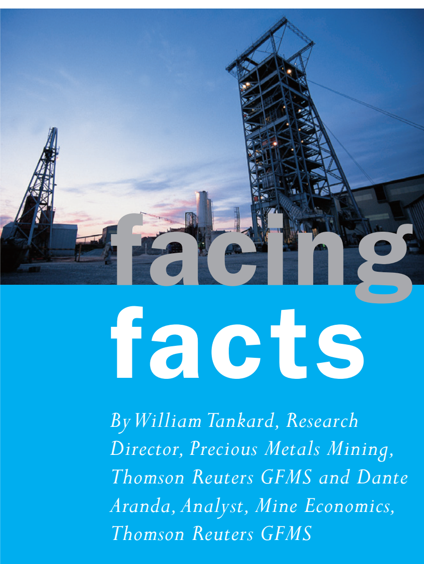


facing facts

By William Tankard, Research Director, Precious Metals Mining, Thomson Reuters GFMS and Dante Aranda, Analyst, Mine Economics, Thomson Reuters GFMS

Following the LBMA's Public Affairs Committee's successful initiation of a metals hedging and price risk management session at the LBMA/LPPM Precious Metals Conference in Vienna last year, and considering the market activity that has recently taken place, producer hedging seems an appropriate subject to revisit ahead of Singapore 2016. Here, we draw on the latest GFMS analysis issued in collaboration with Société Générale and look back to gold hedging dynamics from GFMS research on the subject undertaken prior to the global financial crisis.

The global producer hedge book expanded by more than one-fifth, up by 1.62Moz (50t) on a delta-adjusted basis during the first quarter of 2016. As a result, the hedge book stood at a total of 8.69Moz (270t) at the end of March (see Chart 1). Over the first quarter, Australian-based operators accounted for 50% of the gross hedging, with the majority of the net hedging undertaken by Newcrest, which hedged a portion of Telfer's production out to mid-2018. The second-largest hedge was entered into by Polyus Gold, which added a fourth tranche to its strategic price protection programme covering production over the next four years. Of the mining companies tracked as having a gold hedge position, 57% recorded an increase in hedge cover during the first quarter compared with 43% of the population reducing gold hedges.

An intriguing feature of hedging activities noted by GFMS in recent quarters (and not illustrated by Newcrest's and Polyus's above-mentioned longer-term hedging) has been the willingness by a growing population of mining companies to hedge, but for many companies, to hedge over relatively short tenors. The locking-in of prices over extended time periods was a prominent criticism (among many) levelled at the hedging practices in the 1990s and early 2000s, when the then-substantial contango was used to generate meaningful forward premia. With cash depo rates remaining close to zero in most major currencies, the premium available in the gold forward price now a fraction of pre-financial crisis levels, and perhaps partly as a function of this long-standing negative sentiment, hedges maturing over short timeframes now appear to be very much the norm.

This represents a stark change to the structure of the book when compared to that of 10 years ago. Of a hedge book amounting to 8.69Moz at the end of Q1, more than half of the contracts will be due to mature over the next 12 months with almost 4 Moz (124 tonnes) scheduled to mature within calendar 2016 (Chart 2a), and from this (relatively diminished) level, the volume of hedging appears to be growing. Rewinding 10 years, the book was much larger (but in retreat) at just above 50Moz (1,570t). Of that volume, contracts maturing over the the 36-month period from April 2006 (Chart 2b) represented a minority of the total book.

Outlook

With gold prices briefly reaching new highs following the United Kingdom's decision to leave the European Union and risk reversals comfortably above 2014 levels, we believe there may be a preference on the part of producers to hedge production using collar structures over forward sale contracts. Lastly, the price sensitivity of the global hedge book will also contribute to the hedge book balance. Following the gold price rally in late June, Alacer, PanTerra Gold and St. Barbara announced new hedging activity, covering a total of 0.22Moz (7t), which in addition to the delta effects will add a combined 0.37Moz (12t) of hedge book exposure.

Although new hedging announcements in the second quarter before June were sparse, we believe the uncertainty over several major political developments will help maintain higher prices in 2016 and encourage more producers to join the 'hedging club'. The increase in the number of gold miners hedging over the first half of 2016 speaks to the continued willingness by producers to hedge if it helps ensure the development of a mining asset by de-risking project financings with more stable projected cash flow and also encompasses miners which have chosen to hedge as a means of stabilising cashflow from more mature operations.

As producers continue to express greater openness to hedging, we consider it probable that the outcome for 2016 will be another year of net hedging, the third in a row, and if the activities of the first six months are continued, this could well come in at a level in excess of 3.2Moz (100t).

Chart 2a: Q1-2016 Delivery Profile

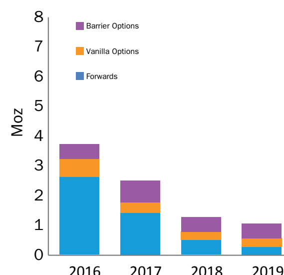


Chart 2b: Q1-2006 Delivery Profile

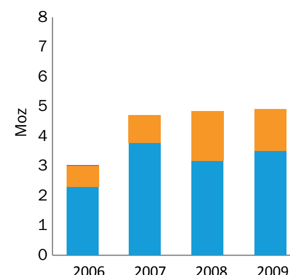
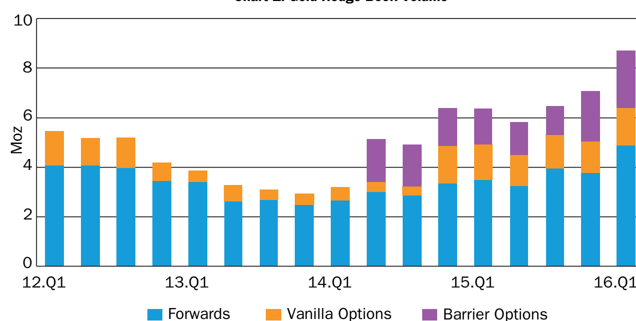


Chart 1: Gold Hedge Book Volume



For freely available research on the subject, visit //forms.thomsonreuters.com/gfms/

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Having joined GFMS Ltd as a Metals Analyst in 2005 to cover the mining sector, William was brought across to Thomson Reuters in GFMS' 2011 acquisition and holds the role of Research Director – Precious Metals Mining, within Thomson Reuters' Commodity Research & Forecasts division. He has accountability for the mining team's research output of global production, mining costs and producer hedging research across the precious metals.

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Dante began his career in the commodities market in 2010 when he joined Thomson Reuters in Toronto as a commodities specialist, working with a broad range of natural resources companies. Now based in London as a precious metals mining analyst, he is heavily involved in the team's modelling of mine production and industry costs using Matlab and VBA and is also a leading contributor to the GFMS team's technical analysis. Prior to Thomson Reuters, he worked at Banco de Credito del Peru as a Junior Trader on the FX structured products desk. He holds a BSc (Honours) in Financial Economics & Applied Statistics from the University of Toronto, where he specialised in Econometrics.