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Under pressure in South Africa

Under the storm of falling commodity prices, South Africa's miners are not getting any sort of break locally, with power shortages, labour issues and regulatory uncertainty still the name of the game

Like most mines globally, the price fall in some key commodities has put strain on the country's major producers, tempered to an extent by a currency that is trading at 14-year lows to the US dollar.

This currency protection does however seem to be waning, evidenced by the June-quarter results from the three largest miners of South African gold. AngloGold, Harmony and Sibanye's South African mines produced a total of 915,000oz in the three-month period at an average all-in sustaining cost of just above US$1,100/oz, about where the gold price is trading at the moment.

"US dollar denominated commodity, and precious metal prices, especially those which are non-interest earning, face the challenge coming from the rising trend in US interest rates and the US dollar which has consequently strengthened," Colen Garrow, economist at Lefika Securities in Johannesburg tells *Mining Journal*.

"Labour disruptions intensify each year, adding to the above-inflation cost burden mines must bear, at a time when dollar revenues for commodities are declining."

Mark Cutifani, CEO of the country's biggest miner, Anglo American, recently pointed out to an audience at the Gordon Institute of Business Science (GIBS) near Johannesburg that the sector still contributed about 18% of GDP, 60% of exports, more than 500,000 direct jobs, and more than 800,000 indirect jobs. And through taxes and other benefits, it pays for 20c in every rand that is invested in public infrastructure and social benefits.

"At the heart of the issue is how we get South Africa's mining industry back on the growth track, where it can generate relatively consistent and attractive returns over the long term," he said. "Quite simply, it is because acceptable, consistent returns over the long term are proving so elusive that investor confidence has taken a beating, and why investors continue to shy away from the mining industry here.

"Labour disruptions intensify each year, adding to the above-inflation cost burden mines must bear, at a time when dollar revenues for commodities are declining"

"So we need to turn the vicious circle that we are now experiencing into a virtuous circle, with the industry operating in a facilitating environment that is conducive to its making profits, and where investment attracts further investment. And that requires a shift in mindset on all sides – from business, government and labour – if our mining industry is to continue to be a crucial partner in development as a significant contributor to the fiscus, a major employer and a cornerstone for the ongoing livelihood of host communities."

Statistics South Africa's (Stats SA's) 2014 Environmental Economic Accounts Compendium provided estimates on depletion rates for various minerals estimating that at current production levels the country will exhaust its coal resources in 119 years, platinum in 218 years and gold in 33 years.

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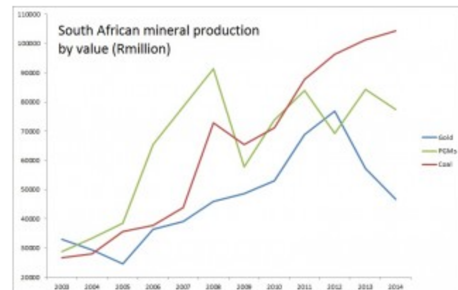
In 2014 coal production was the major commodity by sales value, according to data from Stats SA, followed by PGMs and gold. The three commodities made up about 60% of the total mineral production by value.

“Mining’s value added contribution to gross domestic product continues to shrink. The economy has diversified away from old style sectors like mining, into newer sectors like telecommunications, there is no escape from the fact that the contribution mining makes to real GDP has shrunk. In the 1950s it accounted for more than 50% of domestic output, while today that contribution is little more than 10%,”
says Lefika’s Garrow.



Coal contributed the most of any mineral commodity by value to South Africa’s exports in 2014

Stats SA

Despite gold’s fall to third in terms of current annual contribution by value, happenings in the industry continue to gather headlines, given its historical importance to the development of the country and its role as a major employer at about 130,000 people or 25% of the total sector’s employment, second only to platinum with 37%.

Wage negotiations are currently underway between gold miners and unions, and while strikes have not yet taken place, the unrest is being felt.

“At the operations, it does have a disruptive effect, even if we are not in dispute or strike mode. There is a lot of positioning by unions and associations and it does distract our workers,” Neal Froneman, head of the country’s largest gold producer, Sibanye Gold, recently told investors. “I think you will find every company in the sector will report weaker results because of this.”

He says Sibanye has worked very hard over the past 18 months addressing some of the social issues faced by its employees, including high indebtedness and housing conditions.

“The primary reason for doing that is to win their hearts and minds. There is a huge trust deficit at the moment between unions and employees, because of the competitive environment between NUM and AMCU.”

At over half the total, labour remains the single biggest cost on South Africa’s gold mines.

Most stakeholders would like to avoid anything close to the five-month long industrial action in the country’s platinum sector last year.

Lefika says: “The impact of strike action was profound, pushing the overall economy close to the precipice of recession. T central bank estimated that domestic output may have been as much as 2.2 percentage points higher in Q1 2014, had strikes on the platinum not taken place, instead of the -0.6% the economy contracted by.”

Of course these types of environments can sometimes result in major change and the current state of the gold mining sector could force consolidation in the industry, something Froneman says is inevitable.

“Moving assets around between owners is like moving the deckchairs around on the Titanic while it’s sinking. Yes there are some synergies between neighbouring operations, but the real benefit of consolidation in a sector like this at the moment is really around corporate costs, shared services and so on.”

"Clearly if the current gold price environment persists I think it is going to put gold companies under similar pressure to what you are seeing in the platinum sector and then we can have proper, balanced conversation."

Major job losses

Labour union Solidarity has just completed a report compiling an estimate of the proposed job losses across the country using media sources and comments made by its members. The numbers are not pretty.

Retrenchment estimates from 220 employers total 45,000 with the mining sector representing the largest affected sector with 19,800 jobs at risk, spread over a variety of commodity producers, including in iron-ore, diamonds, gold and platinum.

Platinum companies under pressure even include those that seven years ago attracted major takeover offers, including Eland Platinum which Xstrata bought for $1 billion in 2007 and Lonmin which Xstrata made a $10 billion hostile approach for in 2008.

> ***"There is a lot of positioning by unions and associations and it does distract our workers"***

Lonmin's situation is probably reflected by its fall in value, the world's third largest platinum producer by ounces now has a market capitalisation of about US$300 million. Eland which was adopted by Glencore when it merged with Xstrata is currently being considered for closure.

A Venmyn Deloitte report, commissioned by the World Platinum Investment Council, has just been released and highlighted the large amount of platinum production that is set to exit the market over the next couple of years.

It estimates the reduction in capital investment expenditure by South African platinum producers will limit output of the precious metal by as much as 16% in 2016 and 2017, compared to 2015 levels. The report tracks capital investment by South African producers over a 20-year period and estimates a decline in platinum output of more than 600,000oz in 2016.

"In the event that 2016 capital expenditure is consistent with the level announced for 2015, the refined platinum output projected for 2017 could also be at least 16% below 2015 levels," says the report.

It also highlights that annual platinum production from South Africa declined by over 500,000oz/y, or 11%, from 2008 to 2013.

Over the same five-year period annual capital investment in South African platinum mining declined by more than 40%, from R30 billion/y to R17 billion. Capital investment in 2014 was R13 billion and published capital investment for 2015 is R11 billion.

Not SOE easy

To best show how South Africa's power problems are affecting industry, one just needs to take a look at its contribution to overall costs for gold production at Sibanye.

In 2007, electricity made up 9% of the cost of producing an ounce of gold, now it is 19%, despite the company reducing electricity consumption by 20% (106MW) over the same period. "We expect it to become 25% of our costs," says Froneman.

Following a round of public hearings energy regulator Nersa, recently rejected a request for an increase in prices by Eskom.

"I do believe we were quite instrumental in ensuring that the additional 12% increase that Eskom was asking for didn't go through," says Froneman.

The company has also started to quantify the effects of load shedding on production and estimates that 270kg of gold production was lost in the first half of 2015. AngloGold estimates its losses in the period at 207kg.

"The actual number is bigger – these are direct kilograms. If you think of starting and stopping a metallurgical plant, there are additional inefficiencies that occur," says Froneman. This is something the company wants to try and quantify in future. "It's real and it is actually hurting," he adds.

As part of its response, Sibanye continues to progress its proposed 150MW photovoltaic solar plant, a phased R3 billion project with first generation by the end of 2017 (50MW).

"This is not the first prize in terms of becoming less dependent on Eskom, we really have to do something more material and continue to explore independent power producer (IPP) projects, which means we will probably have to look at becoming involved in coal resources," says Froneman.

The blank canvas

One company that is getting to start with a 'blank canvas' of sorts is Vedanta, which is developing a new pit from scratch at the Gamsberg zinc deposit, located in an incredibly remote area of the Northern Cape Province. Speaking on the back of the first official blast at the operation, Deshnee Naidoo, CEO of Vedanta Zinc International told *Mining Journal*: "This project has been almost four decades in the making and even after we announced [that we were proceeding] there was still some scepticism that it would go ahead."

The very sparsely populated location of the mine is a real benefit as the process of community relocation can sometimes be lengthy and expensive.

"The only thing I need to relocate is basically my succulent plant species, so that I can rehabilitate them somewhere else," she says. "But I have got to bring a community to Aggeneys [local town] in order to deliver this project."

The first blast at Vedanta's Gamsberg mine

The Northern and Eastern Cape have historically been areas that actually fed the rest of South Africa with good miners, according to Naidoo.

"So part of the programme would be to attract some of our miners back to the region to work on a mine near their hometown."

She adds that since Vedanta has been engaging with local authorities around permitting, it became clear that government was not entirely happy with what has happened in previous mining towns that have become ghost towns left behind to the authorities to run despite not being on their respective integrated development plans.

"What they have asked us to do in our little area (3,000 people live in Aggeneys) is for us to look at a strategy to try and build housing and infrastructure in the associated region to get people to the mine, so that we can leverage off their schooling and their healthcare instead of trying to create a silo within Aggeneys."

The company has started formal prestart mining activities, essentially the V-cut, the north access ramp, as well as some of the prestripping activites. "We are currently in the process of doing the detailed engineering work for the plant and we will only make the decision on when to physically start the plant at the end of this year," said Naidoo.

The majority of the investment, about $630 million, will go towards developing the open-pit zinc mine, concentrator plant and associated infrastructure at Gamsberg.

The remainder of the total $782 million capital requirement will be used to convert the Skorpion zinc refinery 350km away and over the border in Namibia, to handle the sulphide concentrates and convert them into high-grade zinc metal.

"Outside of capital allocation, the reason why we are also looking at when we want to physically start the plant is that we have the Black Mountain mine 20km away of the Gamsberg resource and although the orebodies are very different, I really want to pressure test the team to see if we can treat some of the early Gamsberg material in the Black Mountain plant."

This would involve possibly stockpiling the high-manganese material from Gamsberg and treating the low-manganese material through the Black Mountain plant.

Things are equally as positive on the other side of the border in Namibia. When Vedanta bought the assets from Anglo American in 2010, the Skorpion mine and refinery near Rosh Pinah was basically in a ramp down and close phase.

One of the first things Vedanta did after a life of mine exercise was increase it by another year and the latest work managed to increase the life of the pit by another 2.5-3 years.

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This integrated project idea also required some luck to fall Vedanta's way, after the company's own employees had come up with the idea of treating the high manganese concentrate in the Skorpion refinery.

"It is only in the last year, that the government announced a project in Namibia to upgrade the road between us here and Rosh Pinah. If it wasn't for that road we wouldn't have made this decision."

The potential is there

Despite its well telegraphed challenges, both at a macro and local level, South Africa's mineral wealth is still a treasure any country would love to have within its borders.

There are also several advantages the country has over its African peers with similar mineral wealth.

Andrew Chubb, from corporate finance advisory firm Hannam & Partners, told *Mining Journal*: "I think there is a body of investors that don't like the political risk. They see a government that is increasingly focused on resource nationalism and looking to preserve jobs, potentially at the expense of productivity.

"But having said that, South Africa's infrastructure is still incredibly impressive and it has got a highly skilled labour force and support industries in the mining space. And almost all of the construction of mines in Sub-Saharan Africa is undertaken or led by South African teams, I do think it is a good destination, but you do need to manage the government and labour relations."

The World Bank has also just released a report finding that South Africa is undergoing a profound demographic shift in which the working age population expanded by 11 million since 1994, and comprises 65% of South Africa's population of 54.9 million in 2015. It is also expected to grow by a further 9 million in the next 50 years.

Since 2000, the number of jobs in South Africa grew by only 2.8 million mainly in services. Agriculture, manufacturing, and mining sectors shed workers in the same period, with the result that total jobs created fell far short of the growing labor supply.

South Africa's minerals minister Ngoako Ramatlhodi

The report shows that if in the next 15 years enough jobs could be created to absorb new entrants and lower the unemployment rate by three-quarters, and if vocational training could be used to retool the long-term unemployed to make them more attractive to employ, and if education improved so new entrants to the workforce are better equipped for the modern workplace, real GDP growth would accelerate to 5.4% per year, enough to allow per capita income to double and extreme poverty to be virtually eliminated by 2030.

Cutifani said in his recent address at GIBS: "We all need to change the nature of the conversation we have in mining so that all constituencies start to work together in tackling the constraints that are hampering the traditional powerhouse of South Africa's economy from being globally competitive once again. Only through success in this will the South African mining industry restore its competitive advantage, be able to attract essential foreign investment, and regain its rightful position near the top of world mining's Premier Division."

Zimbabwe stable

Zimbabwe's economic recovery in recent years has been underpinned by the mining and agriculture sectors, which accounted for 93.5% of export revenues between 2009 and 2013. According to the African Economic Outlook, mining, which made up 65.2% of export earnings over the same period, is a typical enclave sector, with weak linkages to the rest of the economy.

While not much has changed politically over the past few years in Zimbabwe, gold mining companies there continue to make it work despite the difficult conditions.

Metallon, the private gold producer and the country's largest, has made further progress growing production back to levels before it closed its mines a few years ago.

The company, having bought certain Zimbabwean gold assets formerly owned by Lonmin plc in 2002, has been dewatering and reopening its various mines since 2009. Production of the five assets under Metallon peaked in 2005 at 156,000oz, contributing about half of the Southern African country's gold output in that year.

Gold production totalled 99,000oz in 2014 and a target of 130,000 -150,000oz has been set for 2015. The company has an ambitious target to be a 500,000oz producer by 2019.

In September last year finance minister Patrick Chinamasa slashed royalty rates to 5%, from 7%. Mwana's then chief executive Kalaa Mpinga said: "We have actively engaged with government on this issue and it is very pleasing that – in a spirit of understanding and co-operation – it has recognised the challenges inherent in the gold mining industry at present."

Mwana has since been through a boardroom coup which has resulted in the departure of founder Mpinga and his allies. The change of management was said to have been engineered by the company's largest shareholder Chinese International Mining Group Corporation (CIMGC) and its chairman Yot Hoi Ning.

Mwana operates the Freda Rebecca gold mine and the Bindura nickel mine in Zimbabwe. The intentions of the new board have not yet been made clear.

Another gold producer, Caledonia continues to implement its Revised Investment Plan at its Blanket mine, which involes the sinking, deepening and equipping of four shafts. This should translate into increased production in the March quarter 2016.

Steve Curtis, Caledonia's president and CEO said: "The successful implementation of the plan will result in a significant increase in Blanket's production and operating efficiency; the lower gold price increases the importance of delivering the revised investment plan as scheduled."

Economically, the period 2009-12 was marked by an economic rebound following the introduction of the multiple currency system, with the economy growing at an average rate of 11.0% per annum. However, GDP growth decelerated sharply from 10.6% in 2012 to 4.5% in 2013 and an estimated 3.1% in 2014. Real GDP is projected to marginally improve to 3.2% in 2015. This projected marginal improvement will be on the back of planned investments in agriculture, mining, communications and other infrastructure projects, including in the water and energy sectors.