# Interview: These 2 Controversial Industries Are Primed For A Comeback

## Description

t's a tough time to be in the commodity industry.

Thanks to weak uranium prices, shares of **Cameco** (TSX:CCO, NYSE:CCJ) closed down more than 3% earlier this month after the company reported weaker-than-expected fourth quarter results and scrapped its five-year production targets.



It's a similar story over in the platinum business. There prices are hovering near 52- week lows thanks to weaker demand from emerging markets and robust supplies. As a result of these headwinds, most investors have abandoned these two sectors.

However Rick Rule, Chairman and Founder of Sprott Asset Management, is optimistic. He sees several developments that could bode well for these respective commodities and related products like the **ETFS Physical Platinum Shares** (NYSEMKT:PPLT) and **Uranium Participation Corp.** (TSE:U). Below is the transcript of our conversation; it has been lightly edited for clarity.

**Robert Baillieul: You're optimistic on commodity prices, but what is the best way for investors to play it? Do you invest in miners or the raw commodity itself.**

**Rick Rule:** I think it's very difficult to characterize the mining industry rationally. How do I put this, I think you need to look at individual companies and individual commodities. Certainly you get into individual commodities where the price is substantially below the cost of production, and those markets look attractive to me.

An example once again would be uranium. I think the supply demand characteristics makes it virtually inevitable that the price of uranium goes up.

In the platinum palladium business, I think that as long as we all enjoy the air quality, the platinum price has to go up. Platinum function in catalytic converters for reducing auto emissions is absolutely critical to the air quality we enjoy today. But the platinum and palladium business on a worldwide basis does not earn its cost of capital.

What that means in a very simplistic fashion is that either prices rise or we have more smog. I don't see any broadly based social movement around the world, you know like young kids in university, with signs chanting, 'More smog! More smog! More smog!'

The truth is that it costs the industry $2,200 an ounce to make platinum, they sell it for $1,600 and if the realization comes to people that it costs $200 to equip a car today which reduced emissions more efficiently.

Let's say the price of platinum were to now double and the cost of the platinum to improve the car was now $400 as opposed to $200. In other words an incremental increase to enjoy the air quality we enjoy in place like San Diego was $200, versus an $18,000 sticker price for a car. I would suspect that the decrease in incremental demand from the doubling in platinum prices would be nil.

Now it's important to take that into account because it is instructive when it comes to commodity markets who in time prices have to go up because the industry doesn't earn its cost of capital. And it can go up because the utility of the commodity to consumer with platinum is so high that a $200 increase in the price of the commodity would have absolutely no effect on demand.

I think that's true also of uranium. The price of uranium is such a small component of the cost of the finished product that comes out of a nuclear powerplant, that the fact that if uranium prices doubled it would have absolutely no effect on the demand for the product.



And I point out these facts to your readers, not to encourage them to buy uranium, platinum, or palladium particularly, but rather to understand the nature of commodity markets. One makes money in commodities markets by buying what I would describe as set-ups. Situations where in two to four years an event has to happen and can happen.

**Baillieul: I just got off the Barrick Gold's (TSX:ABX, NYSE:ABX) conference call. Activists are pushing for miners are selling off assets, reduce production, and cut back spending. And for the most part, it looks like the companies are following through. Do you think this is a smart way for these companies to be managed?**

**Rule:** I do. I think you have to temper one's enthusiasm for any certain set of circumstances that would apply to the industry as a whole and apply it on a company by company basis.

Barrick is sort of a poster boy in the gold business for much of what went wrong. The investment community expectations with regard to commodity producers was set in the 1970s when you had a very rapid rise in commodity prices and the equity prices of commodity producers rose even faster.

The paradigm among investors became look for companies that exhibit maximum leverage to commodity price increases. And that's ironic because it meant that you'd look for the most marginal of producers. A high cost producer enjoys a faster rate of margin expansion in a period of rising commodity prices than a more efficient producer.

Wall Street asked the mining community to exhibit high leverage. Which is a different way of sayingthat we asked the mining community to become marginal. And sadly the mining community reallycomplied.

You have a whole series of really large but capital inefficient investments made because they increased leverage to the commodity price. The consequence of that very idea is that the mining industry over the past six or seven years wrote off $70 or $80 billion worth of high-priced acquisitions or high prices developments. We had to pay pretty strongly for the sins that we brought on ourselves as investors in the mining community. That investment went to money heaven. My suspicion is that we may overshoot in terms of correcting it.

Many people value mining and energy businesses on for example a pure price/earnings basis. Which is fallacious. You can't value a mining business on a price/earning basis because of the deprecating nature of the asset. Everyday that you operate a mine your business get smaller by definition. It's not like a bakery where there are a bunch of inputs in front and bread comes out the back. The truth is that you have a finite amount of resources in a mine or an oil well and that's why you have depletion charges.

What I see happening now is a situation where capital investment probably so constrained as a consequence of the sins of what the industry manifested ten years ago, that we're going to have supply shortages going forward. And companies are not taking into account the fact that they need to reinvest into exploration and development to remain on-going concerns.



The truth is that we are living as a society on deposits that we discovered 30 or 40 years ago, that were advanced 20 years ago, that are now becoming long in the tooth. We're using on a global basis one Bingham Canyon copper mine a year. And we're not finding anything like one Bingham Canyon mine a year.

There isn't anything particularly perspective in this discussion, it's just the fact that our pricing expectations with regards to resources was set in the 1970s to the paradigm that we have adopted was a 1970s paradigm. It has taken us 40 years to disconnect from that paradigm and now I suspect that we will overshoot in the other direction.

**Coming up next…**
In previous interviews, Rick has called for a 'darwinian cleansing' of the junior mining sector. In part four of my conversation, Rick and I discuss the state of the mining industry today.

**CATEGORY**

1. Investing

**TICKERS GLOBAL**

1. NYSEMKT:PPLT (Aberdeen Standard Platinum ETF Trust - Aberdeen Standard Physical Platinum Shares ETF)
2. TSX:ABX (Barrick Mining)
3. TSX:CCO (Cameco Corporation)

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