IN THIS EDITION

BENEATH THE SURFACE

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WHAT THE FUTURE HOLDS

The South African Mining industry looks set to enjoy a much-needed reprieve as 2018 shapes to be the year the industry can catch its breath. It is still very dependent on the discussions between the Chamber of Mines and Department of Mineral Resources to finalise the Charter and impasse. The fourth quarter experienced the highest growth rate of 2017, with the economy expanding by 3,1% quarter-on-quarter (seasonally adjusted and annualised). Mining's growth was spurred on, in part, by increased production of manganese ore, chrome, and iron ore, according to a recent article by Stats SA. This increase is closely linked to production of steel contributing to these increases.

Cost optimisation and increased productivity will remain core to the mining industry. The strategies adopted over the past few years will place mining companies in a strong position to capitalise on improved operating margins and if market conditions continue to strengthen, the focus will shift to growth developments which will come in the form of asset expansion as well as asset acquisition.

In recent times expansion projects and tenement developments have been put on hold but as many sites enter into the final stages of their life, these developments are once again commencing to ensure asset continuity.

Asset acquisitions have most recently been driven by some maintenance with pockets of investment, although this is still relatively low. There is some realignment of some of the major players with change in strategy and a number of loss making sites up for sale. These predominately equity based transactions will continue in 2018 and will consolidate the position of the mid-tier and larger players helping them in their respective commodities at the peak of the next cycle.

While the industry is by no means at the beginning of a boom, the overriding sentiment of the sector is one of off shoots of optimism. While it is safe to say that the focus will still be on strengthening the balance sheet, improving commodity prices have freed up funds to replace much needed equipment which will ultimately filter down to the suppliers. As the focus, shifts to the future miners will ensure they have the best assets in their portfolio to achieve sustainable growth and maximise the financial return to their shareholders. The Department of Mineral Resources needs to also play its part in supporting and guiding the industry and encourage new exploration and mining developments.

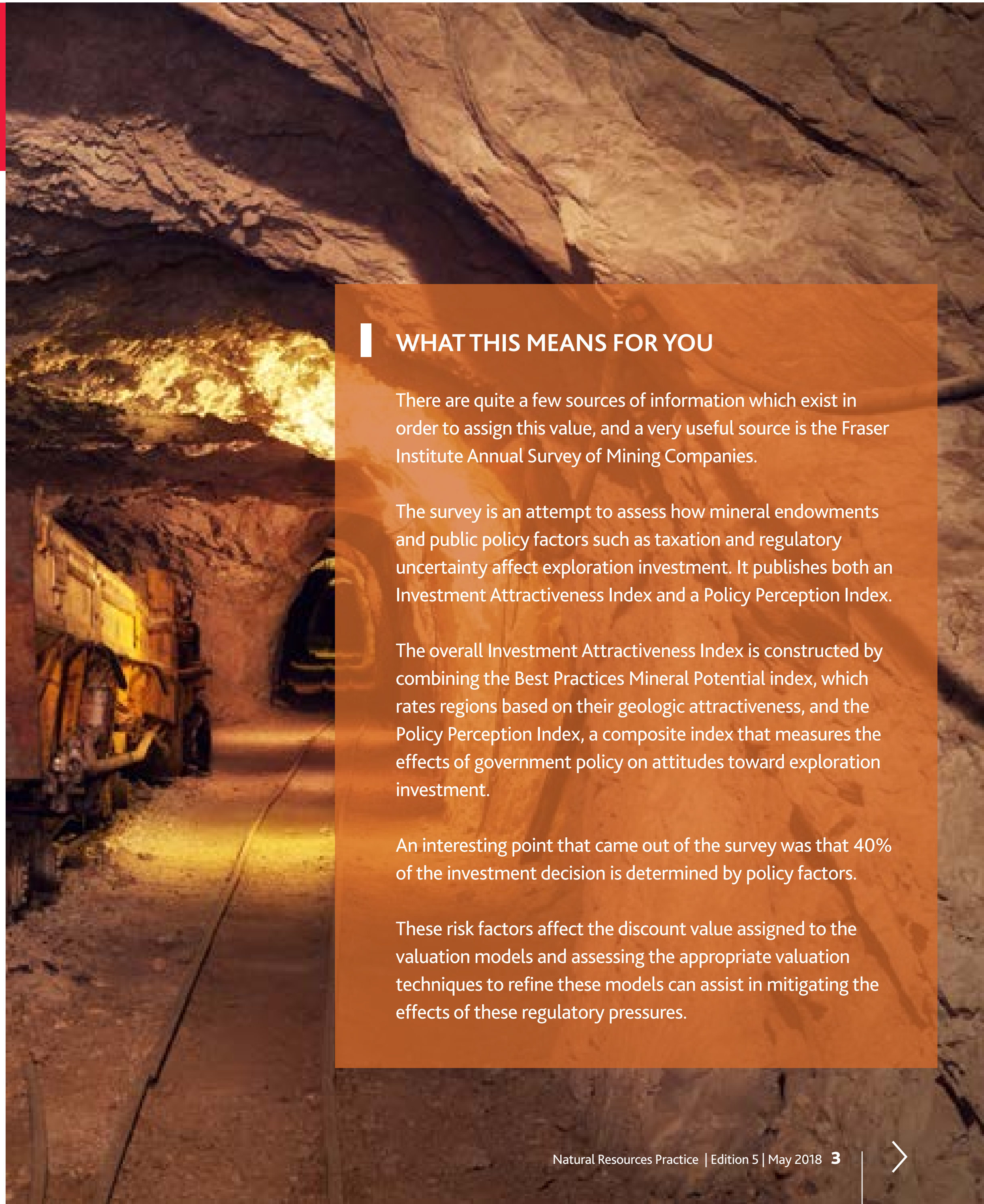
PREDICTIONS TO KEEP TOP OF MIND

In the past few years, a lot has been said about what the mining sector needs to prepare for to remain sustainable and relevant within the economy. We have considered various challenges and opportunities that we believe may affect the industry. Companies that have not recognised the changes that are coming need to be aware that there is a widening gap between the leaders and followers.

INCREASED GOVERNMENTAL REGULATIONS LEADING TO INCREASED UNPREDICTABILITY OF LIFE OF MINE PLANS

Regulatory risk has been a feature of mining for many years and life of mine (LOM) models have developed country risk factors that affect the discount rates applied in the valuation models used for such purposes. This process of assessing country risk has been undertaken on a country by country basis and is largely driven by an assessment of the degree of political stability in a country. We have witnessed increasing degrees of government regulation in areas that were previously assumed to be fairly stable. For example, new regulations relating to state ownership, royalties and mining tenure in Tanzania have purported to supersede all the stability agreements that were entered into over the last 20 years, and which were specifically designed to attract new investment in the mining sector in Tanzania.

Our prediction is that LOM modelling techniques will have to be refined to cater for this factor via a more sophisticated approach to the historical data available and the general factors underlying this.



WHAT THIS MEANS FOR YOU

There are quite a few sources of information which exist in order to assign this value, and a very useful source is the Fraser Institute Annual Survey of Mining Companies.

The survey is an attempt to assess how mineral endowments and public policy factors such as taxation and regulatory uncertainty affect exploration investment. It publishes both an Investment Attractiveness Index and a Policy Perception Index.

The overall Investment Attractiveness Index is constructed by combining the Best Practices Mineral Potential index, which rates regions based on their geologic attractiveness, and the Policy Perception Index, a composite index that measures the effects of government policy on attitudes toward exploration investment.

An interesting point that came out of the survey was that 40% of the investment decision is determined by policy factors.

These risk factors affect the discount value assigned to the valuation models and assessing the appropriate valuation techniques to refine these models can assist in mitigating the effects of these regulatory pressures.

DEEP LEVEL MINING CHALLENGES

The health and safety issues that attach to deep level mining are increasingly being brought under the spotlight. Much has been written about mining being disrupted by digital transformation and new processes, but in this area the degree of change, the cost of research and the implementation of new technology is greater. We believe that easy wins have been achieved and are in the process of being implemented in areas such as the metallurgical and the stores systems. Replacing age old drill and blast processes is in a different league.

We predict that the drive to develop cost effective alternatives to traditional mining processes to continue, but that developments will be constrained by the cost of this research, as well as the risk on implementing new technology until such time that the cost/benefit analysis has been established to justify its introduction on a larger scale. We expect that innovation and investment in this area will increase, but investors will not commit large sums until such time that the various prototypes have established themselves as cost-effective solutions.

WHAT THIS MEANS FOR YOU

The South African government has recognised the role that innovation and research and development plays in this area and has developed an array of tax and other economic incentives to encourage entrepreneurs to develop solutions in this area.

One of the strategic approaches to minimising the effects of these said challenges is to take advantage of these government incentives.

GREATER NEEDS OF STAKEHOLDERS INCLUDING COMMUNITIES

In the comment on the political risk factors we mentioned above, we said that governments are increasingly intervening in mining regulations to make the valuation of mining projects more unpredictable. A further trend we have noticed is that community engagement models are playing an increasingly important role in establishing a company's "social license to mine".

All listed mining companies have sustainability reports that measure various factors relating to the mining companies' operations, their impact on local communities, and their efforts to mitigate such impacts. We predict that these trends will continue and that even if the mining company has complied with the national legislation affecting its operations, that the communities around the mining areas are increasingly demanding a say in a variety of areas, some of the important ones being the environmental impact and whether the area will be sustainable from an agricultural point of view in the future.

The consequence of this is that this will become a bigger area of focus in feasibility and pre-feasibility studies and that this area will have to be more carefully managed in the future.

WHAT THIS MEANS FOR YOU

Stakeholder engagement is becoming increasingly important for companies who issue integrated reports and those that publish separate stakeholder reports.

Therefore, in preparation for the future, strengthening communication channels with your stakeholders will be a critical step to curbing the effects of the often unexpected developments in the communities you operate in and their impact on your business operations. In essence, as you undergo stakeholder mapping exercises, you are prompted to understand what needs are paramount to them and how to best engage them.

LATEST NEWS

The South Gauteng high Court delivered its judgement on the hotly debated subject of the "once empowered, always empowered" principle. The Chamber of mines and its members have been resisting claims by the Department of Mineral Resources (DMR) that this principle should be respected and in order to bring the matter to finalisation, the Chamber approached the High Court for a declaratory order to confirm the principle.

The High Court said in its judgement that when the shareholding targets that had been set in the Mining Charter are reached, the mining right holder "… is not thereafter legally obliged to restore the percentage ownership… controlled by HDPs [historically disadvantaged person] or HDSAs [historically disadvantaged South Africans] to the 26% target referred to in the original charter and in the 2010 charter where such percentage falls below 26%…"

The aforementioned ruling seems to have fallen heavily on the shoulders of the DMR, which has since taken the decision to appeal it. This is contrary to the expectations that it would let the matter rest. This decision sends a negative message to investors, as the implications of companies potentially having to issue vendor funded shares every three years can result in significant dilution for existing shareholders.

This remains an interesting topic for many businesses both directly and indirectly related to the mining industry, while they wait to see what the future unfolds, as developments continue to form shape with the involvement of various stakeholders weighing in on the pros and cons that the Mining Charter presents them.

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