WILL THERE BE A SUBSTANTIAL COMMODITY PRICE INCREASE NEEDED WHEN DEMAND RETURNS?

By Andy Clay

Having met with many of our clients in recent times, most have cut back on exploration or curtailed capital projects. A good example is the chrome and ferrochrome industry which has switched off production rather than produce at sub-economic prices.

Venmyn has carefully reviewed many of the commodity sectors and suggests that whilst all ore deposits are lognormally skewed to lower grade, the production costs are lognormally skewed to the higher costs. Consequently, if a company's strategy is to be in the lower cost quartile their chances of acquiring projects that have sufficient grade flexibility to achieve that objective is low.

Consequently, Venmyn suggests economic stress testing of each orebody to identify the commodity price required to achieve a 30% margin based on full cost accounting. Full cost includes total fixed and variable PLUS the acquisition cost of the project and capital. In some cases this demonstrates that the commodity prices must be between 30% to 50% higher than current spot even for robust orebodies.

It is a sobering thought and the inevitable conclusion is that once demand returns, there should be a substantial increase in commodity prices.

Please do not hesitate to forward your comments to Andy Clay.