Ecclestone on PGMs – Strategic Chess Pieces in a Russian Game

As tensions heat up again with Russia over the long-simmering Ukraine dispute things are likely to go one of two ways. Either the West will wimp out and let Russia keep doing what it's doing or the screws will be tightened. As I have written before the oil price fall has dealt a body blow to the Russian economy and exchange rate. This triggered soaring interest rates and raised questions amongst oligarchs as to whether Putin was in their own best interests. However while the West has indulged in financial sanctions (and may have orchestrated the oil price tumble) it has not restricted imports of mineral products from Russia, most noticeably Uranium or Palladium (and Platinum). This is rather a cynical move as restrictions of either or both would send prices of Uranium and the PGMs soaring. Of course, the Russians themselves might resolve to take some retaliatory action by restricting exports of these products. That could play merry hell as the Russians represent so much of the capacity in both metals that prices would go wild.

I thought it apt then to follow up my previous musings on Uranium and Palladium in light of the Russian "threat" with a review of PGMs with a tight focus on their supply and price dynamics without dallying on issues of metallurgy.

Uses – Cars Lead the Charge

PGM demand in recent years has been good with Platinum demand climbing 4.9% to 8.42 million ozs in 2013, according to the refiner, Johnson Matthey, however some of that may have been end-users stocking up in anticipation of industrial action in South Africa.

Platinum has a diverse consumer base with demand coming from four main sectors: auto catalysts 37% in 2013), jewellery (33% in 2013), industry (21% in 2013) and investors (9% in 2013). The breakdown of the main users in industry are the chemical, electronics, glass, petroleum and medical industries.

While emerging market car demand is booming, that in major Western markets has never got back to the ebullience per-2008. The US made a good recovery after the slump but not enough while Europe has only just started to fire up again (though the UK had been doing better than most of Europe). Interestingly Palladium has been stealing the thunder of Platinum because it is cheaper and it has captured an increasing part of the catalyst market.

Meanwhile the other industrial uses are pretty stable, jewellery fluctuates with economic growth, fashion and the metal prices. The Chinese have taken a particular shine to platinum jewellery in recent times (with 63% of all platinum jewellery demand). The industrial applications in electronics of the whole range of PGMs have been on the rise, but not enough as yet to quantify as a surge by any means in the broader usage of the metals. The investment usage of the metals was spurred by the strong prices prompted by the South African price which sucked interest into the ETFs and physical holding of the metals. That however mainly takes its lead from the rest of the usages. Therefore if the outlook for auto usage was down then price perceptions would be down and investment interest would fade as well.

However, all in all the industrial usages look good with Western auto demand now coming to the party and the slower Chinese economy not seemingly denting demand there. Indeed, with property so high in value, a car of any sort becomes the affordable status symbol.

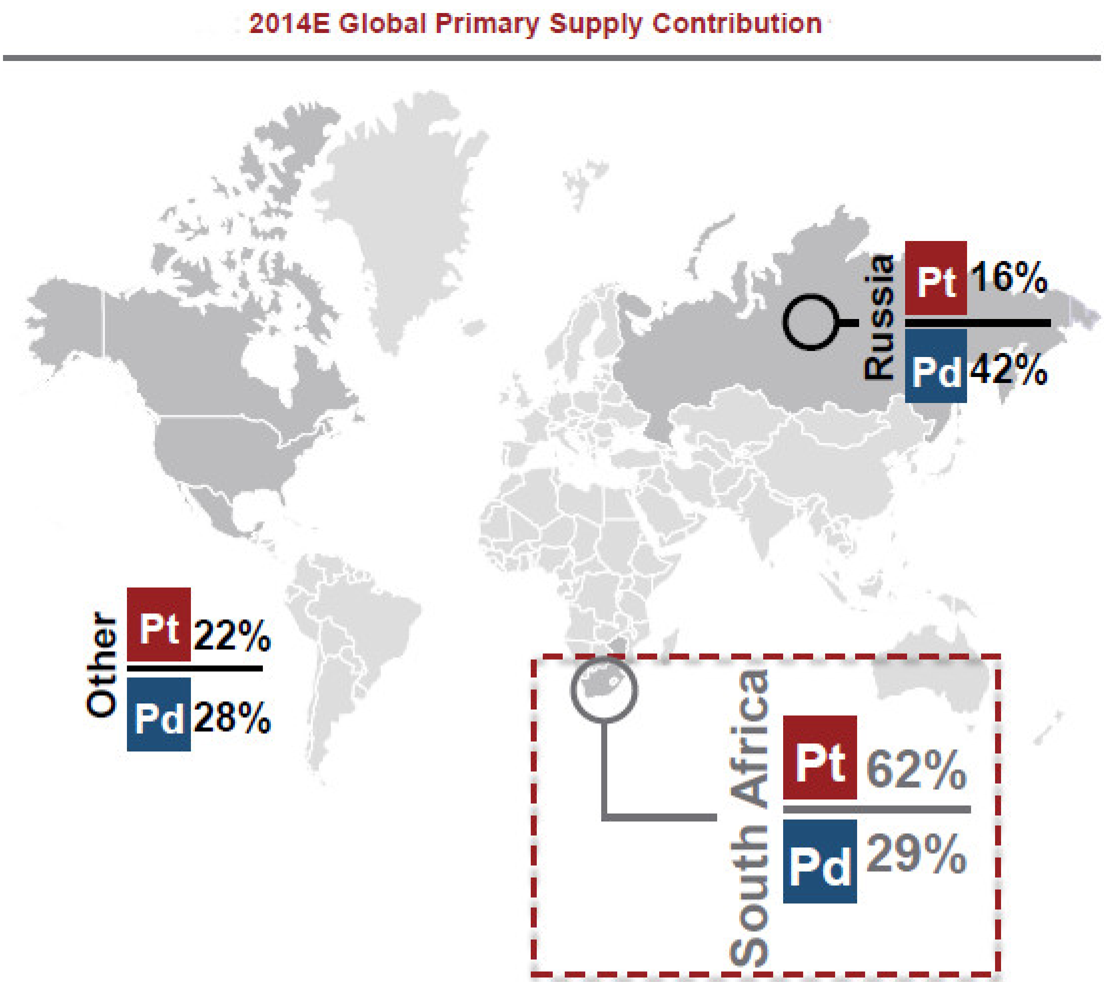
The chart below belies this enthusiasm though looking rather sickly of late.

Supply – The Club of Three

PGMs are up there with a few very obscure metals in having a very tight range of supply sources. This is not to say that PGMs aren't found broadly around the world but the production side has evolved into one that is highly concentrated with Russia and Southern Africa (essentially South Africa and Zimbabwe) dominating the supply-side.

The chart below shows the sources of supply. South Africa has the dominant role in Platinum and Russia Palladium. In South Africa we have industrial disputes, latent political instability, energy supply issues and mediocre profitability while Russia is inefficient and now a political pariah. Output has generally been in decline in recent years with Johnson Matthey data showing that production peaked in 2001 at 1.3 million ozs, falling to a low of 785,000 ozs in 2009. It recovered to 835,000 ozs by 2011, but has since started to fall again. The weaker trend is expected to continue as ore grades deteriorate. It's interesting to mention that other basket case Zimbabwe where mining news tends to be dire. However production of platinum has been soaring there (from 165,000 oz in 2006 to 408,000 oz in 2013) so they must be doing something right. Indeed they have been taking up the slack left by falling Russian supply. Whether the growth will continue to match Russia's decline strikes me as unlikely.

The big mystery with Russia how much of its sales of Palladium are actually from stockpiles rather than production. The size of ex-Soviet stockpiles has long been a mystery as has been the rate at which they are being run-down. It has been thought in recent years that these are nearly exhausted.



Recycling is also worth a mention with the USGS estimating that 155,000 kilograms of platinum, palladium and rhodium was recovered globally from new and old scrap in 2014, including about 50,000 kilograms recovered from automobile catalytic converters in the United States. Palladium is interesting from the recycling point of view as most of the metal goes into auto catalysts so it is very recyclable. In fact the second largest source of the metal is now recycling after Russian production and ahead of South African production.

Store of Value

Unlike the wild oscillations in perceptions of what the gold:silver ratio should be, the platinum price is more often spoken of in terms of parity with the gold price. As the chart below shows the gold price has risen and platinum has fallen and brought both back to near parity after a period of outperformance by platinum partly fired by the misconceptions engendered by last year's miners' strike in South Africa. I never bought into the argument that the strike was a turning point for the better, as no strike lasts forever. It shows the extent to which metals watchers like to grasp at straws. In any case the strike ended and platinum went on the skids heading back down to levels not seen since 2009.

Part of this slide was unwinding of stockpiles built up by users in anticipation of the strike. As the strike didn't last as long as many feared (and others hoped) not only was the disappointment reflected in the price but users then were able to sit out of the market and just use up their hoards of the PGMs they had paid up for in 2013. As the strike didn't last forever neither will the destocking and we expect the price to start ticking upwards again in the near future.

Names to Conjure With

We have dealt with North American Palladium and Stillwater before so no need to say too much and of course, I remain very fond of the Palladium ETF (NYSE:PALL) as an avenue to specifically play that metal in the physical form.

We have long followed the eponymously named, Platinum Group Metals (PGM.to) which is one of the few TSX-listed names pursuing projects in South Africa. I have known them since they first appeared on the scene but slowly but surely they have inched through the thickets of BEE negotiations and are on the way to building themselves a mine on the famed WWW belt.

Another name to have recently surfaced is Wellgreen Platinum which comes with Greg Johnson of NovaGold fame as the head of the company. Its Wellgreen property is in the Yukon and was formerly a project of HudBay but many eons ago. The company describes its project as one of the largest undeveloped platinum group metals deposits outside of southern Africa or Russia. Maybe I shall elaborate on this more at a future opportunity.

I also met recently with another nickel/PGM project in West Africa, Sama Resources in Cote d'Ivoire which is run by an amalgam of ex-SEMAFO, ex-Xstrata and ex-Salares Lithium people. All of which I hold in high esteem. With a capex of only a tad over $200mn it also comes in at one of the lowest capexes for either nickel OR PGMs that we are acquainted with. This is another one I hope to expand upon in the future.

Conclusion

The Russia/Ukraine matter is on the slow boil at the current time but this does not mean it has gone away. If the heat turns up it is not beyond the Machiavellian playbook of Putin to play the mineral export card selectively and Palladium, Uranium and to a lesser extent Platinum are powerful cards to play. Restricting supply would send prices ballistic which would then probably have the Russians leaking out supply to the spot market. Russians do love chess and Palladium is a particularly strategic piece on the board.. will they play it?