Mining Industry Struggles with Inflation and Supply Chain Pose Challenges for a Low-Cost Green Future

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Despite the fact that consumers are starting to see faint glimmers of hope that inflation might finally be peaking and starting to hopefully roll over, the same can not be said for everybody. In the case of the mining community, where projects are developed over the span of years and decades, not days or weeks, the curses of the supply chain and inflation are continuing to rear their ugly heads.

There has been a spate of announcements suggesting that economics for these projects remain robust but costs are growing materially, or in one case, the company has put off the final investment decision until the second half of 2024. This is not encouraging when one thinks about how quickly governments around the world want to expedite the green economy and transition away from fossil fuels, given we are talking about the mines that will supply the resources to undertake this task.

Generation Mining's Marathon project's CAPEX just went up by 25%

The first example is Generation Mining Limited (TSX: GENM | OTCQB: GENMF), which is developing the Marathon Project, a large undeveloped palladium-copper deposit in Northwestern Ontario. The Company released its initial Feasibility Study ("FS") in 2021, but keep in mind a lot has to happen between an FS and the start of construction, of which environmental assessments, permitting, and financing, are some fairly large and time-consuming components. Correspondingly, now that Generation Mining has received its environmental assessment approvals and recently announced an indicative offtake term sheet, it's time to get serious about financing. Naturally, the Company needs to review how much financing they will need to move forward, so a revised FS was undertaken.

Despite management's positive spin, the news wasn't pretty. At the end of March, Generation Mining announced a 25% (C$224 million) increase to the initial construction CAPEX reported in the 2021 FS. Albeit, approximately 19% or C$43 million was due to scope changes, which is reasonable, but 71% (C$160 million) was due to cost escalation, and the final 10% (C$22 million) was a result of increased contingency. That's a big chunk of change, although it is unlikely to slow the project down as the economics remain solid and global demand for copper seems to be bullish in the long run. As well, the project is touted as being one of the lowest CO2 equivalent intensity mines in the world, which is a factor I'm sure will continue to become more important as time goes on.

Trilogy Metals announces updated Feasibility with CAPEX up 40%

Example number two is a similar story, Trilogy Metals Inc. (TSX: TMQ | NYSE American: TMQ) is advancing exploration and development at the Upper Kobuk Mineral Projects, high-grade copper-zinc-lead-gold-silver-cobalt properties in Northwest Alaska. Very similar to Generation Mining, in mid-February Trilogy announced an updated FS for its Arctic Project. But if you thought the Generation Mining results were exorbitant, wait until you see what happened to Trilogy. Granted it's not exactly apples to apples given the original Trilogy FS was a year older (2020) and there are somewhat different commodities in a different geographic jurisdiction but…

You know it's going to be a big number but I personally find it hard to conceive. The updated FS for Trilogy Metals' Artic Project has gone from US$1.22 billion to US$1.72 billion or a 40% increase. On top of that, annual payable metals production is down from the 2020 FS, implying that little to none of the surge in CAPEX was due to scope creep. Sure there was more than a doubling in mine closure and reclamation expenditures (US$205.4 million to US$428.4 million), which could be regulatory changes or any number of uncontrollable issues. But that still leaves US$271 million seemingly attributable merely to things getting more expensive.

This should be a bit of a wake-up call to investors everywhere who are banking on the optimism of "friend-shoring" natural resources. There are a lot of highly valued junior mining companies with a pre-feasibility study or possibly even less than that, who might be in for quite a reality check if/when the project starts to get serious.

Newmont delays Yanacocha Sulfides Project

All this might explain the simplicity of my third example. Newmont Corporation (TSX: NGT | NYSE: NEM) decided it wasn't even going to go there with its Yanacocha Sulfides project in Peru. Last September the Company announced it will delay the investment decision for the project to the second half of 2024. As part of the press release Newmont stated that evolving market conditions, including the continued war in Ukraine, record inflation rates, the rising prices for commodities and raw materials, prolonged supply chain disruptions, and competitive labor markets were part of its decision-making process. Unless

I'm missing something, I would have to say that "war in Ukraine" is more of an acknowledgment than anything else, because I'm not sure how that impacts a mine in Peru. I would also think the rising price for commodities would be a good thing but maybe they intended it in a different way. Nevertheless, you see the recurring theme of inflation and supply chain in there, so I've included it in my synopsis.

Final thoughts

What's my point? I alluded to it earlier but I will expand on it. First off, I think there might be a little too much optimism baked into a lot of the junior explorers at present. Yes, General Motors (NYSE: GM), Tesla (NASDAQ: TSLA), Ford (NYSE: F) et al are signing deals left, right, and center with numerous companies, and that's a very bullish thing. But what if GM and Tesla are smart enough to sign deals that have the miner get stuck with all the mining cost increases? The examples above show how an initial Feasibility Study may not be overly relevant a couple of years down the road. So that begs the question "What are the REAL economics of a project?"

Lastly, and this is more of a thought experiment kind of comment, in the grand scheme of things it would appear the world simply doesn't realize how much new critical minerals projects are going to cost. It seems that old metrics might not be overly relevant anymore. Inflation may have a much larger trickle-down effect than anyone imagined and the price of future EVs might cost a King's ransom, despite government subsidies.