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Gold needs a hug—as central banks run riot, the legacy monetary asset languishes at $1,200 an ounce—but don't go pitying Barrick Gold Corp. (ABX in New York and Toronto). The least esteemed and most encumbered of all the gold-mining majors is on the upswing, we are about to demonstrate. Skipping down to the bottom line, *Grant's* is bullish on it.

Gold stock investors are a bruised and resilient breed. They've been rich and they've been poor, and they dearly miss being rich. Contrary to the bone, they have an abiding weakness for long shots. That is, for most long shots. At ABX, the company that hedged away the sweetest gains of the long bull gold market, they tend to draw the line. Barrick is the company—a gold company, mind you—that outbid a state-owned Chinese rival for the Lumwana copper mine in Zambia in 2011, incurring almost $8 billion of debt in its famous victory. It's the company that, since 2012, has taken $23.1 billion in impairment charges. It's the company, also since 2012, that has run up its ratio of debt to equity to 1.02:1 from 0.56:1. And it's the company that, since 2011, has run down the price of its common stock to $12 from $50. Not even the analysts like it: Bloomberg counts eight buys, 19 holds and four sells.

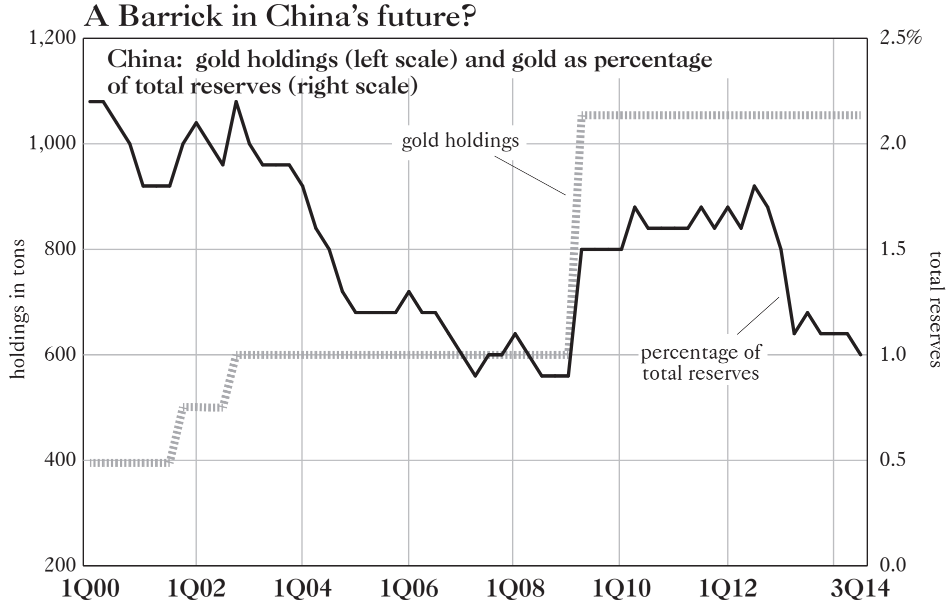
Barrick didn't wreck its finances and alienate its investors all by itself. The outside world pitched in, too. Thus, the price of copper was $4.30 a pound when Lumwana entered the corporate fold; it is $2.65 today. The price of gold was $1,900 an ounce in September 2011; it is $700 lower today. The royalty rate on open-pit mining in Zambia was 6% last year. Now the government in Lusaka is demanding 20%. At the new, confiscatory level, Barrick threatens to shutter its Zambian copper operations. The government has refused to yield; talks proceed. The U.S. dollar exchange rate has rallied, and Treasury prices are falling, on the prospect of tighter Federal Reserve monetary policy.

The bullish case for Barrick rests, first, on the price of gold. In this respect, the investment proposition is little different than that for any other big-cap gold miner. Either you believe in the efficacy of present-day monetary methods—zero-percent money market interest rates, QE, the whole nine yards of policy improvisation by former tenured economics faculty—or not. If not, you are at least potentially receptive to the bullish case on the time-honored alternative to government-issued scrip. What makes Barrick different is, in the first instance, financial leverage, and in the second, China.

Operational leverage is integral to the mining business. Integral to Barrick besides is $13.1 billion worth of financial leverage (or $10.4 billion in debt net of cash and equivalents). Doffing these cement shoes is management's job No. 1.

China is the subtler and more speculative of the two distinctive Barrick differences. The People's Republic owns 1,054 metric tons of gold, according to the World Gold Council, equal to just 1% of Chinese official reserves (an estimate that some contend is much too low; as in the case of all Chinese statistics, one takes it with a cellar of salt). For perspective, Italy owns 2,452 metric tons, equal to 66.6% of Italian official reserves. China is thought to want to be more like

A Barrick in China's future?



source: World Gold Council

Italy—or Russia or Switzerland or France or Germany or the United States, all of which own gold equivalent to between as little as 7.7% (as in the case of Switzerland) to as much as 72.6% (as in the case of America) of official reserves. In Barrick's new chairman, the People's Republic may have found the man to help.

John L. Thornton, 61, who succeeded Peter Munk on April 30, 2014, arrived at Barrick without mining experience and with no particular affinity for gold. He seems never even to have owned a Krugerrand. Thornton is an investment banker by vocation and a Sinophile by avocation. It's the overlay of these interests, we speculate, that will constructively operate on the Barrick share price.

A product of Harvard, Oxford and Yale, Thornton is a former president and co-COO of Goldman Sachs. He is a one-time director of Intel and Ford Motor Co., of the HSBC and News Corp. He is the co-chairman of the board of trustees of the Brookings Institution and the progenitor of the John L. Thornton China Center at Brookings. He is a member of the International Advisory Council of China Investment Corp., the Chinese sovereign wealth fund, and a one-time director of Industrial and Commercial Bank of China. He is a professor and director of global leadership at Tsinghua University in Beijing.

Thornton makes an incongruous gold miner. Until landing at Barrick, his sunlit career was one from Wall Street central casting. Successful and well-adjusted people normally keep their distance from gold. The metal rather appeals to any who feel the need to hedge against the very institutions inside which Thornton has drawn his weighty paychecks. Above all things, gold is anti-city hall; pro is Thornton, to judge by a glance at his luminous c.v.

Then, again, as the world's top gold producer, Barrick is necessarily a part of the gold establishment—and would have been all the more so if, a year ago, on the eve of his installation in the chairman's office, Thornton had succeeded in negotiating a merger with Newmont Mining, the No. 2 producer. "Barrick counts few enough friends among gold investors," colleague David Peligal observes. "But nobody disputes that Barrick's top assets are some of the best in the world. They include Cortez (situated in Nevada), Goldstrike (Nevada), Lagunas Norte (Peru), Veladero (Argentina) and a 60% stake in Pueblo Viejo (Dominican Republic).

"Then," Peligal proceeds, "there's Donlin Gold, the immense Alaska deposit of which Barrick and Novagold Resources each own half (see *Grant's*, "Nature's own bitcoin," Jan. 10, 2014, and "Puts on Ph.D.s," May 17, 2013). Donlin is one of the largest undeveloped gold deposits in the world. How big? There are 39 million ounces of contained gold in the measured and indicated resource categories. It's the right size, the right grade, and in the right jurisdiction, but it will be an expensive project to build out. Donlin needs a higher gold price for the economics to work, say around $2,000 an ounce. Then again, Donlin recently moved past the halfway mark in the permitting process. It's somewhat insulated from the price of the yellow metal today. Certainly, it still represents an attractive option on a much higher gold price in the future."

In 2014, Barrick produced 6.25 million ounces of gold at an all-in sustaining cost of $864 per ounce; Newmont, in the No. 2 position, produced 4.85 million ounces at an AISC of $1,002 per ounce. Barrick's aforementioned core assets are expected to account for 60% of 2015 production at an AISC of $725 to $775 an ounce. "At two grams per ton," to quote from the Barrick fourth-quarter earnings release, "these mines have an average reserve grade more than double that of our peer group average. They are among the most attractive assets in the entire gold industry, generating strong free cash flow even in today's gold price environment, while offering exceptional leverage to higher gold prices."

"Leverage to higher gold prices" isn't the kind of leverage that keeps the thoughtful Barrick bull awake at night. Financial leverage is the main source of worry. To protect the company's low investment-grade debt rating, Thornton has announced his intention to pare back debt by $3 billion this year. "There's no really winning way to proceed in this essential work," Peligal points out. "He could sell good assets at a poor time to realize mediocre prices, or he could sell poor assets at a poor time to realize mediocre prices. He could sell royalty interests by way of mortgaging the future. He could sell stock. Actually, at that, he could not so easily sell stock. The company raised $2.9 billion of equity in a deal bought on Halloween 2013: 163.5 million shares at $18.35 per share. The market would hardly welcome an encore, although, thanks to that financing, Barrick has $2.7 billion in cash compared to less than $1 billion in debt that falls due over the next three years. A $4 billion revolving credit facility, which expires in January 2020, is undrawn. Though it isn't clear exactly where the $3 billion will come from, it would be unlike Thornton not to hit—probably to surpass—his own target."

A rising gold price would solve any number of problems, of course. Pierre Lassonde, co-founder, with Seymour Schulich, of the fabulously successful Franco-Nevada Mining Corp., was on hand last week for the annual BMO Capital Markets metals and mining conference in Hollywood, Fla. Peligal asked Lassonde how he read the investment mood of the attendees. "The question to all the portfolio managers that we see—we had 40 one-on-ones—was: In your resource fund or in your allocation, do you see money coming in, going out, or are you just stable?" Lassonde replied. "Apart from one fund who is seeing some money coming in—and it's a trickle, not a flood—everybody else is either seeing money leaving the sector or it's steady. It's maybe 50% money leaving the sector, and 50% stable. So what that tells me is that, overall, money is still leaving the sector. Therefore, the valuations are going to remain challenged until we start to see money coming back in. Then the question is, 'When do you think you're going to see money coming back in?' And people say it's going to take a $1,400 an ounce gold price for people to even start to think about putting money back into the sector." Maybe the conference-goers are reading Goldman Sachs' research. Analysts at Thornton's alma mater are forecasting year-end 2015 and year-end 2016 gold prices of $1,190 and $1,000 an ounce, respectively.

Though powerless over the gold price, Thornton is master of the Barrick corporate culture. Time was, only three of the top 20 executives owned a single share of ABX (with the remaining three holding among them a grand total of 60,000 shares). Thornton or his family own one million shares, including 400,000 that the chairman bought in December. Under changes he's put in place, the top 35 Barrick executives will draw most of their long-term compensation, if earned, in Barrick stock, which they may not sell until they retire or resign. Over the past year, the headquarters staff was culled by almost half. A "partnership culture" is the new clarion call. "Along with managing financial capital," says the fourth-quarter release, "managing our talent is a central responsibility of Barrick's leaders. Attracting, retaining and developing exceptional people is a fundamental component of our partnership culture."

You don't value a gold company on the quality of its press releases, naturally. By what criteria *do* you try to set a value on a business like Barrick? Jorge Beristain, Deutsche Bank metals and mining analyst, calculates a rough-hewn net present value, or NPV, of Barrick based on gold prices of $1,000, $1,200 and $1,400. The answers turn out to be minus $6.64, $4.75, and $16.13 per common share, respectively. Underscore "rough-hewn." At $1,000 an ounce, management would shut down high-cost assets (a response for which the discounted cash flow model makes no allowance). Nor does a simple net present value protocol allow for the possibility of asset sales or third-party capital infusions at a premium to book value per share. "Lastly," Beristain advises by e-mail, "gold [stocks] did historically trade @ 2x NPV or higher during most of the 1980-2010 period, so even at a reduced NPV at a (temporarily) low gold price does not mean that investors will necessarily trade the stock in lock-step with a highly fluctuating NPV."

"Here's my personal view on gold stocks," Doug Groh, co-portfolio manager of the Tocqueville Gold Fund, chimes in. "If you value gold stocks at current prices, a model would likely imply they are fairly to slightly overvalued and you really wouldn't want to own a gold stock based on spot prices. You can buy gold if you want the spot price exposure and avoid the mining equity risk. The reason to own a gold-mining stock is because you think gold prices are going higher. And here's the important part—that equity ownership gives you multiple ways to leverage up exposure to a rising gold price. It's not just price/margin leverage exposure to a mining operation—higher prices, greater profits—but gold stock ownership provides asset value leverage. The gold assets, such as ore deposits, become more valuable at higher prices. The marginal ores become more economic and profitable at higher prices. And a gold mining company may even make a gold discovery, too. So one should think about how exposure to a gold mining equity offers not just exposure to a rising gold price, but levered and accentuated exposure to a potentially more valuable business."

"The worst house on the best block," is the time-honored formula for success in residential real estate investment. To us, Barrick is the worst big house on the best monetary block. It is the gold company with the greatest gap between bearish back story and bullish front story. To Thornton, it falls not only to infuse a bureaucracy with entrepreneurial esprit. The more tangible job is to solve a host of operational problems.

Bullish as we are on the metal that Barrick mines, and as bearish the world is on Barrick, this publication would naturally take a shine to ABX. We're the more bullish on account of Thornton's well-advertised connections to the highest reaches of the Chinese government. Put yourself in the shoes of the People's Bank. You have international ambitions for the renminbi. You have worries about the dollar. You want to secure gold in bulk at the cheapest possible price, and you covet Barrick's reserve base.

We can visualize the headline: "Ex-Goldman banker pulls off gold deal of the century." Thornton would be that banker. Barrick would be the seller. A Chinese entity to be named in the fullness of time would be the buyer. Barrick shareholders would be the winners. Stranger things have happened.

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