HAS BARRICK BEEN BARRICKED BY THE U.S.?

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According to an announcement dated September 8, 2009, Barrick is going to throw into the dustbin its long-standing hedge policy, and pay for buying back its hedge-book by diluting the value of its common stocks through issuing more than 81 million new shares, or about 10 percent of the outstanding. The so-called hedges of Barrick have been thoroughly discredited and will soon be history. So-called, because the long-term forward sales contracts in question that the parvenu gold miner has invented and flaunted are not proper hedges and never have been. They are a fraud. They are naked short positions pretending to be balanced by gold ore reserves in the moon (or on this earth which, for hedging purposes, is practically the same thing). Part of the newsworthy story, of course, is the fact that the hedge book of Barrick has been increasingly under water for some nine years now, threatening the unfriendly giant with drowning.

Within 24 hours another hasty announcement was made to the effect that the company, instead of issuing 81 million new shares, will in fact issue 94.4 million, that may be raised to 109 million if the demand justifies it, for a total value of $4 billion — the biggest primary equity offering in Canadian history according to the local media. The hike was explained by “strong investor demand”. The market, however, put a big question mark to that “forward-looking statement” of the company in marking down Barrick shares 6.85% on the same day to $36.61, the greatest percentage loss among the leading gold mining shares on the day. Incidentally, in doing this *the market has put a lower value on the Barrick stock* than the company did. Barrick is offering its new issue at the price of $36.95 per share.

The $1.9 billion that Barrick is hoping to raise through this dilution maneuver to eliminate all of its fixed-price gold contracts falls far short of its goal of buying back its hedges. The liability represented by Barrick’s once flaunted forward sale contracts has been carried *off balance sheet* so far. These fixed-price gold contracts have a *negative value* of $5.6 billion, that will be charged to earnings in the third quarter. This negative value will almost certainly increase during the next 12-month period Barrick gave itself to get out of the quicksand. The announcement itself is a virtual guarantee of that: Barrick will have to compete in the gold market with China, Russia, India, Brazil, and other countries (not to mention other gold mines in dire need to de-hedge) for a diminishing amount of gold available for cash delivery, to the tune of 9.5 million ounces in today’s strained gold markets.

The big unknown question is whether Barrick will be able to buy back its hedges fast enough to stop the continuing hemorrhage. Barrick is racing against the clock. Gold is still available for cash delivery, but in what quantities? and for how long? 9.5 million ounces is an awful lot of gold to buy in today’s anemic gold markets with supplies drying up fast. With the threat of the last contango and of permanent backwardation hanging overhead like Damocles’ sword, Barrick’s plan appears to be a pipe dream that will never be fulfilled. I may be in a minority of one on this one, but Barrick's future is anything but rosy. 9.5 million ounces is a lot more gold than Barrick is able to produce in an entire year in the best of circumstances. Even if Barrick were to sell not one ounce of gold in the open market for a whole year, but deliver every ounce it extracts from the bowels of the earth to its hedge books, and even if we accept the most optimistic assumptions of the company to increase its annual production as realistic, there is still a shortfall of at least 1.5 million ounces. I submit that Barrick could not survive if it was to suspend its sales of new gold in the open market for a whole year, while facing the extra cost of forcing up production quotas. No lender in its right mind would finance such a crazy plan. Creditors of Barrick would be all too happy to put the unfriendly giant on the block, and sell Barrick's stellar resources to the highest bidders, who would be able to manage them in a saner and more responsible manner than present managers have. Barrick's managers were given the right advice twelve years ago that, at the end of the road they have chosen, lies ruin and misery. They had all the time to change course. But even at the last major announcement on "hedging" in 2006, when Barrick announced its new policy to lift a part of its hedges, the then CEO Greg Wilkins said at the Annual Shareholders Meeting that Barrick will *always* retain 'a reasonable' amount of hedges as an 'essential risk-management tool'. According to Wilkins, it is supposed to 'stabilize' revenues, and it is supposed to satisfy banks that finance Barrick's projects.

Two years ago I issued a public challenge to the management of Barrick in my piece "*Have Gold Bugs Been Barricked by the U.S.?*" (see References below) as follows.

> **I demand an answer why Barrick ignored my recommendation in 1997 which I personally presented to the then CFO Jamie Sokalsky. During those ten years my worst fears have materialized. It turned out that the "hedging" policy of the company was, as I had stated, deeply flawed. It was an unmitigated disaster of the first magnitude. It resulted in horrendous losses to shareholders. It is not clear why Jamie Sokalsky, widely rumored to be the author of Barrick's "hedge plan", got rewarded with a promotion for executing a disastrous policy, and why his new boss Greg Wilkins has stated in public that the company is standing by its original hedging policy, albeit on a reduced scale. I categorically state that Jamie Sokalsky had been thoroughly familiar with the alternative, what I called the correct principles of hedging. He and I discussed the subject together at great length, and he received from me a Memorandum that spelled it all out. This Memorandum found its way into the book of the late Ferdinand Lips entitled *Gold Wars* and can be seen there by any interested party.**

I am disclosing it now for the first time that Barrick has ignored my challenge. Yet, as its announcement of September 8 last proves, I was right all along. The "hedging" policy of Barrick was so obviously insane, so much in conflict with any common business sense, that it invited extensive speculation that Barrick was not really a profit-seeking business. It was just a front set up and operated by the U.S. (and/or by other governments) in order to cap the gold price. In other words, Barrick has been a partner to the greatest conspiracy in all history: to throw dust into the eyes of the investing community making it believe the gold demonetization fable. If the conspiracy theory is true, then the linchpin to cap the gold price has been Barrick's hedging policy. By aggressively selling gold forward at the expense of the shareholders, the gold price could be kept in perpetual check — or so the script went. Just make Barrick the world's Number One gold producer, its hedging policy will frighten the daylight out of any bullish speculator in gold. And we might as well admit that the conspiracy has been rather successful, in so far as conspiracies can ever be successful.

In the article quoted above I made it clear that I was not a subscriber to the conspiracy theory, although I reserved my right to change this opinion pending future evidence as they become available. A major piece of evidence has just surfaced. Barrick has unceremoniously discarded its long-cherished hedging policy, paying a heavy price in dragging the underwater hedges into its badly punctured balance sheet that was no longer fooling anyone, and in having to dilute the value of its outstanding shares.

Have I changed my mind about the validity of the conspiracy theory? Is it not an appealing interpretation that a decision made by policymakers in the U.S. Treasury and the Federal Reserve deemed that the cost of maintaining the gold cap at $1,000 is becoming too high? The cap can no longer be defended in view of the world's global credit crisis. Subsequently Barrick was to be dumped and let to fend for itself in the rough waters after the sinking of SS. Lehman. Barrick has received what it has so richly deserved: it has been barricked by its partner in crime.

The supreme irony of this scenario would be hard to escape. This would not be the first time that a creature of Peter Munk has been barricked by a government. There are some older guys around still, like myself, who remember how the government of the Canadian province of Nova Scotia has barricked Munk's top line radio and hi-fi console manufacturing business. At that time Peter Munk swore that he would never ever again accept a government subsidy, nor would he participate in a conspiracy involving governments. It is all related in Peter Munk's approved biography in great detail (see References below).

Every business initiative of Peter Munk has ended as a fiasco and he went bankrupt in consequence. After his radio and hi-fi business shipwrecked on the rocky coast of Nova Scotia, his real estate enterprise in Egypt failed where he was to build luxury hotels in the shadow of the great pyramids. His dabbling in oil fared no better. Rumors have it that he also financed a franchise in Israel of Colonel Sanders' and his boys to make pork chops "finger-lickin' good" — that failed, too, although this could not be confirmed.

After an unbroken series of business failures Peter Munk has come to gold. Would gold be kinder to him? There is hardly anybody alive who could appreciate gold's value better than he would. He owes his Holocaust survival to gold that was paid by his father to Eichmann through Swiss intercession for their free passage from Hungary to Switzerland in 1944. Yet there is probably no one in the long line of failed gold mining executives who misconstrued gold more thoroughly than Peter Munk has. Conspiracy or no conspiracy, Peter Munk is an inveterate believer in the power of the U.S. government to manipulate the price of gold. That is the secret of his downfall. Peter Munk's gold business is no better than his other businesses have been, only bigger.

I am still not committed to the conspiracy theory according to which Barrick has allowed itself to be used by policymakers in the U.S. to cap the price of gold, although I must admit that the circumstantial evidence has become a notch more circumstantial with this latest announcement. To me it looks like the desperation of a passenger aboard the sinking Titanic who has lost his life saver. I base my judgment on the timing. To make such an announcement at a time when the gold price is challenging the $1000 level is a miscalculation of Babelian proportions, not to say a suicidal dash to the exit. All this time was wasted, while the gold price was under pressure, when exactly the same announcement would have been helpful to Barrick — as it has to Newmont. It is too late now. I do not see how Barrick can remain a viable business entity once it has lost its tether, real or imagined, tying it to the U.S. Treasury. My sympathy is with the shareholders of Barrick, who are going to fare no better than those of Lehmann Brothers. What people do not seem to understand is that gold locked up in ore is one thing, and gold locked up in vaults is another. There are times, such as now, when their values part company. Why? Because too many gold mines are just a conduit to make the shareholder and his money part company. Remember Mark Twain having said that a gold mine is a hole in the ground with a liar standing guard? Remember Bre-X? It is so much easier to fool people than doing the back-breaking work of bringing up gold locked in the ores deep underground.

Aaron Regent, the new President and CEO of Barrick, commented on the company's announcement as follows:

> "The gold hedge-book has been a particular concern among our shareholders and the broader market which we believe has obscured the many positive developments within the company. As a result of today's decision we have addressed that concern and maintained our financial flexibility. With the industry's largest production and reserves, Barrick provides exceptional leverage to the gold price, which we expect will be further enhanced as we build our new generation of low-cost mines."

But leverage works both ways. In the case of Barrick it has always worked the other way. Mr. Regent sounds as if the troubles of Barrick were now over as management has finally decided to bite the bullet. They are not. The agony will last until the last vestiges of the nightmare of "hedging" will be erased. Even in the optimistic appraisal of management it will take at least one year. In reality, it will take much longer, as ever higher gold prices will frustrate efforts to close the hedge-book for once and all. The fact is that the wolf is at the door and refuses to leave. The problem of the hedge-book will keep resurfacing, until everybody will understand that it is unmanageable. The cat is chasing its own tail.

The job cut out for Barrick is the job of Sysiphus. He was a king who betrayed Zeus' secrets. As a punishment he was confined to Tartarus and made to roll up a boulder to the top of the mountain only to see it falling back, and his travail would start all over again.

When everybody sees Barrick as the latter-day Sysiphus, the company will give up the ghost, and the cheerful creditors will happily carve up the rich caracass, with former shareholders looking on in dismay.

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See also: http://american _almanac.tripod.com/bushgold.htm

September 9, 2009

Calendar of Events

University House, Australian National University, Canberra: first week of November, 2009
Peace and Progress through Prosperity: Gold Standard in the 21st Century
This is the first conference organized by the newly formed Gold Standard Institute.
For further information, e-mail: feketeaustralia@gmail.com ,
On the Gold Standard Institute, e-mail philipbarton@goldstandardinstitute.com
Martineum Academy, Szombathely, Hungary, in March 2010.
Stay tuned for further announcement.

Professor Fekete on DVD: Professionally produced DVD recording of the address before the Economic Club of San Francisco on November 4, 2008, entitled *The Revisionist History of the Great Depression: Can It Happen Again?* plus an interview with Professor Fekete. It is available from www.Amazon.com and from the Club www.economicclubsf.com at $14.95 each.

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