Looking Beyond USD for Gold

written by Peter Clausi | March 10, 2022
Note from Peter Clausi: On June 24, 2019 I originally published this piece. Today, it is arguably even more relevant; and as such are re-publishing for your review.

Gold is glittering again, having its strongest week since April, 2016. Many reasons are offered for this long-expected global run, including natural economic cycles, industry consolidation, the new-normal of rape talk in The White House, conflicts in the Middle East and trade uncertainties.

Whatever the reasons, a higher gold price has a trickle-down impact on the junior exploration companies, the ones in the field doing the high-risk heavy lifting to bring new projects into development and production. It's a well-known axiom to search for gold in the shadow of a headframe, which is why gold camps develop. You find gold near to where someone else already found gold.

Many of these gold camps were historically in production but became economically non-viable when the gold price fell below all-in sustaining costs. I remember attending the world's greatest mining show, PDAC in Toronto, in 2001 when gold was under USD$300 an ounce – a very grim time to be in the mining industry! Mines and exploration projects were shuttered because the anticipated revenue from the deposits was less than the cost of running the mine, which left no cash for corporate operations, and that's not a recipe for success.

Those same projects will be back in play, likely in new hands if gold is able to sustain this run.

PDAC 2012 was giddy as gold had hit its all-time high of

USD$1,900 per ounce the previous August. Projects with iffy economics were being green-lighted to try to exploit that price. We all know how that ended.

Gold is almost always quoted in USD. That's the revenue number, the price at which the producer can sell the gold. What's very interesting is that the majority of costs on a gold project are incurred in local currencies, not USD, so it's important to track not only the USD sale price for gold but the movements of gold in the local currency. If the revenue number is up and gold is sold in USD, and the costs are held steady and incurred in local currencies, the opportunity exists for miners in those jurisdictions to increase their margins. What were barely viable projects can be made economically healthy due to exchange rates. This isn't another trick of accounting from those ivory tower theorists under IFRS. This is the real world of real cash flow.

Look at Australia. The Frasier Institute recently pronounced Western Australia to be the world's second most attractive mining jurisdiction. Gold there is not flirting with a mere $1,400 an ounce. No, gold quoted in AUD hit an all-time high of $2027 last week, and closed out the week above $2,000. (Thanks to goldbroker.com for the chart below.)

This gives the Australian gold projects an advantage in attracting foreign investment capital. If costs are incurred in Australian dollars, and the inflation rate continues to be under 2%, the expanded gross margins will see Australian projects on a fast track. Previously worked mines that had to be shuttered due to the fall in gold will be re-opened.

(Note this only speaks to gross margins. Australian mining companies have the stereotype for being lifestyle companies for their directors and management team, killing the net margins.

The shareholders must ensure that new investment capital goes into the ground, not the Managing Director's pocket.)

Canada is in a similar position. Gold closed the week at CDN$1,852, and Canada had an inflation rate of 2.4% in April, 2019. Low inflation plus a rising revenue number equals renewed global interest in Canadian gold projects.

Saskatchewan finished third globally in that same Frasier Institute report. Quebec, the Yukon, Northwest Territories also made it into the Top 10 globally. Nunavut came in at 15, Ontario at 20. Of the fifteen provincial or territorial mining jurisdictions in Canada, six finished in the top 20 globally. That's impressive, and that's why that same report ranked Canada as the #1 mining jurisdiction on a national level beating out (who else) Australia.

There's more to gold than USD.