VanEck®

Barrick-Randgold Sets Bar for Future Gold Mergers

By Joe Foster, Portfolio Manager and Strategist

Gold Consolidated, Gold Stocks Declined, But Positive Trends Emerge

The gold market spent the month consolidating around the $1,200 per ounce level. There wasn't much news to move the metal, and the markets didn't react to the widely expected September U.S. Federal Reserve rate increase. As a result, gold and gold stocks saw little change. In September, gold declined $8.90 (0.7%) to $1,192.50 per ounce, the NYSE Arca Gold Miners Index (GDMNTR)1 fell 0.3%, and the MVIS Global Junior Gold Miners Index (MVGDXJTR)2 fell 1.3%. As gold consolidates near its lows for the year, whether the next trend will be lower or higher is not yet clear. However, extremely light (short) positioning on Comex (the primary futures and options market for trading metals), seasonal buying, and possible geopolitical catalysts from Italy and the U.S. midterm elections suggest that the trend could be higher.

Recent Industry Conferences Provide Insight on Producers and Junior Developers

We attended both the Precious Metals Summit and Denver Gold Forum recently. Combined, these are the most significant gatherings of institutional investors and gold companies in the world. As usual, we found some interesting discoveries and developments to follow up on with the smaller companies that attended the Precious Metals Summit. This is a difficult environment in which to raise capital for the junior developers. Fortunately, there was a heavy presence of corporate development teams from gold producers globally at the event. Corporates have been a key source of junior funding in this cycle, and we expect this trend to continue.

The producers we saw at the Denver Gold Forum showed their companies to have solid foundations. Most spoke of opportunities to maintain production, and a few talked about growth. Except for a minor impact from oil prices, costs are being contained. Rumors over the weekend ahead of the conference and the announcement early Monday morning of the merger between Barrick Gold and Randgold Resources dominated the thoughts and conversations of those in attendance. We devote the remainder of this update to our assessment of the merger.

Analyzing the Barrick-Randgold Merger

As we have followed the gold market over the years, there are three companies that stand out for their persistent ability to create value. Mid-tier producers Agnico Eagle Mines, B2Gold, and Randgold, have been able to grow their businesses through accretive acquisitions and exploration success. Agnico and B2Gold build their own mines, avoiding a reliance on outside engineering firms. Randgold and B2Gold have become adept at mitigating geopolitical and social risk with successful operations in Mali, Democratic Republic of Congo (DRC), Ivory Coast, Namibia, Nicaragua, and the Philippines. Randgold's exploration success has revealed gold deposits that are so rich they are able to design mines that generate robust returns at $1,000 per ounce. All three companies are headed by long-tenured CEOs.

Now, one of these companies is planning to merge with the largest gold company in the world. On September 24, at the Denver Gold Forum, John Thornton, Chairman of Barrick, and Mark Bristow, CEO of Randgold, announced the merger of their companies. The proposed merger will be voted by shareholders in November, and we find several aspects of it intriguing.

Merger Without Premium Eliminates Arbs; Hopefully, Sets Precedent for Future Deals

Historically, whenever a senior gold company has taken over a smaller rival, it has paid a premium, usually in the 20% to 50% range. A premium deal attracts arbitrageurs (arbs), who sell or short the acquirer's stock and may buy the acquiree's stock. We have seen the acquirers' stock fall as much as 10% on a deal announcement, which usually drags down the target's stock price as well. The stocks may remain under pressure as the arbs increase their positions. By the time a deal has been voted, the arbs may control a significant portion of the company. They have no interest in long-term investing, so their substantial positions are sold once a deal has closed. Arb stock can churn in the markets for months, holding down the price until it finds a home.

In addition to the arb issue, too many companies have paid too much for acquisitions in the past that have destroyed value for shareholders. The market is generally efficient at determining a producing company's value. However, we have seen too many entrenched managements and stubborn shareholders who have refused to deal unless a premium is paid. Mining is a difficult business and not all companies have A-team talent. It is often beneficial to all stakeholders to move properties and projects into companies that are best able to develop them.

Barrick-Randgold is the first major deal we know of in the gold sector without a premium. This kept the arbs out of the market, and the results were impressive. In the week following the announcement, Randgold rose 10.4% and Barrick was up 5.8%, while the NYSE Arca Gold Miners Index was down 1.3%. Historically, we have generated alpha for our investors by anticipating M&A action, overweighting companies we believe are acquisition targets and underweighting possible acquirers. We felt that Barrick was in need of an acquisition and positioned the fund accordingly. While we were correct in our assessment, we didn't get the benefit of Barrick's performance after the deal was announced. Nonetheless, we are excited by the outcome, and we hope it sets a precedent that other companies follow. We would be happy to change our M&A strategy for non-premium deals that trade on market fundamentals rather than arb speculation.

VanEck's Familiarity with Companies, Senior Leadership

I met Mark Bristow in a restaurant on Third Avenue in New York in 2002. He had a project in Mali called Morila that he was seeking to fund. Prior to Morila, Randgold was involved in other African mines that hadn't fared so well. Morila was different. It was a large orebody, near surface with rich grade and simple metallurgy that would allow quick payback. Randgold couldn't raise enough for a world-class project, so Mr. Bristow brought in AngloGold as a partner. VanEck participated in the Randgold financing in 2002 and has been a shareholder ever since. The chart shows it was one of the best investments we have ever made. Mr. Bristow went on to create an extraordinary company. He is an exploration geologist and will be the first we know of to head a major gold company. Unlike at most companies, geologists play a central role in Randgold. Geologists tend to be free-spirited, nonconformist, and sometimes a bit eccentric. They are scientists who take risks on limited information out of necessity. There is only so much geologic information to be gained from the surface of the earth, yet the geologist must decipher millions of years of geologic history to generate drill targets. Finding a mineable gold deposit hidden beneath the surface is like looking for the proverbial needle in the haystack. It takes an abundance of drilling that is mostly unsuccessful. Exploration costs money, but it is key to value creation in the long term. When gold is down and money gets tight, it is the geologists who are asked to leave as exploration budgets are slashed. I lost my job twice as a young exploration geologist, which was the primary motivation behind an eventual career switch to finance. A master's degree and more than a decade of experience left Nevada when we moved to New York. Many geologists have had similar career changes. This lack of consistency in exploration contributes to the lack of discoveries that the industry faces today. Randgold's geologists have an unparalleled record of discovery in West Africa due to a consistent commitment to exploration excellence. The merger enables Randgold's exploration philosophy

Performance since VanEck first invested in Randgold
(August 15, 2002 to September 30, 2018)

Source: VanEck, Bloomberg. Dats as of September 30, 2018. Past performance is no guarantee of future results. Chart is for illustrative purposes only.

to come to the Americas.

John Thornton has been at the helm of Barrick as Chairman since 2014, when the company was burdened with a mountain of debt and an uncertain future. We were avoiding the stock. Since then, Barrick has experienced a remarkable turnaround. Non-core assets have been sold, debt has been slashed, layers of management have been eliminated, and employees have been made partners (shareholders) in the company. Mr. Thornton is a banker by background, and we believe he might see this merger as an opportunity to take Barrick's turnaround to the ultimate level. Randgold has a flat, decentralized management structure. Under Mark Bristow, we expect Barrick to further streamline the organization. Randgold brings skills at mitigating geopolitical risk that can pay off for Barrick in Africa and South America. Randgold's mining and exploration teams can bring proven methods into the new Barrick. And Randgold's two tier-one mines bolster Barrick's world-class properties.

From Randgold's perspective, this is an opportunity to transpose the management structure, financial discipline, and operating culture onto Barrick, the largest gold company in the world. We believe the biggest risk in this merger is that a management style that has worked for a regional mid-tier becomes difficult or impossible when applied to a global organization that is triple in size and complexity. Mr. Bristow's persona and hands-on management of operations and geopolitical negotiations will need to be cloned to two additional continents. Will Barrick prove to be too large and unwieldy? Or will a new industry leader emerge? It will probably take several years and a couple of setbacks, but we believe Messrs. Thornton and Bristow have the conviction, drive, assets, and people to make it work.

[1]NYSE Arca Gold Miners Index (GDMNTR) is a modified market capitalization-weighted index comprised of publicly traded companies involved primarily in the mining for gold.

[2]MVIS® Global Junior Gold Miners Index (MVGDXJTR) is a rules-based, modified market capitalization-weighted, float-adjusted index comprised of a global universe of publicly traded small- and medium-capitalization companies that generate at least 50% of their revenues from gold and/or silver mining, hold real property that has the potential to produce at least 50% of the company's revenue from gold or silver mining when developed, or primarily invest in gold or silver.

Important Disclosures

This commentary originates from VanEck Associates Corporation ("VanEck") and does not constitute an offer to sell or solicitation to buy any security. VanEck's opinions stated in this commentary may deviate from opinions presented by other VanEck departments or companies. Information and opinions in this commentary are based on VanEck's analysis. Any forecasts and projections contained in the commentary appear from the named sources. All opinions in this commentary are, regardless of source, given in good faith, and may only be valid as of the stated date of this commentary and are subject to change without notice in subsequent versions of the commentary. Any projections, market outlooks or estimates in this material are forward-looking statements and are based upon certain assumptions that are solely the opinion of VanEck. Any projections, outlooks or assumptions should not be construed to be indicative of the actual events which will occur.

No investment advice

The commentary is intended only to provide general and preliminary information to investors and shall not be construed as the basis for any investment decision. This commentary has been prepared by VanEck as general information for private use of investors to whom the commentary has been distributed, but it is not intended as a personal recommendation of particular financial instruments or strategies and thus it does not provide individually tailored investment advice, and does not take into account the individual investor's financial situation, existing holdings or liabilities, investment knowledge and experience, investment objective and horizon or risk profile and preferences. The investor must particularly ensure the suitability of an investment as regards his/her financial and fiscal situation and investment objectives. The investor bears the risk of losses in connection with an investment.
Before acting on any information in this publication or report, it is recommendable to consult one's financial advisor.
Forecasts, estimates, and certain information contained herein are based upon proprietary research and the information contained in this material is not intended to be, nor should it be construed or used as investment, tax or legal advice, any recommendation, or an offer to sell, or a solicitation of any offer to buy, an interest in any security. References to specific securities and their issuers or sectors are for illustrative purposes only and are not intended and should not be interpreted as recommendations to purchase or sell such securities or gain exposure to such sectors. Each investor shall make his/her own appraisal of the tax and other financial merits of his/her investment.

Sources

This commentary may be based on or contain information, such as opinions, recommendations, estimates, price targets and valuations which emanate from: VanEck portfolio managers, analysts or representatives, publicly available information, information from other units or Companies of VanEck, or other named sources. To the extent this commentary is based on or contain information emerging from other sources ("Other Sources") than VanEck ("External Information"), VanEck has deemed the Other Sources to be reliable but neither the VanEck companies, others associated or affiliated with said companies nor any other person, do guarantee the accuracy, adequacy or completeness of the External Information.

Limitation of liability

VanEck and its associated and affiliated companies assume no liability as regards to any investment, divestment or retention decision taken by the investor on the basis of this commentary. In no event will VanEck or other associated and affiliated companies be liable for direct, indirect or incidental, special or consequential damages resulting from the information in this publication or report.

Risk information

The risk of investing in certain financial instruments, is generally high, as their market value is exposed to a lot of different factors such as the operational and financial conditions of the relevant company, growth prospects, change in interest rates, the economic and political environment, foreign exchange rates, shifts in market sentiments etc. Where an investment or security is denominated in a different currency to the investor's currency of reference, changes in rates of exchange may have an adverse effect on the value, price or income of or from that investment to the investor. Past performance is not a guide to future performance. Estimates of future performance are based on assumptions that may not be realized. When investing in individual shares, the investor may lose all or part of the investments.

Conflicts of interest

VanEck, its affiliates or staff of VanEck companies, may perform services for, solicit business from, hold long or short positions in, or otherwise be interested in the investments (including derivatives) of any company mentioned in this commentary.
To limit possible conflicts of interest and counter the abuse of inside knowledge, the representatives, portfolio managers and analysts of VanEck are subject to internal rules on sound ethical conduct, the management of inside information, handling of unpublished research material, contact with other units of VanEck and personal account dealing. The internal rules have been prepared in accordance with applicable legislation and relevant industry standards. The object of the internal rules is for example to ensure that no analyst will abuse or cause others to abuse confidential information. This commentary has been prepared following the VanEck Conflict of Interest Policy.

Distribution restriction

This commentary is not intended for, and must not be distributed to private customers.

Index Descriptions:

All indices named in the commentary are unmanaged indices and include the reinvestment of all dividends, but do not reflect the payment of transaction costs, advisory fees or expenses that are associated with an investment in the Fund. An index's performance is not illustrative of the Fund's performance. Indices are not securities in which investments can be made.

25/28 North Wall Quay
Dublin 1 | Ireland
vaneck.com | international@vaneck.com | +35 31 485 4989