THE CONTINGENCY PLAN:
HOW TO FOCUS ON SURVIVING UNTIL THE NEXT PRICE RUN UP

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This is the third time I have been through a major metals price decline. Just like déjà vu all over again, everyone is hoarding cash, cutting costs, selling "non-core" assets, laying people off, and killing projects to focus on production. None of this is very good for the long term, but miners are focused on just surviving until the next price run up.

So, is there a better way? Which companies had a contingency plan in place which was executed and that helped maintain share value?

Strategic planning is thought by many to be a luxury that they cannot afford. This level of life-of-mine and or life-of-company planning is rarely implemented by anyone but the majors, and, in my experience, rarely implemented well. To be fair, there are some very clever strategic planners out there who do really good work, but the evidence today suggests that if there were contingency plans in place that were executed, those mining company's share price did not see much benefit. I believe that proper strategic planning is absolutely necessary, along with an implementable contingency plan, to react to metals price movements in either direction.

A strategic plan today is generally an optimal solution for one set of circumstances. This plan can be varied by tweaking some of the major components, such as commodity price, or cost, but it is difficult and time consuming to re-optimize the whole business to develop a potentially esoteric result. Indeed, many of the optimization levers such as variable cut-off grade, stockpiling, the grind-throughput-recovery options, and other processing value levers, are not considered or are considered at best in simple terms.

Let's back up a bit. What are the options available for a miner when the price changes? We have mentioned the obvious one, reduced spending. However, there are some drastic measures that can be taken. Which mines have costs (and I mean total, all in, real costs) that exceed the realized revenue of the commodity produced? This is information that may be hard to come by unless someone has gone through and analyzed this beforehand. Take this one step further- what is the cost to close the mine? What is the cost to put the mine on care and maintenance? Again, it would be nice to know this a priori.
If this information is known, then the hard decisions become easier, but not easy.

When do you make the hard decision? It could be proposed that after a certain period of commodity prices below a certain level, an action is triggered. Further, if the price continues to fall after another prescribed time period, further action is taken. This is how successful investors make money in the stock market, by being cold-hearted decision makers with rules that they stick to.

I can hear you now- oh, the decision isn't that easy! There are all of these other things to think about! Yes, there are. However, if there is a decision-making framework in place, vetted by the board and management, this process becomes more streamlined. I suspect that we will see the price change again- when and how much and which way is hard to say, but it will change.

There are less dramatic courses of action, such as reducing production or processing stockpiles. Maintaining the same-size workforce can be a challenge in a low price market, and perhaps short term contracts for workers would help alleviate the employment issue. Again, this is something that needs to be considered before the price drops.

So far we have talked about the doom and gloom of a declining price market. It wasn't always this way, and we should remember the gold price increase 2006 through 2012. It is just as important, and possibly more so, to maintain discipline and core values in a rising price market. Looking back, this period in the cycle tends to be where the damage is done, as miners acquire and begin to develop assets that are marginal and expensive. These marginal excursions will then bite back hard when the price drops as they become money pits that are hard to get rid of and hard to stop working on. It would be far better to be conservative in this stage of the cycle, pay out a dividend, and "save for a rainy day".

Robust strategic planning does not solve these issues, but it certainly gives management a better understanding of what their projects look like in differing price climates. Uncertainty analysis and stochastic modeling are also tools that are not generally used, but that would inform management about risk. This is difficult and complex work, not for the faint of heart. The information gained, however, would be very valuable when it is needed. I have been told by management on several occasions that a “90% Probability” model would come in very handy. This is complicated by the fact that one needs to assess the 90% probability across all of the relevant data, from the metal estimate in the resource model, to process plant recovery, to capital and operating costs. These are just a few of the tangible items that we look at currently. Future management decisions that have material impact on the cash flow are difficult to predict, and the further out you are in the future the more chance there is that a management decision invalidates some of the assumptions of the initial study. However, this is not a reason for not planning long term.

The good news is that in the bottom of the price trough miners should be at the leanest and best, with the exception of having nothing in the pipeline. Now is as good a time as any to consider the business risk of the company as it looks now, and what it may look like after several well-thought out, well-executed acquisitions. Perhaps we miners can learn from history instead or constantly repeating it.

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