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Kirkland Lake Gold: Gearing Up For Significant Growth At Macassa

Sep. 27, 2021 6:07 AM ET | **Kirkland Lake Gold Ltd. (KL)** | 2 Comments | 2 Likes

Summary

- Kirkland Lake Gold is one of the best-performing gold stocks this year, up 3% year-to-date vs. a double-digit decline in the Gold Miners Index.
- While all eyes continue to be on the company's previous breadwinner, Fosterville, Macassa is one of the most impressive mines globally, not getting nearly enough attention relative to Fosterville.
- This is especially true, given that we're nearing the final stretch for completion of the #4 Shaft Project, set to take the governor off the operation, and no longer mine-constrained.
- Given Kirkland Lake's position as the lowest-cost senior producer in the sector with meaningful growth at two of three assets, I continue to see the stock as a Buy on weakness.

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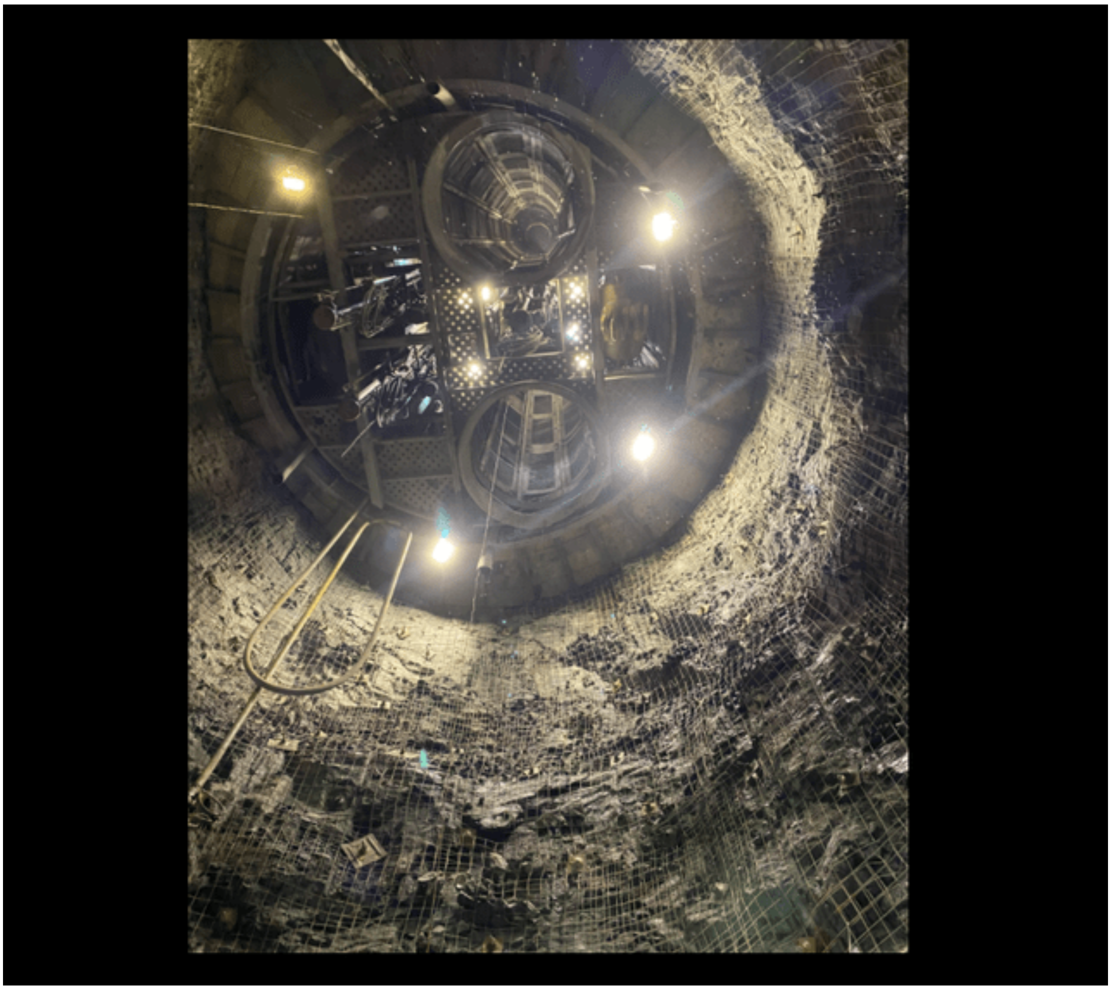
It's been a tough 13-month stretch for the Gold Miners Index (NYSEARCA:GDX), with the ETF down more than 30%, and many producers sliding as much as 50%. Kirkland Lake Gold (NYSE:KL) has been a rare sanctuary during the carnage this year, up nearly 5% on a total return basis vs. a 17% decline for the GDX. This outperformance is likely attributed to a massive increase in reserves at its Detour Lake Mine, the company tracking ahead of guidance, and meaningful output growth next year at Macassa. However, while Fosterville gets all the attention, Macassa is an incredible asset, and it's now gearing up for significant growth. Given Kirkland Lake's position as the lowest-cost senior producer in the sector with meaningful growth at two of three assets, I continue to see the stock as a Buy on weakness.



(Source: Company Website)

All eyes have been on Fosterville over the past year, with many anxiously awaiting new high-grade results from the asset, worried that a decline in Fosterville production would spell trouble for the million-ounce producer. This is because the Australian mine was Kirkland Lake's breadwinner over the past few years, with peak production of ~640,500 ounces in FY20202 at all-in sustaining costs [AISC] below $325/oz. However, after years of extracting the low-hanging fruit (highest grades) from the mine, Kirkland Lake chose to "right-size" the asset, moving to a lower grade profile, resulting in output guidance of ~425,000 ounces in FY2021 and closer to 400,000 ounces at the high-end of guidance in FY2022 and FY2023. This decision was the right move to allow the asset time to bolster the asset's reserve base. Still, it spooked many investors with the assumption that Kirkland Lake would become a high-cost producer without the benefit of Fosterville.

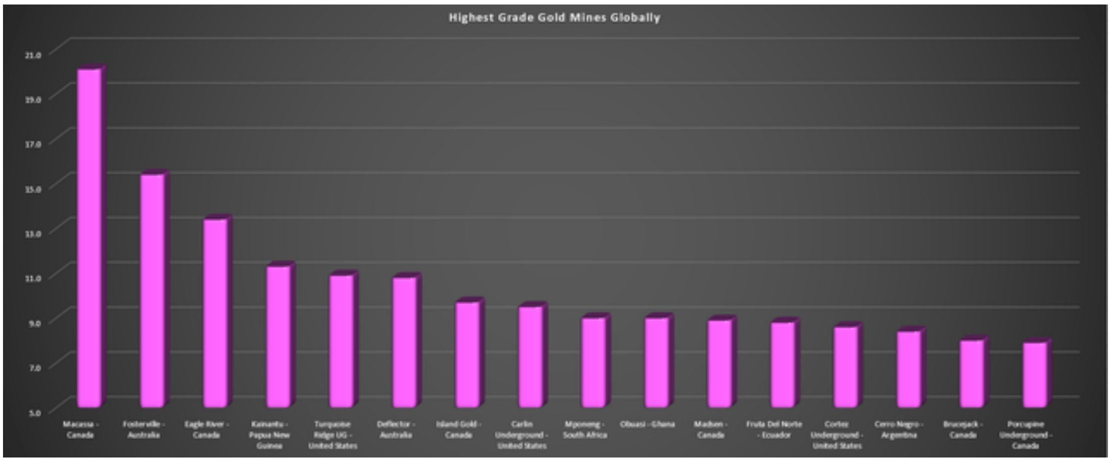
It's quite clear from the 2021 Detour Life Of Mine Plan that Detour is not a high-cost asset at all, despite its grades, with projected AISC of less than $800/oz over the next five years. Meanwhile, Kirkland Lake's other mine, Macassa, is the highest-grade gold mine globally and receives zero attention, with Fosterville stealing all the spotlight. So, while some might still believe that Kirkland Lake Gold is not the same company since the Fosterville right-sizing, I would argue that it's actually a much better company, with a more diversified asset base (3 mines, not 2), with ownership of two of the highest-grade gold mines globally, and the ability to churn out well above 1.0 million ounces of gold per year without reliance on ounce-per-tonne material, which is obviously not sustainable. Let's take a closer look at Macassa below:

Table 6-1: Historical production (1933 to 2018).

Decade of Production	Tons (000s)	Grade (oz/st)
1930's	564	0.49
1940's	1,087	0.45
1950's	1,440	0.40
1960's	1,290	0.48
1970's	943	0.56
1980's	1,314	0.49
1990's	1,294	0.46
2000's	859	0.36
2010's (to date)	2,902	0.42
Total	11,693	0.45
Period of Production	**Tons (000s)**	**Grade (oz/st)**
2010-2014	1,325	0.35
2015	370	0.43
2016	365	0.46
2017	451	0.44
2018	391	0.63
Total	2,902	0.45

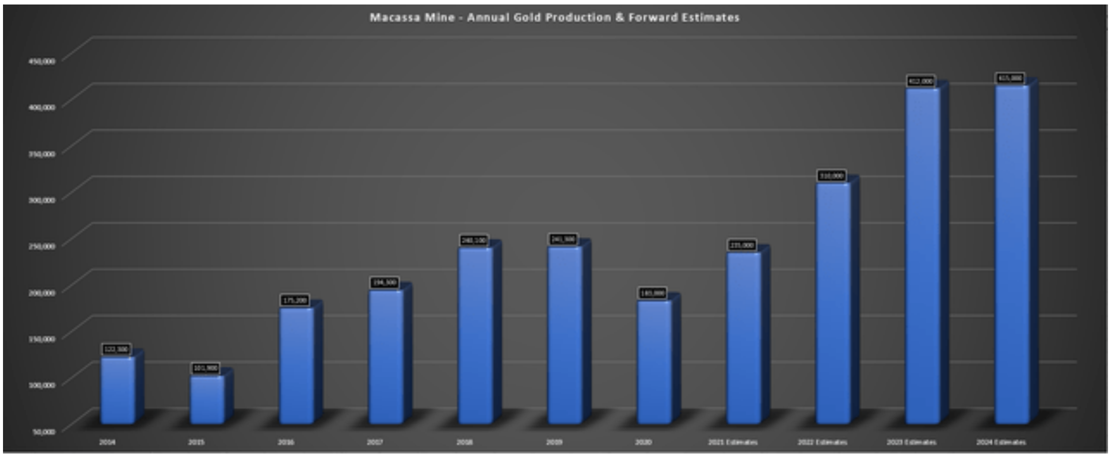
(Source: Company Technical Report)

Before digging into Macassa today, it's worth looking at the mine's rich history, with production extending back nearly a century to 1933. For those unfamiliar, operations began nearly 90 years ago, with the mine producing over 5.5 million ounces at a grade of half an ounce per tonne over the past 88 years. The asset was purchased (mine & plant) for a song in 2001 by Foxpoint, which was later renamed Kirkland Lake Gold, for just $5 million, plus a $2 million reclamation bond. This acquisition was completed after the mine was offline for two years due to low gold prices, with the outstanding gold grades at Macassa shown above. As the chart below shows, even after nearly 90 years of mine production, Macassa is the highest-grade gold mine globally by reserve grade, yet the asset receives little praise. This may be due to its higher cost base than Fosterville and its smaller production profile, but as will be explained, this is about to change.



(Source: Company Filings, Author's Chart)

Just over three years ago, Kirkland Lake announced plans for a new shaft at its Macassa Mine (#4 Shaft), designed to improve ventilation, allow for more effective exploration east of the South Mine Complex [SMC] and also take the governor off the operation. This is because the new shaft has a hoisting capacity of 4,000 tonnes per day vs. ~2,200 tonnes per day for Shaft #3 or nearly double the capacity. The completion of the #4 Shaft Project in H2 2022 (less than 12 months away) will allow Kirkland Lake Gold to fill its ~2,000 tonne-per-day mill at Macassa, which up until now, has been operating at less than 60% of full capacity. With mine production increasing to more than ~722,000 tonnes per annum to fill this mill, production is expected to soar, with a compound annual production growth rate of ~14.6% vs. FY2019 levels, or total growth of more than 70%. Let's take a closer look below:



(Source: Company Filings, Author's Chart)

As the chart above shows, Kirkland Lake Gold has guided for production of ~412,000 ounces at the mid-point in FY2023 and ~310,000 ounces next year, translating to ~29% growth next year and ~70% growth looking out to FY2023. This is set to transform Macassa from an asset that has barely contributed to Kirkland Lake Gold's production profile (post-Detour acquisition) to a mine that will be a massive contributor and the same size, if not larger than Fosterville. Importantly, this massive increase in annual output is expected to pull costs down from $721/oz in FY2019. In fact, Macassa's all-in sustaining costs were expected to average $537/oz from 2020 to 2027, ranging from $375/oz to $675/oz. So, once Macassa's #4 Shaft Project is complete (beginning Q3 2023), we should see the mine's all-in sustaining costs below $600/oz and closer to $550/oz.

I have used more conservative figures for costs post Shaft #4 Project, given this is a 2-year old report (July 2019). I have used FY2019 figures to discuss the growth rates above, given that FY2020 figures were impacted by FY2020 and less comparable. Relative to FY2020 levels, Macassa will see 125% growth in production looking out to FY2023.

UNIT COSTS		
Per tonne ($/tonne)		
Mine (per tonne drawn)	$	235
Mill (per tonne milled)	$	41
Site Admin (avg mine and milled tonne)	$	28
Operating Cost (avg mine and milled tonne)	$	313
Per Ounce (CAD $/ounce sold)		
Cash Cost (per ounce sold)	$	522
AISC	$	714
Per Ounce (US $/ounce sold)		
Cash Cost (per ounce sold)	$	392
AISC	$	537

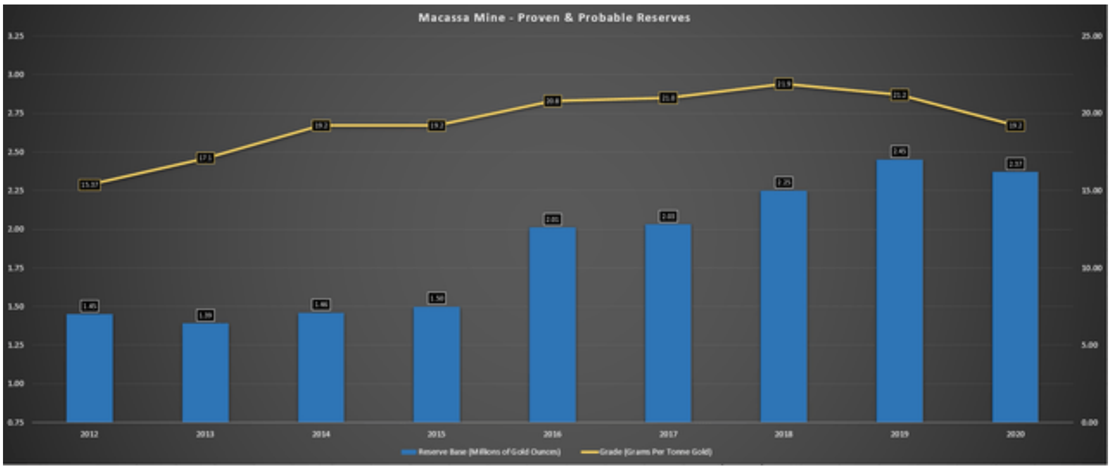
(Source: Company Technical Report)

Based on a conservative gold price of $1,700/oz, this will boost Macassa's margins from sub 50% in FY2019 ($722/oz costs vs. $1,405/oz gold price) to more than 70% in FY2023 ($580/oz estimate vs. $1,700/oz gold price). So, while Fosterville should see higher costs in FY2023 with production in the ~375,000-ounce range unless Kirkland Lake meets the high end of guidance (400,000 ounces), Macassa is going to pick up the slack. At the same time, Detour Lake's costs are expected to drop consistently from ~$1,000/oz to below $800/oz, with optimization work ongoing and the mill ramping up towards a goal of 28 million tonnes per annum.

As should be clear by now, all the groans about a Fosterville slowdown hurting the Kirkland Lake Gold investment case were overblown. This is because Fosterville's increased costs are being offset by a 20% dip in costs at Macassa and a more than 20% decline in costs at Detour Lake. Therefore, Kirkland Lake Gold should maintain its position as the lowest-cost producer in the sector in FY2023 through FY2025, with costs at or below $800/oz. This is supported by 1.1 to 1.2 million ounces per annum being produced at Macassa and Detour coming in at below $800/oz. Combined with a Tier-1 jurisdiction profile (Canada/Australia) and one of the only mines in the sector with close to a 30-year mine life based on reserves (projected in 2022 Detour LOMP), Kirkland Lake Gold continues to be one of a kind.

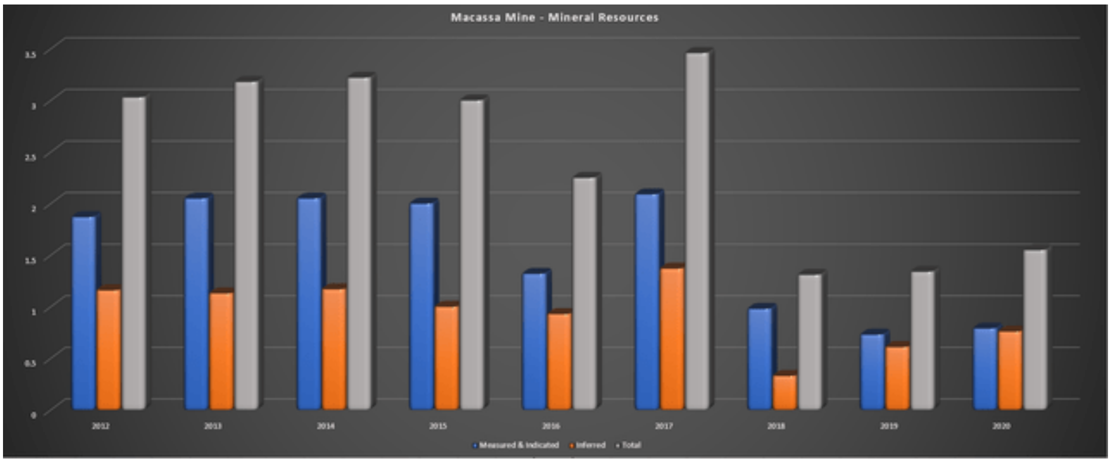
So, what about reserves at Macassa?

As shown in the chart below, Macassa's reserves currently stand at ~2.28 million ounces of ultra high-grade material (20.1 grams per tonne gold), with a total of ~2.37 million ounces of gold, including near-surface material (86,000 ounces at 8.7 grams per tonne gold). This translates to just ~6 years of production at the new ~412,000-ounce per annum run rate, but it's important to note the trend in reserves over the past decade. As was the point in constructing this chart and the history earlier on the asset, Macassa has doubled its reserve base after depletion since 2012, despite almost no increase in its gold price assumption (2013: $1,200/oz, 2021: $1,300/oz). Therefore, this reserve growth has come at the drill bit and from new discoveries, not from adjusting gold prices, as some producers do, to cover up depletion in the reserve base. In fact, despite more than 1.5 million ounces produced since 2007, the reserve has increased by more than 1000%, from less than 200,000 ounces of gold at ~19.3 grams per tonne to ~2.37 million ounces at 19.2 grams per tonne gold. Excluding near-surface material, which dilutes the average grade, reserve grades are actually up, at 20.1 grams per tonne gold.



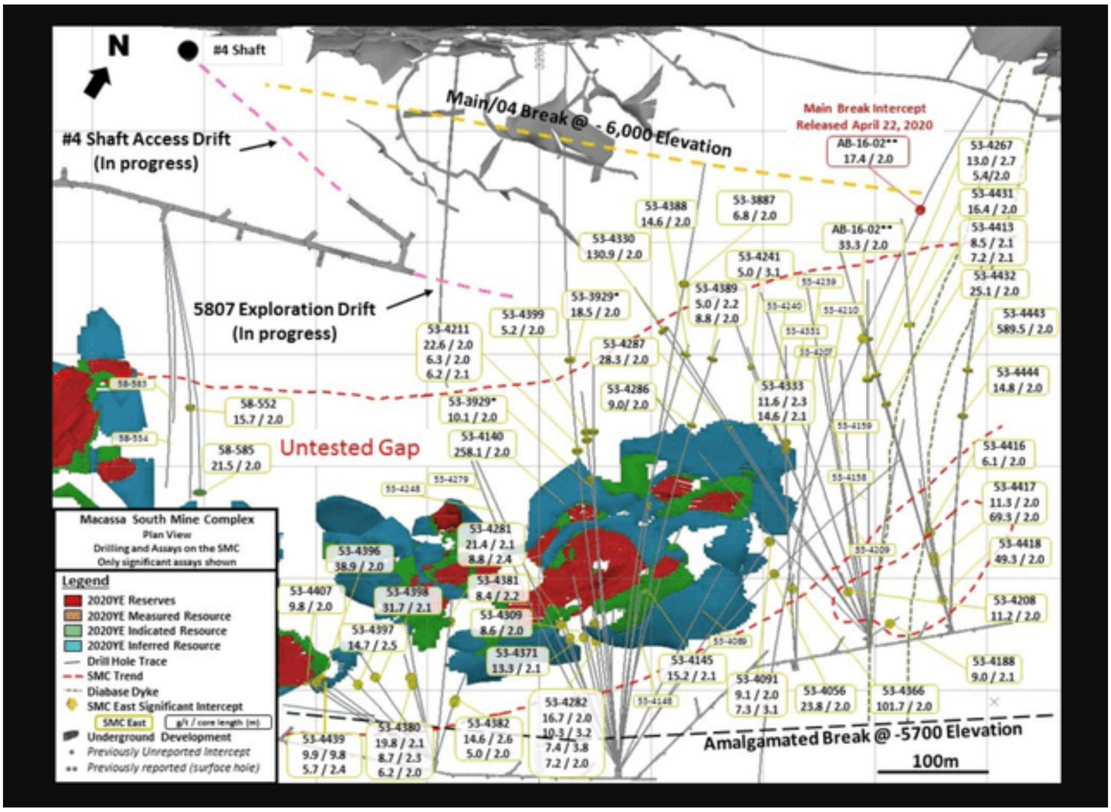
(Source: Company Filings, Author's Chart)

Meanwhile, it's important to note that Macassa has another ~1.5 million ounces of gold exclusive from reserves that backs up this ~2.3 million ounce reserve base. This is shown in the chart below, with Macassa currently home to ~790,000 ounces of measured & indicated resources and another ~760,000 ounces of inferred resources. While this material is lower-grade (~15.0 grams per tonne gold), it's still very high-grade and would allow Macassa to maintain its position as one of the highest-grade gold mines globally. Therefore, there should be no worries about Macassa's reserve life. If we assume 80% conversion of M&I resources, and 65% conversion of inferred resources, this would add another ~1.07 million ounces to Macassa's reserve base. This would give the asset a reserve base of more than 3.4 million ounces of gold, or nearly ten years of mine life, assuming no reserves added net of depletion. As history has shown, reserves have always been replaced net of depletion.



(Source: Company Filings, Author's Chart)

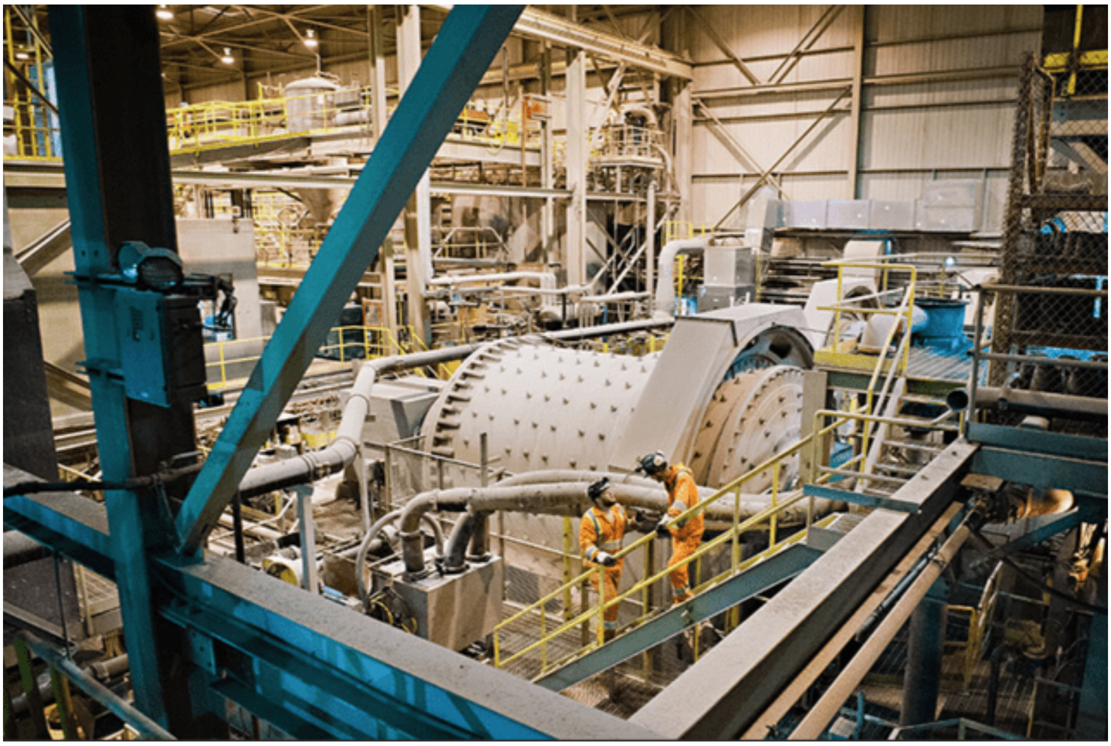
The other point worth mentioning about Macassa is that with the much lower costs expected from the #4 Shaft Project, Kirkland Lake Gold will be able to drill more effectively east of the SMC, and could also look at boosting resources with a slightly lower cut-off grade. The latter is possible due to the sharp decline in operating costs once #4 Shaft is complete, which would be a tailwind for resource growth. Currently, Kirkland Lake Gold uses a very conservative cut-off grade of 8.6 grams per tonne gold at 04' Break/Main Break, 5.1 grams per tonne gold at the South Mine Complex, and 3.4 grams per tonne gold for its near surface material at Macassa.



(Source: Company Presentation)

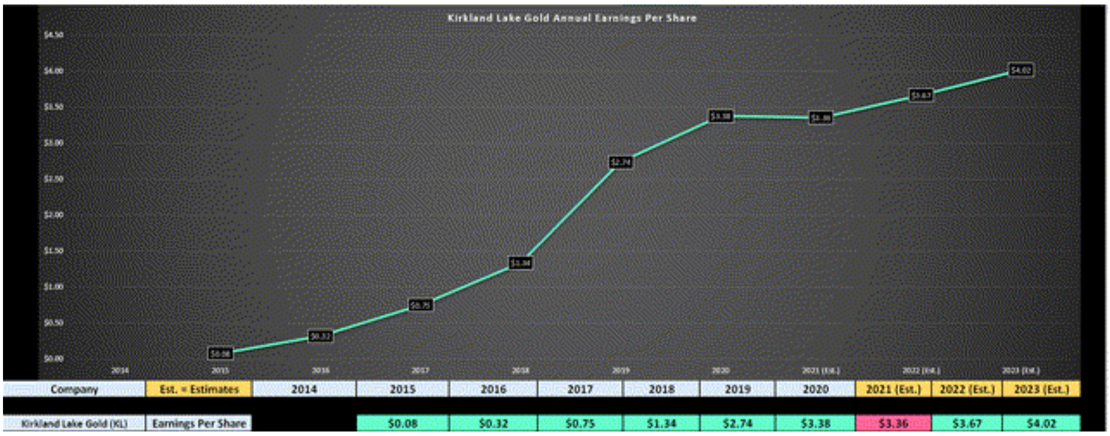
In terms of exploration, we can see that Kirkland Lake Gold has continued to announce impressive hits outside of its reserve and resource base, including intercepts like 2.0 meters of 101.7 grams per tonne gold, 2.0 meters of 49.3 grams per tonne gold, and 2.0 meters of 130.9 grams per tonne gold. Most recently, Kirkland Lake announced a blockbuster hole of 2.0 meters of 589.5 grams per tonne gold east of its reserves at SMC, with other hits that included 2.0 meters of 25.1, 16.4, and 14.8 grams per tonne gold, respectively. This points to meaningful resource and reserve growth, especially when we consider that this year's ~250,000-meter drill program is much larger than historical exploration programs at Macassa. In fact, with the significant cash flow generation from Detour following the acquisition, the company has never been in better shape.

This is because the added free cash flow from Detour Lake allows Kirkland Lake to easily fund up to $125 million in combined exploration per annum at its two high-grade assets (FV + MC) while still building up the balance sheet, paying dividends, and doing share buybacks. This increases the probability of making major discoveries, increases the probability of bolstering reserve bases to support 10-year mine lives consistently at these operations. It also affords the company excess capital to optimize these operations and improve its costs through technological improvements. In summary, the Detour Lake acquisition was brilliant, and it's significantly de-risked the Kirkland Lake investment case and arguably the best move we've seen made in the sector in years.



(Source: Company Technical Report)

Despite this material growth at Macassa, one of the sector's most aggressive exploration campaigns, and being the owner of the two highest-grade gold mines globally, Kirkland Lake Gold trades at a dirt-cheap valuation of less than 11x FY2023 annual EPS estimates. This is based on a current share price of $42.50 and FY2023 annual EPS estimates of $4.02. If we back out estimated year-end net cash of ~$1.05 billion ($4.05 per share based on ~259 million shares outstanding), Kirkland Lake trades at less than 10x FY2023 annual EPS estimates. This valuation might make sense for a producer with a $1,200/oz or higher cost profile, translating to sub ~30% margins at $1,700/oz gold, but Kirkland Lake's margins come in ~53% even at a $1,700/oz gold price. I would argue that a fair earnings multiple is 16, translating to a fair value of US$64.32 based on FY2023 estimates or an 18-month target price 50% higher than current levels.



(Source: YCharts.com, Author's Chart)

While some investors continue to be hung up on Fosterville, I don't see any reason to justify this pessimism, given that Kirkland Lake has two assets with massive growth on the horizon. If we combine this with the fact that Kirkland Lake Gold has made two of the best acquisitions in the past decade (Fosterville/Detour Lake), and has nearly cash that it could unleash to make another small-bolt on acquisition in th would argue that Kirkland Lake Gold is the most attractive producer in the especially true, given that it's defensive to gold price weakness, with its industry-leading margins. With the stock trading at less than 11x FY2023 earnings estimates, I continue to see the stock as very reasonably valued despite its outperformance, and I would view any weakness as a buying opportunity.

This article was written by

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