Turkey – Treasure Chest or Lobster Trap?

In their heyday, one of the principles that the Rothschilds (supposedly) operated by was that the best time to invest was “when the blood was running in the streets”. In more recent times the mantra has been cited by Mark Mobius, the guru/PM of Templeton as a measure for testing emerging markets for investability. By this criteria Turkey would certainly be a very attractive market for bottom-fishers these days. However for us, the “blood running in the streets” is less attractive if it is our own or that of mining executives, and thus investors should be careful what they wish for.

Multiple terrorist attacks in Turkey have made even walking through the airport or one of the major streets of Istanbul or Ankara an exercise in which one literally puts one’s life at stake. This has been further compounded by the recent attempted coup in Turkey. In the wake of the failed military uprising has come a round of oppression that has sent all indicators of investability (or even moral acceptability) plunging, leaving a challenge for miners that are either established already with operating mines in the country or in the process of proving up mineral properties. From my own bitter experience of the country (running a gold explorer in Turkey for three years) the problems for foreigners doing business in the mining sector there have been brewing over a much longer period and predate the latest terrorist outrages and problematic coups. Turkey under the current regime is just “bad business”.

Treasure Chest?

Turkey sits in the prime stretch of the Tethyan Belt that stretches from Pakistan, through Afghanistan, Iran, Turkey the Balkans and then arches up to become the Carpathian Mountains in central Europe. Along its way is strewn some of the most impressive base and specialty metals deposits on the planet, not to mention resources in precious metals. For obvious geopolitical reasons the “eastern end” of the belt became a no-go zone in recent decades, except for the truly intrepid, while the western end has been intensively mined in the past but fallen into relative quiescence in the post-Communist period as states morphed into EU territories with varying degrees of mining friendliness (or unfriendliness). Turkey sat in the middle as ostensibly a Western(ish) state with a perceived rule of law and much vaunted “open for business” attitude.

Turkey has been the scene for Western companies, in particular hunting for gold and, to a much lesser extent silver, some desultory hunting for base metals and almost no attention to its specialty metals. There was even a uranium hunt going on with a foreign company involved, looking to service Turkey’s nascent nuclear energy build-up.

Lobster Trap?

The trouble in paradise for miners began way before the political train was derailed. The old adage of “Looks like a Duck, Walks like a Duck and Quacks like a Duck, but not a Duck” held for Turkey and the 800lb gorilla of international mining. Newmont found out a decade ago that the duck could bite even if it didn’t have any of the other advertised qualities. The company held the most advanced gold project in the country, Ovacik, when it ran into “local opposition” that effectively blocked it from moving forward and ended up with Newmont selling out for a song to a local group. The local group went on to greater glory, listing with much fanfare and sharp elbows amongst international investment bankers. It peaked at around a $3bn market cap in a welter of enthusiasm that it was the “anointed” of the government in the gold mining space, a national champion. The wheels fell off that theory in recent years when the group fell out of political favour and was accused of being involved with the cleric who is currently getting the blame for the attempted coup. The group's problems mounted. Say no more…

Many is the time that we have heard the claim about how foreigner-friendly the Turkish mining regime is. However, our own experience has been that the devil is in the details, to put it tactfully. Owners of mining concessions in Turkey may have once been able to stake them relatively cheaply but then they find themselves brutally milked for forestry licenses (even when there is nary a tree or bush on their properties). License and concession renewals, and the rigmarole involved, consumes enormous amounts of time and money to the detriment of actual exploration. For a junior miner the effect is somewhat like going to the bloodbank and forgetting to say "whoah".

Then comes the *coup de grâce*. A project gets to the feasibility stage and has to get an Environmental Impact Assessment (a ÇED in the local parlance). This is when the fins start appearing in the water. Someone sidles up to the unsuspecting miner and tells them the news that that they hadn't heard before that to get the ÇED they must take on a local partner – indeed a "secret" partner – and the secret partner will open all sorts of magical doors and, by the way, the secret partner is a free-carry.. A what?? Yes, the secret partner's work is so valuable that he/she gets to have not 5% , not 10%, not 20% but up to 40% of the equity and will pay nothing for the privilege. Indeed the foreign miner should consider themselves favoured that the tailor to the Great & Good or the person who is a human hot water bottle to "Number One" has deigned to choose your humble project to be taken to the Most High. Indeed, it's not just the foreign policy that is Neo-Ottoman in "modern-day" Turkey, it's like the eunuchs in the Topkapi Palace are back in business.

This sets the scene for the naïve miner trying to wrap their brain around how they explain (lie?) to the auditors, regulators and shareholders as to how they are gifting 40% of the company to somebody that just appeared out of the fog of the *shisha* smoke in the bazaar. This naïve miner, in December 2013, when confronted with a demand for $1m to a certain minister and $800,000 to another minister (fortunately, and foolishly, laid out on a fax that the clueless intermediary left in our possession) fled to Istanbul airport, convened a board meeting the next day to repudiate attempts by those seeking *baksheesh* and reported the matter to the TSX. We suspect we were one of the very few to do so.

Like so many others we disappeared from the Turkish scene (making slightly more noise as we departed) but avoiding our own starring role in a personalized version of Midnight Express. Well may one ask of those that haven't departed as to what they had to do to get their ÇED. Don't expect a straight answer because there are laws on the books in Canada, the US and the UK that don't comprehend the existence of "secret" partners.

Post-Coup

Ever ones to put a positive spin on a situation, we are sure there are miners out there that probably say under their breath to investors that the coup was a good thing because it sank the Turkish lira and thus made costs "so much lower". The slight wrinkle in this theory is that "secret" partners like to deal in dollars and they aren't in the business of haggling or giving discounts no matter how hairy the political situation gets.

Conclusion

Regimes that start heading down the road towards totalitarianism rarely have a Road to Damascus and get back on the path to righteousness. Turkey is now on the slippery slide. The EU was prepared to tie itself in moral knots to accommodate the increasing repression of critics. The US was prepared to play along with a major NATO partner. Now that both have felt the fangs of the dog that bites the hand that feeds, the mood is souring rapidly. Even as we write the history books are being rewritten as to who lit the touchpaper on Syria and who sold arms to both sides in that war and then bought oil from both sides.

Is this a place that one wants to make a mining investment at this point? Sure the geology is great but frankly with Iran, its eastern neighbour in the Tethyan Belt, rising in the acceptability stakes as Turkey takes a dive, and knowing what we know about Turkey’s “mining friendly” regime (take a rabies shot before you negotiate), who needs it? Financing money is starting to flow again but it is not, as yet, indiscriminate, and countries with coups, failed or otherwise, in their immediate past are going to be a tougher sell than ones where the regime is stable and trustworthy. With countries like Argentina and Iran coming in from the cold then who needs to be invested in a country that has yet to show an example of any Western miner having knocked the ball out of the field? Turkey will still be around when all this passes. Better to await the coup that finally works out.

Slow Suffocation of the US Mining Space

The old adage about the frog in the boiling water slowly getting cooked without jumping out is a good metaphor for the mining industry in the US over the last 12 months.

While the big story in commodity circles has been the oil price decline, a far more potent force has been the currency moves. The rampant US dollar has “saved” the bacon of many a miner in Australia, Canada, South Africa and elsewhere while brutally pressure-cooking those that are focused on the mining space in the US.

The chart above sourced from US Global Investors shows the last twelve months’ move in the gold price in various currencies. The USD gold price is clearly the laggard while Brazil has been stellar. It’s a pity there are not more Brazilian gold mining opportunities on offer. Ironically the strength of the Real for the preceding five years meant that Brazil was not such a good place for junior explorers to spend their drilling dollar.

The attractiveness of Canadian gold miners is even starting to outstrip the advantage that Australian clawed back last year. While the AUD has stopped failing (touch wood) against the USD the Canadian dollar has dropped even further as the oil price has plunged to new depths.

The chart below though shows the ten year gold price in AUD. While still a few hundred dollars off its all-time highs, the Australian industry has gained some ground on cash costs since the 2011 high, due to the falling oil price and the onset of some cost deflation in a broader sense after the rip-roaring FiFo days of champagne and roses that mine workers experienced Down Under.

The clear message from all these gold price movements in non-USD is that US gold producers are getting outfoxed by just about everyone these days and their currency is the culprit.

The Torture of being a US Gold Miner

Looking at the list of Nevada mines below, which was sourced from the USGS and which shows 2013 production numbers, one can't help noticing that US gold production is dominated by heavyweight international majors. Of the non-majors, both Allied Nevada and Veris Gold have gone either bankrupt or into protection from creditors since the USGS made these calculations, while Waterton is a predatory hedge fund.

Our thinking here is that having a US presence, and a sizeable one, is an ego thing for many of these companies but we are left wondering how profitable these mines owned by majors actually are in the current environment. As we have noted before cash costs and all-in sustaining cash costs can hide a multitude of sins (particularly AISC). With large multinational operations the very biggest gold miners can apportion costs to mines across borders that can ameliorate some of the pain they may be suffering in their domestic (i.e. US) operations.

However the longer the agony of the high US dollar goes on the harder it is to pretend that it is not hurting. The recent demise of Atna Resources and farther back, the travails of Gryphon Gold both at the hands of Waterton Global may ultimately prove that hedge funds wandering into the mining space may not actually be the "smartest guys in the room". What appears to be taking candy from babies may actually be a poisoned chalice, to mix a metaphor.

There would appear to be little that operators in the US gold mining space can do except hunker down and wait for a turn down in the dollar or the less likely turn up in the gold price. A major loss of face would accompany mothballing major US mines but it would appear to be the best course for some in preserving value during the lean times.

And South of the Border

Goldcorp again starts to look like one of the smartest operators amongst the Big Gold crowd with its weighting towards more Latin climes. Mexico, for an oil economy, has not seen its currency weaken as much as many others with a similar oil “affliction”. It has certainly helped miners there that the rate for the peso has shown a meaningful decline against the USD over the last twelve months.

While it’s not as powerful as the kicker given to Canadian or Australian mine operators it has at least helped to widen margins for those Canadian miners operating in Mexico.

Conclusion

In the late 19th century US politics was wracked by the debate over bimetallism with William Jennings Bryant arguing that the country was being crucified on a Cross of Gold. He was of course a silver bug. Nowadays its gold being crucified on a Cross of Dollars as the soaring currency threatens to choke off future development of the gold industry in the US.

Ironically though the US dollar rising while oil is falling, this is coming at the end of a decade where the dollar and US economy were vindicated by increasing energy independence. The higher the dollar goes and the lower oil falls the greater is the certainty that the energy independence, that $100 per bbl oil and the accompanying fracking boom brought, will be halted (which has happened) and reversed (which is in full flight as we write). Oil production in the US (and those who lend to it or invest in it) are the first line victims but the collateral damage is US gold producers and most US exporters of almost anything. This would then signal that yet another tipping point awaits the US in which the Wall of Worry about the trade balance reappears and then the dollar goes on a slide.

But returning to gold mining, the US has had high cash costs per ounce for a long time now and excepting the lower price of energy it is now even more “out there” in that regard. Whether miners operating in Nevada are making a loss in absolute terms on each ounce they produce or just a wafer thin margin is now somewhat immaterial while Australian and Canadian producers are seeing margins widen out dramatically with gold stable in USD terms and dramatically higher in their own terms, while energy costs have fallen more than their currencies have depreciated and their opex in USD terms has declined by 30% or more. Frankly who would invest in a US gold miner in that scenario?

We expect a scenario for several years in which junior miners with US focus will languish. They should pack up their drill-rigs and go home. Majors will massage their numbers to make it look like their cash costs are under the current gold price but ultimately their bottom lines are telling the really story of just how unprofitable US gold mining is in absolute and comparative terms in these days of a rampant dollar.