the surface and there is at least 20 years of mining life remaining.

But even though Gold Fields is one of the highest-volume unhedged gold producers in the world, its South African operations have caused it to be a HUI underperformer over the years. Since most of SA's near-surface veins are depleted miners have to go deeper and are faced with more complex ores. This of course drives up costs. When you combine these factors with currency issues and a nationwide electricity crisis you can see how South African miners have been challenged to say the least.

And though Gold Fields has not been immune to declining production and rising costs, it has done a fine job refocusing its efforts on the organic development of its global operations. With some big capex out of the way over the last year Gold Fields is now able to focus on operational efficiencies. In the most recent quarter cash costs (high \$400s/oz) are down and production is up over the previous quarter.

AngloGold Ashanti (AU-NYSE): AngloGold Ashanti is the world's third largest gold producer and is the newest member of the HUI. Just in the last few months AngloGold replaced Golden Star Resources, this swap giving the HUI a lot less volatility risk since AU's market cap is about 30x larger than GSS's. Without reasoning for the drop of GSS, AU's aggressive dehedging program was impetus for it finally being added to this index.

In the last year or so AngloGold Ashanti has cut its hedgebook nearly in half, to 6m ozs. So with annual production of about 5m ozs this qualified it for HUI inclusion. Unfortunately it still has hedges remaining and had to take a huge charge in 2008 to get where it is today. But this move is a step in the right direction as it will achieve better leverage to the rising gold price. These hedges also amount to only about 9% of AngloGold's massive 68m-oz reserve base.

Operationally AngloGold Ashanti is part of the HUI's South African contingency, but its production profile is better diversified than the others. About 40% of AU's gold production comes from South Africa with the rest spread out across other African countries, Australia, South America, and the US.

Overall AngloGold Ashanti has greatly improved its fundamentals in the last year or so. With cash costs just over \$400/oz and less gold sold forward at lower prices, AU's margins are getting better and this should reflect in its financials in the coming year.

Compañía de Minas Buenaventura (BVN-NYSE): Buenaventura is also a newer addition to the HUI. Though this stock has been trading on the NYSE since 1996, of the gold stock investors that had even heard of this company they knew of it as the obscure Peruvian miner that was Newmont's JV partner at Yanacocha.

The big reason for Buenaventura's oversight was indeed what kept it out of the HUI, its hedges. For many years BVN carried dreadful hedges on a large chunk of its gold production. And investors hadn't taken too kindly to this in a rising gold price environment. In early 2008 BVN finally righted the ship and closed its hedgebook, and with the help of a HUI listing investors are now starting to take notice.

Interestingly Buenaventura is not just Yanacocha. Though its 43.65% ownership interest of South America's largest gold mine is indeed its primary asset, there is a lot more to BVN. It operates several other Peruvian gold mines that allow it to collectively produce over 1m ozs of gold per year. And BVN also happens to operate a bevy of impressive silver mines including the fourth largest in the world. The Uchucchacua mine produces over 12m ozs of silver per annum.

Agnico-Eagle Mines (AEM-NYSE): Agnico-Eagle Mines has become almost a cult-like market-darling gold stock. From veteran gold stock aficionados to CNBC's Jim Cramer this mid-tier gold miner has attracted a lot of attention. And this attention has inflated Agnico-Eagle's market cap to a range where its peers are producing 1m+ ozs of gold per year. Yet in 2008 AEM *only produced 277k ozs.*

Agnico-Eagle's draw is not its historic naming convention (the combination of the elemental symbols for silver (Ag), nickel (Ni), and cobalt (Co)), but strong fundamentals and the *anticipation* of massive future growth. On the operational front strong byproduct credits from its flagship LaRonde mine in Canada have allowed AEM to produce its gold at cash operating costs in the negative in recent years. It has been a money-making machine!

And while byproduct metals prices are down big of recent, certainly having an adverse affect on costs the last couple quarters, Agnico-Eagle is still producing its gold at costs in the lowest quartile of the industry. AEM's growth prospects are also incredibly attractive. It has grown its gold reserves by over 400% since 2001 and production is expected to increase by 5x from 2007 to 2010 (to 1.3m ozs per year) as it brings online three new mines on top of the two that were just commissioned in 2008.

Randgold Resources (GOLD-NASD): Judging by its name you would think Randgold Resources is another South African gold miner. But interestingly this Channel Islands-based company that has its primary stock listing in London has

no mining operations in South Africa. Randgold's growth story has actually played out through its impressive Malian mines.

Mali has long been one of Africa's strongest gold producers, now ranked third behind South Africa and Ghana. And Randgold's Morila mine used to be one of the largest in all of Africa, producing 1m ozs per year in its prime. This 40/40/20 JV with AngloGold Ashanti and the government of Mali still has about four years of mining life remaining, but production will be on the decline until its closure.

Randgold's flagship projects are its Loulo mine in Mali and the Tongon development project in neighboring Cote d'Ivoire. While Randgold does have a small hedgebook of 127k ozs, its 2009 production of about 400k ozs and reserve base of 8.5m ozs qualify it as one of the HUI elite.

Randgold Resources has a strong cash position and should be able to self-fund the development projects in its pipeline. And by 2011 its production is expected to ramp up to 700k ozs per annum, more than triple 2004 volume.

Kinross Gold (KGC-NYSE): Kinross Gold is a HUI component that also holds a small hedgebook. But well within the HUI criteria and less than 2% of its total reserves, this hedgebook is negligible. Hedges aside, Kinross has grown to become one of the world's elite senior gold producers. From its humble beginnings as a junior producer in the early 1990s, to its massive three-way merger with TVX Gold and Echo Bay Mines in 2003, and then its 2007 acquisition of Bema Gold, Kinross is one of the HUI's finest.

Kinross Gold's impressive operations include eight gold mines that span many different regions of the world. Its Kupol mine in Chukotka, Russia is one of the largest gold/silver mines in Asia. Its Paracatu mine in Brazil is pulling from a reserve base of 18m ozs and has an equivalent mine life of 30+ years. Its Maricunga mine operating at nearly 15k feet in the Chilean Andes is quite impressive. And its Fort Knox mine in Alaska shows that the United States actually has two Fort Knox gold caches.

Operationally Kinross Gold is one of the rare gold producers actually exhibiting growth. It will have grown its output by 60% from 2006 to 2009 and is expected to surpass 2m-GE-ozs-per-annum production this year. And if it can bring its massive Cerro Casale (11m ozs) and Fruta del Norte (14m ozs) exploration projects into production, Kinross can nearly double its volume over the next three to five years.

Coeur d'Alene Mines, Hecla Mining (CDE-NYSE, HL-NYSE): Coeur d'Alene Mines and Hecla Mining round out the HUI. But interestingly they aren't actually primary gold producers. While CDE and HL both produce small amounts of gold, they are primary *silver* miners. In 2009 CDE will produce about 20m ozs of silver

with HL producing about 9m ozs. Ultimately I'm not sure why these stocks are still in the HUI since there are other qualified US-listed candidates.

As you can see the HUI is comprised of a wide range of gold stocks. These impressive miners range in size from smaller mid-tier producers to the largest in the world and they mine their gold from all over the planet. But these mini-profiles don't give justice to each company's overall fundamentals.

In order to understand the big picture for each gold stock you must peel away the inner layers. It is important to consider such things as company history, management, and financials and then to drill down on operations to understand sustainability, longevity, and growth potential. After all this you need to package together what you know and perform comparative analysis within peer groups.

Once you do all this the cream will rise to the top and clear winners will emerge. And as I mentioned earlier the HUI is the best place to start when searching for quality gold stocks. This BUGS has exhibited exceptional performance for a reason. Over the course of the gold bull the HUI has returned a trough-to-peak gain in excess of *1300%*! Compare this to the competing and less-restrictive XAU gold/silver stock index with gains of *only* 393% over this same period of time and you can see why it pays to be unhedged.

And it is not too late to buy gold stocks either. Even though the HUI has performed exceptionally well over the last few months, it is still vastly underperforming gold based on historical precedent. I encourage you to read Adam Hamilton's essay from last week that puts the [HUI's recent surge](#) into perspective. Once you understand the historical HUI/gold relationship, you'll see that there may still be a lot more room left to run for gold stocks.

If researching gold stocks seems like too daunting of a task I encourage you to consider our latest [gold-producing stocks research report](#). We painstakingly sifted through the universe of gold stocks and found what we believe are those with the highest potential for success.

Many of these HUI stocks indeed made the cut into our favorite 12, but many did not. And there are others that made the report that are not in the HUI and have just as good if not better fundamentals. [Purchase this report today](#) to have this comprehensive fundamental research at your fingertips. And as always, subscribers to our acclaimed [newsletters](#) can buy this report at a discount.

The bottom line is researching and understanding gold stocks can seem a bit overwhelming for investors not familiar with this small but promising sector. But even though there are hundreds of gold stocks out there the HUI is always the best place to start as it holds this industry's elite.

Within the HUI are BUGS that have collectively returned legendary gains over the course of gold's secular bull market. These miners are responsible for a good chunk of global gold production and most are well-managed money-making machines. As more and more investors pile into gold stocks, I encourage you to do some research and get to know them.

Scott Wright

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