MineSearch .NET

News and commentary on the global minerals industry

Welcome to the introductory issue of MineSearch.net. This is a complimentary news digest and accompaniment to JsMineset.com, an online publication that is presently ranked among the leaders in its market segment. For the moment, Minesearch.net will only be available in PDF format. In the near future, it will be accessible as a fully-searchable web page with an active menu bar.

The mandate of Minesearch.net is to educate readers about the minerals industry, along with the market and economic factors that drive metal prices and the search for new production sources. We are not here to promote anything or anyone - especially listed entities. However, we will attempt to provide insights into metal-specific market trends and extraneous factors that impact commodity prices and your investment in a sector that will play a leading role in the industrialization of the developing world.

We invite questions from readers and will address ones of general interest in this column. However, we can not respond to individual questions by e-mail or any other means. Please e-mail your questions to: minesearcheditor@gmail.com

David K. Duval
Publisher/Editor

Mineral Commodities: Overbought and Oversold?

Metal prices have a reputation for being volatile but the speed of the recent downturn for key industrial commodities such as copper, nickel, zinc and lead is simply unprecedented. Nonetheless, so has the downturn in global equities markets where trillions of dollars have been shaved off the market caps of some of the world's biggest companies.

In the current maelstrom, gold has held up relatively well in the face of a stronger U.S. dollar. In fact, gold has risen to its highest level in years in Aussie and Canadian dollar terms along with the Euro. In the case of gold, however, the broader market sell-off has impacted share prices of producers and explorers alike, with the latter coming under increasing pressure as financing opportunities dry up and fixed project and related commitments deplete their corporate treasuries. For major companies and others with cash in the bank (or access to it) opportunities to acquire assets at fire sale prices have never been better.

In this particular market environment, emotion appears to be driving prices rather than fundamentals. And I would argue that this statement applies more to metal prices (which are usually driven by supply/demand fundamentals) than the equities market where the valuation methods that have driven stocks to such lofty levels make about as much sense as the complex structured products (derivatives) that got us into the current financial mess.

While metal prices obviously have a speculative component, good old fashioned supply and demand is the largest factor in pricing. In this metals commentary I'd like to use nickel as an example of what can happen when prices reach unsustainable levels. Nickel is used in the manufacture of stainless steel and as a hardener in steel production among other applications. Spot nickel prices are currently trading below $5 U.S. per pound which for most primary producers is well below the cost of production. This is certainly the case for most companies mining conventional sulphide ores and even more so for production from newly commissioned laterite (oxide or weathered ores) sources. With profit margins moving into negative territory, mine closures are inevitable which will tend to balance nickel supplies with demand. One significant mine closure was recently announced in Canada (First Nickel in Canada's Sudbury nickel belt) and more will likely follow. Nickel prices have been falling since the end of 2007 largely due to increasing nickel pig iron supplies and growing nickel production capacity, both of which can be attributed to nickel prices reaching record levels (almost $25 per pound 16 months ago).

In response to escalating prices, China developed a technology for processing low grade nickel ores to produce nickel pig iron, a potentially a long term supply source for the Chinese and global nickel industry. However, high production costs associated with this particular product are simply not sustainable so nickel prices will have to rise to ensure future production can meet demand. Clearly the market is heavily oversold and some form of equilibrium will arrive in the marketplace sooner than later.

One thing that caught my attention recently is the heavy trading in Companhia Vale Do Rio Doce (RIO) which has traded more than 80 million shares per day on several occasions. In addition to being the world's largest producer of iron ore pellets, Rio is also the world's second largest nickel producer, having bought Canada's Inco Ltd. for $18.9 billion approximately two years ago. The company recently announced a share buyback program that could see the acquisition of up to 69,944,380 common shares and up to 169,210,249 preferred class A shares, corresponding respectively to 5.5% and 8.5% of the free floating shares of each class. Rio is a well managed company that is betting the bull market for industrial commodities is not over - a strategy I personally wouldn't bet against.

"Look at market fluctuations as your friend rather than your enemy; profit from folly rather than participate in it."

Warren Buffett

Questions and Answers

David,

I thought gold prices were weak, but platinum prices have fallen by half in the past few months. Why such a precipitous fall for a metal whose prospects looked so bright a short time ago?

C. Greer,
San Francisco

Answer:

Platinum prices have been impacted by the strength of the U.S. dollar. Under normal conditions (if there is anything "normal" these days), gold prices would also have been impacted more than they have. However, gold's safe haven appeal has lent support to the metal unlike its close cousin, platinum. Keep in mind that platinum is used in the manufacture of catalytic converters for the auto industry which has seen demand plummet for all the major manufacturers. When auto sales recover, platinum will rise too.

David,

What impact will the recent strengthening of the U.S. dollar have on gold producers?

J. Crannock
Seattle

Answer:

Gold and other metals are denominated in U.S. dollars. Since most of the world's major currencies have been falling against the U.S. dollar, profits repatriated in local currencies will reflect the higher exchange rate. Gold is trading at its highest level in years against the Canadian and Aussie dollars so returns in these currencies will tend to rise. Nonetheless, most gold companies report earnings in U.S. dollars so lower gold prices will negatively impact their bottom lines and, presumably, their share prices. One thing that's worth keeping in mind: Oil prices have dropped in the face of a rising dollar and reduced global demand which is certain to have a positive impact on production costs for most gold producers seeing that energy costs are a major component in production costs. So I would expect that established gold producers should do reasonably well in this environment - more so than their listed counterparts in other sectors.