Tracking the trends in mining
Key issues facing the mining and metals industry in 2015

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Quick introduction

Tim Biggs
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- Deloitte UK Metals & Mining sector leader
- Based in London
- Mining clients in gold, copper, diamonds, iron ore, coal (met and steaming)
- Client operations in Australia, South Africa, Canada, Chile, Egypt, Russia, Ukraine, Kazakhstan, United States
- Client corporate headquarters in London, Jersey, Johannesburg, Brisbane, Adelaide, Hong Kong, Santiago, Denver
- Piano player
Global context

FTSE All Shares Index for the last 12 months

Note: the movement in the FTSE 100 is almost identical.

Source: London Stock Exchange plc

Global context

Oil price for the last 12 months:

Source: Financial Times, 22 April 2015
Global context

Iron ore benchmark price for the last 12 months:

Source: Financial Times, 21 April 2015

Gold price for the last 12 months:

Source: Financial Times 22 April 2015
Coffee price for the last 12 months:

Source: International Coffee Organization

Copper price for the last 12 months:

Source: Financial Times, 22 April 2015
Global context

Key influences:

- OPEC decision to maintain output
- Iron ore majors decision to maintain output
- China growth slowing
- Middle East/North Africa tensions
- Russia/Ukraine tensions
- Eurozone continues to be very mixed
- US market generally good
- Seaborne freight rates dropped
- Equity markets strong

Top 10 key issues in mining

Some key themes:

- Ongoing price volatility – impacts parts of the sector more than others, eg juniors, coal producers (flow-on effect from iron ore), explorers, mining services.
- Need to move beyond reactive cost reduction to “business as usual” operational excellence.
- Stakeholder engagement (shareholders, governments, communities etc) absolutely vital.
1. Back to basics
The pursuit of operational excellence

- Miners have sharpened their focus on sustainable productivity improvements
- Insourcing vs outsourcing decisions critical, eg:
  - Owner mining vs contract mining decisions
  - EPC contracts vs owner-managed capital projects
  - Reduced supplier base, trade off loyalty for discounts
- Miners want operational excellence and the “cost down” culture to be embedded before commodity prices recover and the imperative is lost.
- Companies are improving their collection and use of data to ensure quality of decision making.

2. Innovation
It’s about more than just cost control

- Incremental improvement is not enough to control costs in a sustained lower-price environment
- Innovation can make a significant difference, particularly if it can
  - reduce expensive labour costs
  - reduce transport costs
  - prolong equipment life
  - enable higher intensity mining
  - reduce the risk of lost time injuries
- In mining, successful innovation is more of an implementation problem than a technology problem
3. The new energy paradigm
Reducing project power costs

- Energy shortages are becoming more pronounced
- Grid power prices increasing, despite lower current oil price
- Power outages, or the threat of power outages are a serious problem for many mines – certainty of supply is vital
- Cost of infrastructure increasing, includes power connections
- Modern mining and larger plants very energy intensive
- Makes adding renewables to the mix more attractive
- Miners can suffer from political decisions to switch power to more “palatable” customers (eg load-shedding industry to preserve supply to domestic consumers)
- Another reason to focus on innovation – energy efficiency
4. Dwindling project pipelines
Walking the supply/demand tightrope

- To control costs and preserve cash, marginal projects are being mothballed or shut altogether, poorly performing assets divested (if a buyer can be found), and exploration spend reduced.
- Brownfield exploration preferred over greenfield, which is often left to the juniors.
- The slowdown in exploration may significantly impact supply in the next decade.
- The difficulties in obtaining external funding for exploration will further constrain the future project pipeline and worsen the future supply shortage.
5. Disappearing financing
Implications reverberate across the market

- The struggle to raise capital continues
- Global mining stocks are down 43% since 2010, investors are wary
- Situation is difficult for large and mid-tier players, extremely difficult for junior miners, explorers and mining services companies
- Investors expecting cash returns, either through maintained dividends or share buy-backs, regardless of the drop in commodity prices
- The critical link the juniors play, particularly in exploration, often seems to be forgotten
- Alternative financing options, eg royalty streaming, offtake agreements, etc, are becoming more critical
- Big private equity houses waiting for the “bottom of the cycle” before spending their cash

6. Survival of the juniors
Navigating troubled waters

- Difficulty in raising both equity and debt
- Pressure to bolster short-term profits, and the need to maintain cashflow in low-price environment, leads to reactive decisions that cause long-term value erosion
- Growth through acquisition has dried up
- Juniors not as well equipped to deal with the increase in government and community activism
- Good news for mid-tier players with money, and the private equity investors, is that there are quality assets available from the majors’ spin-offs and the juniors’ distressed assets.
7. Seeking new skillsets
Shifting industry realities call for a new generation of talent

- The immediate call for talent has waned
- Demand for specialised skills is still strong
- New types of skills-shortages are emerging:
  - Directors, now expected to accept much greater responsibility and with significant focus on corporate governance standards, are often ill-equipped to cope with their expanded mandates
  - Competition for scarce technological talent with non-mining sectors
  - Difficult to attract quality to remote locations or less secure juniors
  - Training still important to secure the next generation of mining talent
8. Geopolitical uncertainty
From “best guess” planning to embracing uncertainty

- Hard to predict the impact of geopolitical movements
- China growth slowing
- India the next big thing?
- Africa still a continent of huge opportunity but also huge challenges
- Tensions with Russia
- Still serious corruption issues across Africa, South America, CIS and parts of South-East Asia
- High quality risk-assessments and evaluations are vital
- Staying close to policy makers very helpful
9. Stakeholder engagement
Companies struggle to balance competing interests

- Many companies still poor at effective stakeholder engagement
- Need to find ways to enhance stakeholder and constituency management, although there are challenges:
  - Number of stakeholders keeps growing
  - Frequently there are fundamental conflicts between different stakeholders’ interests (eg community desire for economic benefit vs environmental concerns)
  - Government focus (eg desire to make a project economically attractive vs desire to increase the tax take)
  - Indigenous and traditional owner demands
- Poor stakeholder management can lead to delays, court challenges and in the worst case, loss of licence to operate.
- Done well, stakeholder support can lead to high community engagement and goodwill, easier and faster approval processes and a lower cost of mining

10. Engaging with government
Finding new ways to communicate and collaborate

- Miners are having to be more strategic in dealing with governments
- Real risk of governments “killing the goose that laid the golden egg”
- Some governments have realised this and are seeking to make development more attractive through:
  - Implementing laws to attract investment and make development approvals easier
  - Working to make the industrial relations environment more certain
  - Introducing royalty and taxation regimes which incentivise companies to grow
- Other governments unfortunately are going the other way, eg raising taxes on miners to pay for social programmes without consultation
- Miners, in the current low-price environment, are responding quite quickly to extreme cases of government disincentives by closing mines and sometimes exiting countries altogether.
In summary

**Costs and prices** – cost reduction vital, prices down, funding harder, innovation a must, energy security an issue

**Looking to the future** – project pipelines dwindling, juniors struggling

**The operating environment** – engagement with communities, governments and other stakeholders vital, geopolitical uncertainty shows no sign of abating

**People** – talent harder to find

**Sounds a bit dismal?**
In summary

Challenging yes, dismal no.

Mining produces what we need to live our lives, and copper is a fantastic example of that.

We are very confident in the future of mining.