



TDV Trade Alert - Goldcorp Earnings Play

Kashyap Sriram, Junior Analyst

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>> Buy Goldcorp (GG) November 2, 2018 \$10 puts at 16 cents or better

Idea in a nutshell: Goldcorp is releasing its Q3 results after market close today. The consensus EPS is negative 3 cents, I think the net loss is going to be larger than anticipated due to troubles at their biggest mine.

Goldcorp had a string of 7 profitable quarters from Q3 2016 to Q1 2018, attributable mostly to the massive \$4.9 billion impairment charge they took in 2015 (over half its current market cap) and the recovery in gold prices that started in early 2016. That ended in Q2, when they surprised the market with a \$131 million net loss, or 15 cents per share, when the consensus estimate called for a profit of 7 cents per share. The reasons given were:

- (1) an increase in deferred tax expense arising from currency devaluations, particularly in Argentina
- (2) lower sales volumes at Peñasquito, and
- (3) income tax expense of \$156 million impacted primarily by currency translations

In other words, they blamed the dollar strength and operational adjustments at their largest mine. One would assume a rising dollar is great for their operations, since their operating costs are in the local currency, but apparently this isn't so for Goldcorp. Their production costs at continuing operations actually went up by 2.5% compared to Q2 2017. The dollar has been even stronger in Q3, setting the stage for an even bigger Q3 losses.

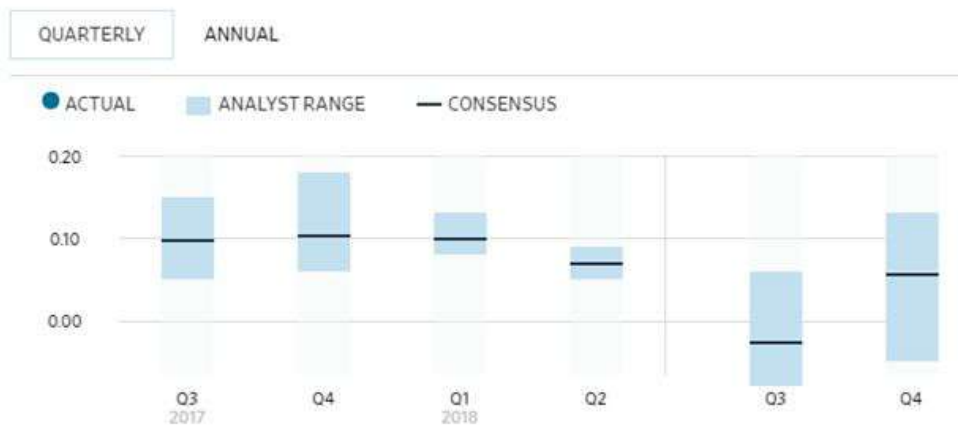
However, the market has probably priced that in. What's not priced in is this little tidbit from the Q2 conference call on Peñasquito:

With the commissioning schedule of the pyrite leach project accelerated into the third quarter, the production plan for the third quarter has been modified, lower than planned mill throughput and low mill head grades, which we expect to range between 0.2 and 0.25 for the quarter. These low grade stockpiles are the preferred material to be processing during the commissioning phase, where we do expect lower recoveries and throughput.

In other words, expect even lower production and at higher costs, but it's all planned. Things will improve in 2019. This isn't a one-time occurrence. In their 2017 guidance, they commented that production is expected to decrease compared to 2016, as a result of lower overall grades as the high-grade zone depletes. Management always appends the word "planned" while reporting any negative operational results, but guidance of such "plans" is left out of prior quarters' reports.

Goldcorp management has a history of throwing negative surprises at investors. After stressing that they are only interested in their internal pipeline of projects, and they definitely will not make any acquisitions, they acquired Kaminak Gold and Exeter Resources. They proclaimed that they have achieved \$250 million in annual cost efficiencies across their mine sites, but production costs at their 7 main operating mines in H1 2018 are actually up \$30 million compared to H1 2017.

Per-Share Earnings, Actuals & Estimates Goldcorp Inc.



GG will report Q3 earnings on 10/24/2018

Q3 2018 Estimate Trends

Current:	\$-0.03
1 month ago:	\$0.06
3 months ago:	\$0.10

Q4 2018 Estimate Trends

Current:	\$0.06
1 month ago:	\$0.10
3 months ago:	\$0.11

Three months ago, the Q3 consensus was an EPS of 10 cents. The current consensus is a 3 cent loss. I think the loss is going to be even bigger than anticipated, and is going to take investors by surprise.

The Risks

The second-half of the year is traditionally stronger for miners than the first half. Maybe the Q2 loss is an aberration in their return to profitability and not the start of a new trend. Maybe the dollar strength will be beneficial to their operating costs this quarter, and the effect of the \$250 million in annual cost efficiencies which they are supposed to have achieved will show up in Q3. Or the market has already priced in everything I am expecting and the shares are going to move with gold regardless of the quarterly results.

Note: Goldcorp is still a buy in the long-term stock portfolio. The above trade is meant as a hedge or a method to profit from a potential earnings surprise.

Kashyap Sriram

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