

STOCK OF THE WEEK



The stock's recent surge towards all time highs appears to be a product of both strength in the gold price and improving company specific fundamentals

By Tim Morris | 29.06.2009

Stock: Kingsgate Consolidated Ltd

Code: KCN

Market Cap: \$605m

Recommendation: Buy

When it comes to views on the gold price, the middle ground is a fairly quiet place to be at the moment. Fence sitters are few in number. Instead the field is dominated by chronic gold bulls, often termed 'gold bugs', and more bearish investors who believe that after shining brightly in 2008, gold's lustre is bound to fade as we enter an economic recovery. With the heavy weather now starting to abate, gold remains stubbornly close to record highs. The share price of Thai based gold producer Kingsgate Consolidated is also testing this important milestone. Do the two share a close bond? Or have Kingsgate's good fortunes been driven by company specific factors?

Kingsgate is a classic example of the dream that many prospectors hope to follow. Having listed as an exploration 'tiddler' in 1988, the company spent several hard years turning rocks before a gold discovery in Thailand released it from the market's penny dreadful doldrums in the mid 90's. This discovery later became the Chatree gold mine. Commissioned in 2001, the mine has now been producing for 7 years. During 2007 and 2008 production started to wane on the back of lower gold grades. The original Chatree mine was being exhausted and the company was aiming to develop known mineralisation on ungranted leases to the north.

Uncertainty over whether these additional mining leases would be granted created considerable anxiety for the stock during 2007-08. However this burden was lifted following official grant of the 'Chatree North' mining tenements in mid 2008, which secured Kingsgate a fresh "lease" of life.

The higher grade ore from Chatree North has allowed production to head back towards full capacity and the company is on track to produce 150,000oz in 2009. Cash costs are currently below \$US400/oz, which provides for strong margins at current gold prices. But how long will the party last? Is mining at Chatree North set to go down a similar path to the original Chatree mine? Current reserves stand at 1.4million oz, which implies a mine life of 7-10 years. Ongoing drilling aims to increase the resource base, but we're heartened by the company's ambitions to expand its Chatree processing plant. Kingsgate aims to double its capacity, a plan unlikely to have been tabled if management weren't confident in the riches that lay beneath their freshly acquired acreage. A doubling of the company's production profile could deliver a very welcome boost to potential earnings.

Therefore we suspect an update on the proposed expansion over the coming months could be good news for the share price. On the other side of the fence, bears argue that increased political risk should be factored into the stock given issues in securing new leases over recent years. Thailand hasn't exactly been a sea of tranquillity lately, so we would consider that a fair call. The pessimists would also argue that the stock is 'overbought' near the top of a well established trading range, at risk of any weakness in the gold price. Being an unhedged producer, the yellow metal is likely to be the X factor driving Kingsgate's performance, however investors should bear in mind that it creates both up and downside risks.

The stock's recent surge towards all time highs appears to be a product of both strength in the gold price and improving company specific fundamentals – but we think there could be more upside in store. Technically, although the stock is near the top of its trading range, we feel it could be warming up for another phase of growth similar to that seen in 2002 and 2005. The underlying fundamentals are in agreement and we expect its plans to expand production and ongoing exploration success to drive a re rating. Therefore we have recommended our clients buy into the stock.

Tim Morris is an analyst at wise-owl.com, one of Australia's leading independent stockmarket research houses.