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Viewpoint > From-the-capital

Newmont courts new investor base

Newmont Corporation chief executive Tom Palmer has given himself an improbable challenge: to convert a long-standing gold market proxy into a competitive S&P 500 investment.

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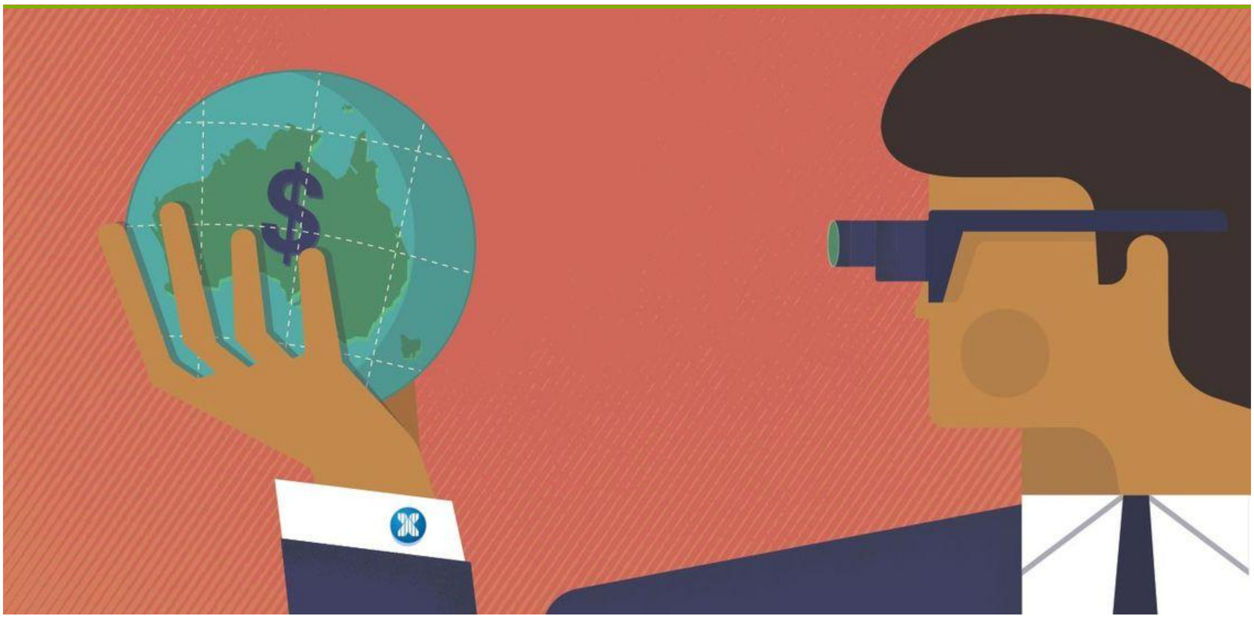

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Speaking recently on the CNBC cable business channel, Palmer portrayed Newmont as moving beyond its role as a gold proxy to embrace those he described as generalist investors. As the only gold miner in the S&P 500 share price index, Newmont has a unique platform to help make the transition.

As it happens, Newmont has a history of underperforming both the S&P 500 and the gold price.

Between 1990 and 2006, Newmont's share price undershot the movement in the gold price by a margin of 39% to 58%. Both undershot the S&P 500 by more than 235 percentage points.

Subsequent to 2006, the gold price kept rising. By the end of 2012, it had gained more than 160%, while Newmont put on just 11%. Since then, the gold price has declined 5% and Newmont has added 8%, while the S&P 500 more than doubled.

Since the start of 1990, the S&P 500 has risen over 800%, gold is up 294% and the Newmont share price has risen 67%.

The performance differential has been narrower or even positive from time to time over short periods. Since the start of 2018, for example, Newmont, gold and the S&P 500 have netted similar returns of 22-25%.

Newmont was able to outperform both gold and a rising equity benchmark significantly in the first half of 2016. Then, rising production, falling costs, a doubling in operating profit and a turnaround in free cash flow breathed life into an otherwise struggling investment.

Those 2016 circumstances hint at what is needed to produce the superior returns for which generalist investors search. To realise his ambition of widening his shareholder base, Palmer will have to persuade investors of a sustainable change in outcomes.

Newmont relies heavily on occasional reinvention of its business to kick start investment returns. Palmer implied as much in his own comments this month. Mining Journal quoted him as saying that "as this company has done many times in the past, Newmont has demonstrated its ability to adapt to change".

> “ **Generalist investors are less interested than they once were in company specific results than index performance**

Adaptability is an admirable corporate attribute. Responding to opportunities or creating new paths to profitability has powered Amazon, Facebook and Apple to market leadership. In contrast, change has been forced on Newmont in response to a business often functioning below its potential.

Miners typically suffer from two valuation handicaps in competing for generalist investor interest. Earnings cyclicality is one. That is not necessarily a deterrent to the generalist investor if overall returns compensate for relative volatility. Unfortunately, history says that will not happen.

A finite resource base is also a valuation impediment. Newmont's S&P 500 peers like Apple, Amazon, Microsoft, Lockheed Martin, MasterCard, JP Morgan Chase, PepsiCo and Pfizer are credited with unlimited lifespans. Investors will readily capitalise an assumed uninterrupted earnings stream when deciding what a non-mining company is worth. That is true despite the business continuity assumption having proven erroneous in such cases as Eastman Kodak, Sears, Lehman Brothers, Toys R Us and RadioShack, all former S&P 500 constituents and revered leaders in their business spaces not so long ago.

Miners typically need repeated low-probability exploration successes to replicate the life span of a non-mining entity. The likes of PepsiCo are equivalently challenged to meet changing business conditions but smart managers outside mining are more capable of controlling their own destiny than those within the mining industry.

Newmont will battle these deeply entrenched obstacles in trying to modify its investment role. Critically, to allay doubts about the company's longevity, Palmer underscored "a business that has a steady production profile for decades to come" in the CNBC interview.

Newmont directors have flagged a 79% hike in quarterly dividend to a US$1 a share annual rate to further solidify its investment case. The mooted 2.3% yield would compare favourably with the average 1.9% yield for S&P 500 stocks.

Newmont is capable of generating more than $10 billion in free cash over the coming five years at current gold prices. More share buy backs have been flagged and a still higher dividend is feasible if the gold price holds and cost reduction goals are achieved.

Directors are displaying their wariness about future conditions in their assumption of a $1,200 per ounce gold price for planning purposes. Capital management timidity is understandable but a yield only slightly above average without revenue growth and only cost cutting to modify the share price impact of uncontrollable macro influences fall short of persuasive arguments for a competitive investment.

Newmont is not cheap despite its share price underperformance and potential for a $1.7-1.8 billion 2020 profit, or even something better if the gold price holds above $1500/oz. Applying the current S&P 500 valuation of around 19 times 2020 operating earnings would put Newmont's valuation within 10% of its current market capitalisation.

Newmont has already been given credit for the reproducible profit stream it has yet to achieve. Plans for further cost reductions over the coming five years imply scope for modest ongoing capital appreciation in the event that the gold price at least holds the line but nothing to cause unusual investor excitement.

Newmont's recently revamped asset base and likely financial strength will anchor its membership of the S&P 500, now a benchmark for some $6.5 trillion in funds and another $3.4 trillion in indexed assets.

Today's generalist investors are less interested than they once were in company specific results than index performance. As long as Newmont retains its S&P 500 spot through its mining industry leadership, it will benefit from the pervasive influences of the trends toward passive investing.

The growth of passive investing and Newmont's membership of the exclusive S&P 500 club enables it to ride the coattails of companies with far more compelling growth prospects. That is its most likely source of new investment funds.

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