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Miners face ‘production cliff’ but new investments throttled by cycle of uncertainty

SUNNY FREEMAN | March 6, 2017 11:21 AM ET

Pedro PARDO/AFP/Getty ImagesConcerns over production declines have risen steadily since 2013, when it was considered the 10th biggest issues

Fears of over supply has been replaced by demand-related pricing woes as the top concern among miners in 2017 as they gather for the 85th Prospectors & Developers Association of Canada convention in Toronto this week.

KPMG’s latest Insights Into Mining survey found that mining executives believe the ability to develop and replace reserves, including access to new projects, is the biggest concern in 2017. Concerns over production declines have risen steadily since 2013, when it was considered the 10th biggest issue.

Many analysts have raised the issue of a "production cliff" said to peak sometime this decade, declining steadily thereafter due in part to a lack of investment toward new discoveries and the shelving of some planned projects amid low metals prices.

But as many observers point to the start of a new cycle, miners are once again focused on the longer-term, including exploration, merger and acquisition opportunities and new sources of capital.

"I think that reflects some of the sentiment in the industry following the supercycle several years ago down to the commodity price decline and almost crisis over the last few years," said Heather Cheeseman, a partner in energy and natural resources at KPMG.

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"Now people are beginning to put their heads up and look forward."

It was the first time in the short history of the consulting firm's survey that commodity price risks did not top miners' list of concerns. Still, even as commodity prices have improved, worries over low prices did not fall far from their minds. Selling prices were miners' number two concern.

The newfound focus on production comes after years of focusing on managing the bottom line through cuts at operations, including slashing production levels and divesting some assets to ride out the commodity price bust.

Many companies cut back not only on operating costs but on development projects, acquisitions and exploration spending, Cheeseman said.

"The lasting effect of that or the impact now is that some of their options may be more limited as they start to look ahead. They need to be able to find these projects in order to sustain production."

Resource nationalism, fiscal and political risk, which was not even in the top 10 issues cited in the previous year, shot up as the 6th largest risk amid heightened geopolitical uncertainty.

Economist Dambisa Moyo, one of Time Magazine's most 100 influential people and a keynote speaker at this year's Prospectors and Developers Association of Canada convention, said the de-globalization backlash spreading across the world is a key driver of uncertainty.

Andrew Harrer/BloombergDambisa Moyo, international economist and author.

Major causes of heightened instability include unknowns over the timing and impact of Britain's exit from the European Union and whether U.S. president Donald Trump's rhetoric will actually result in the country turning inward to become more isolationist, she said.

Such trends could result in increased tariffs for natural resource companies exporting to protectionist markets, she said, adding a U.S. retraction could disrupt the all-important Chinese economy and its demand for natural resources.

"It's very hard to make massive multi-billion dollar investments with this type of uncertainty," she said.

That, she said, leaves questions over aggregate demand looming amid lacklustre economic growth projections: many emerging markets, where the population is more than 50 million on average, are growing far below the "magic number" of 7 per cent, in which per capita incomes can double in one generation.

"Most of the forecasts from the IMF and the World Bank and other multinational institutions still see a world of weak and anemic economic growth," she said.

"I think that puts the lid on the opportunity for much of the natural resources and specifically the mining sector."

Moyo believes the resource scarcity is actually the easier problem to solve — one that could be fixed by innovation as technology helps miners extract resources more efficiently and could even produce solutions to replace traditional mining practices.

Miners, now settled into the reality of an era of immense uncertainty, are starting to look at merger and acquisition opportunities again, said Michelle Grant, EY's British Columbia metals and mining transactions leader.

"At this stage, I think everyone's of the view that we're at the start of a new cycle. You start looking at things like productivity, access to capital and optimization."

EY's recent Mergers, Acquisitions and Capital Raising report found activity picking up in the second half of 2016 and she believes it will continue to do so in 2017.

However, Grant noted, it appears mining companies have learned lessons from the previous boom cycle and will no longer chase production just to show growth.

"You have a portfolio of 10 opportunities and you hope three of them are home runs and those offset the seven dogs"

"We're seeing a move away from building production at any cost and really thinking through the mechanics of whether a mine makes sense from a cost perspective as well as whether there's some other option that's more viable."

The volume of deals is picking up, but the price tags attached are smaller, with big players opting to buy a minority stake in a number of small exploration companies to diversify their risk, she added.

"It's kind of like an investment house, you have a portfolio of 10 opportunities and you hope three of them are home runs and those offset the seven dogs."

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