AISC – a Transparent Figleaf for an over-exposed Mining Industry

As so often happens in the mining industry new measures are introduced with little thought or consultation and certainly little discussion with players lower down the totem pole. The “Great & Good” have a tendency to decide what is best for all. This might be acceptable if the policies introduced were well thought out but, also typically, the ideas are half-baked and end up backfiring on the whole industry, not just on the authors. The best example of this is recent times in the concept of publishing All-in Sustaining Costs (AISC). That the AISC concept was the brain-child of the World Gold Council says quite a lot also. This dubious “initiative” has become some sort of industry practice that should be blackballed by miners.

In the world of physics (and pretty much everywhere else) there is the concept of an action engendering a reaction. AISC was an attempt to reconcile the fact that miners were claiming that were producing at hundreds of dollars below the reigning gold price and yet were reporting losses. Despite the introduction of AISC by many companies the murk in the numbers has not dissipated. Companies are still losing money despite this measure because of the costs that are NOT included in the measure (and because of the sheer incompetence of many mining managements).

An interesting example is depreciation and amortization. In recent times we have seen a welter of writedowns of producing assets (mainly by majors). The effect of this is to lower the residual value of the asset and thus lower the depreciation and amortization going forward as it pertains to depletion of the asset. Lowering D&A lowers the AISC despite the fact that the money has been spent to get the project to where it is.

Here is a table that may prove useful in looking at what is “in” and what is “out”:

The All-in Sustaining Cost contains numbers that are both forward looking and backward looking. The company that uses this is beating itself up on what the future mine closure costs will be. A extreme example is to look at Antimony mines. As we have noted before these usually have thin reserves that signal only a few years mine-life. So does one presume a LOM based upon the reserves and thus artificially suppress earnings per oz/lb produced when the mine may run for multiples of the current mine-life. If one had used AISC on Bingham Canyon in the 1920s what sort of mine closure costs would one have used when the mine is still going nearly a century later.

Then one might also consider that some of the costs are for future production (exploration, stripping etc) and not costs of current production. Does a retailer account for what a cashier will cost in one year’s time when calculating whether he made money in the current quarter? This flies in the face of accepted accounting practice for the rest of the capitalist system. As we have seen money invested today in exploration or other mine development not related to production frequently does NOT bear any fruit so why should it be charged (even in theory) against current production?

As one can note the All-in cost is totally bogus, particularly when it is linked to ounces currently produced as it contains items that have nothing to do with either production of the current output or the mine that is being produced from. It is essentially all the “other stuff” that a mining company may be doing, indeed sometimes on the other side of the globe.

Ernst & Young have noted that there is considerable complexity in differentiating between sustaining and non-sustaining capex with the main reasons being:

- Non-sustaining costs are costs incurred at new operations and costs related to “major projects” at existing operations where these projects will materially increase production
- All other costs related to existing operations are considered sustaining
- Does not address discretionary nature of certain capital expenditure
- Calculation is net of by-product credits

All of these points are valid but we would note that in some cases the by-product credits are now the tail that wags the dog when it comes to many gold and silver mines. Indeed there was a point last year with Lead and Zinc resurgent and silver static that it seemed the tables would be turned on many mines that deemed themselves precious but were likely to end up as dependent upon base metals’ revenues. The tide receded there but should return again.

A recent report for a company, that caused us intense head-scratching, was using AISC calculated per silver-equivalent ounce without consideration for by-product credits. Fathoming how much the cost of producing the gold or the silver or the lead or zinc was beyond the most complex algebra and hence one wonders “why bother?”. The fundamental question is still “is the company making money?” and if the answer is “no” then AISC is yet another faulty crutch on which the industry leans for support.

The auditing firm also notes that the items excluded from the calculations include:

- Income taxes
- Working capital (except for adjustments to inventory on a sales basis)

- All financing charges (including capitalised interest)
- Costs related to business combinations, asset acquisitions and asset disposals
- Items needed to normalize earnings, for example impairments on non-current assets and one-time material severance charges

Since when is working capital not part of the cost of production? Why aren't financing costs (if allocated to a particular mine) not part of the cost of doing business at that mine? Any company worth its salt in whatever industry has a grasp of its cost- (and revenue-) centres and should know what each mine is costing without comingling numbers beyond shared central costs. If downsizing the workforce or firing expensive FiFo staff are not part of the cost of doing business at a particular mine then what are they?

As a non-GAAP measure, AISC in itself becomes something that is largely self-regulated and can be to mining companies whatever they want it to be. Resembling the witches brew of the three hags in Macbeth it has toe of salamander, eye of newt and some wolfbane and, hey presto, here is a spanking new measure that will "keep 'em honest". Instead we feel that the mining industry has made a rod for its own back. AISC has only served to make deteriorating measures look worse and further confuse an investing public who want anything but confusion in these troubled times for mining equities.

Conclusion

Companies should eschew this measure and if it is not going to be compiled and calculated consistently across the industry then the regulators should step in and shut it down. Rumour has it the SEC is less than happy with it. Isn't it ironic that one of the regulators that knows least about mining and its metrics should have lighted upon this new metric and decided that it is not really "apples to apples" and might deserve being pulped?