Resource Nationalism:
How to grow, not shrink, the pie

Nick Holland
CEO Gold Fields
GIBS, 15 August 2013
Resource Nationalism is entirely rational...

**Definition:**

Countries’ efforts to extract maximum value and developmental impact for their people from their finite natural resources.
...particularly as states are under fiscal pressure

Note: Includes the 41 countries who have continuous central government debt data from 2003 to 2011
Source: World Bank
But Resource Nationalism is viewed badly

“Resource nationalism a key threat to mining”  
BlackRock, Oct 2011

“Miners encounter the hard rock of resource nationalism”  
The Telegraph (UK), Nov 2011

“Resource nationalism plagues the oil market”  
Wall Street Journal, Mar 2012

“Resource nationalism: the usual suspects or a wider problem?”  
RigZone, May 2012

“Resource nationalism is miners’ number one fear and major threat to global security”  
Mining.com, December 2012

“Canada’s veto of Petronas deal raises spectre of resource nationalism”  
Daily Telegraph (UK), Oct 2012

“Resource Nationalism #1 on mining risk list”  
Ernst & Young, Aug 2011
What is the disconnect?

1. Too many fingers in the **wrong pie**
   – Mining profits

2. **Not growing the right pie**
   – The Mining Economy to create jobs, fuel development and attract investment capital
Too many fingers in the **wrong pie**

- At first glance, it might appear there’s a bigger slice to take

*Mining Net Profit - pre Tax and Royalties: Global 2012 = ~$280B*

- Dividends 42%
- Direct corporate tax 25%
- Net Profit post Dividend 25%
- Royalties 9%

Note: Data based on PwC Mine 2012 analysis of income statements from the top 40 companies but scaled up to represent the whole mining sector
Source: IHS Global Insight; Mine: PwC Mine 2013
Why? Wrong cost metric

- At first glance, it might appear there’s a bigger slice to take

- Our industry has made this pie look more attractive than it is by focussing on cash costs not all-in sustaining costs

Gold example

'Cash cost' hides unprofitability of gold mining
GATA, August, 2009

Gold miners need to think differently about costs
Nick Holland, August, 2012

Average total production cost was $1170/oz, compared with an average reported cash cost of $773/oz
Gold analyst, Bell Potter, Jan 2013

More transparency needed on gold production cost
BlackRock, December 2012

Gold Miners Come Clean on Costs After Lost 6 Years
Bloomberg, February 2013

The (gold) industry has to change and make sure they're very transparent around how they report costs
Northern Star Resources, January 2013
Mining industry is going through tough times

- At first glance, it might appear there’s a bigger slice to take.
- Our industry has made this pie look more attractive than it is.
- In reality, margins and returns from mining are in decline.

Gold industry example: Costs up; Returns down

- Costs rising at ~12% (CAGR (06-11))
  - Operating cost per tonne (2006-2011)
- Yields down 5% (CAGR (06-11))
  - Average gold yield (2006-2011)

Exploration budgets up 20%  New Discoveries down 7%

- Exploration budgets: Grassroots + 75% of late stage budgets (1997-2011)
- New Discoveries: 3-yr avg potential production in new discoveries (mil oz) (1997-2011)

Note: Cost per tonne is the weighted average of 8 major gold producers by total ore mined; average grade is the weighted average of 8 major gold producers by total ore mined; Major Gold producers: AngloGold Ashanti, Barrick, Harmony, Kinross, Goldcorp, Gold Fields, Newmont and Newcrest.
Source: Gold Fields company data; annual reports, Condemned to Excellence report (IAMGOLD Corporation, Dec 2012)
Margins in the gold sector are under pressure…

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**Gold industry example: margins in rapid decline**

- Margins under greater pressure as gold price has since fallen as low as $1300/oz.

**Gold price**

**Avg cash costs**

**Avg capex**

**% margin (RHS)**

**Source: Streetwise reports website**
… as they are for the Top 40 global miners

- At first glance, it might appear there’s a bigger slice to take
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- Similarly the top 40 mining companies are experiencing serious financial troubles

Industry is not self-funding at present

- At first glance, it might appear there’s a bigger slice to take
- Our industry has made this pie look more attractive than it is
- In reality, margins and returns from mining are in decline
- Operating cash flows not sufficient to cover investments

Top 40 2012 cash flow ($Bs)

$137B

- $169B

Operating

Investing

Note: Data based on PwC Mine 2012 analysis of top 40 companies
Source: IHS Global Insight; Mine: PwC Mine 2013; Note: Gearing ratio = Net borrowings / Equity
Investors are deserting the sector

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- Operating cash flows not sufficient to cover investments
- Equity model is at breaking point
Industry is halting new investments…

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- Mining investments under threat

A harsh environment with new projects increasingly being delayed and cancelled

Sources: Factiva, Literature search
... and cutting back on existing operations

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- Mining investments under threat.

Existing mines under pressure from price decreases and cost increases; greater taxes will aggravate the problem.

150 jobs go as Tanami closes mine
The West Australian – April 24, 2013

South African miner Amplats closes shafts and cuts jobs
BBC – Jan, 2013

Xstrata's Sinclair mine in WA to close, follows closure of nearby Cosmos
Dow Jones - May 2, 2013

Brunswick Mine closes Bathurst-area operation: Unemployment hit 20.2%
CBC News - May 1, 2013

Sibanye Gold to Cut 1,110 Jobs to Return Beatrix West to Profit
Bloomberg – May 29, 2013
This is why mining earnings is the wrong pie

- At first glance, it might appear there’s a bigger slice to take
- Our industry has made this pie look more attractive than it is
- In reality, margins and returns from mining are in decline
- Operating cash flows not sufficient to fund investment
- Equity model is at breaking point
- Mining investment is under threat

The revenue pie shows just how little there is still to take

Note: Data based on PwC Mine 2012 analysis of income statements from top 40 companies but scaled up to represent the whole mining sector
Source: IHS Global Insight; Mine: PwC Mine 2013
This is the **lose:lose** pie

- The more everyone takes, the greater the risk the pie shrinks:
  - Rising costs of mining...
  - ...combined with a greater fiscal take...
  - ...jeopardise further investment

- The result: loss of jobs and long-term government revenues
No Development without Growth

- GDP growth is essential for governments targeting effective development and economic transformation.

Countries must both grow AND develop. Growth OR development is untenable.

Source: Brenthurst Initiative, 2003
Growing the **right pie: Mining GDP**

- GDP growth is essential for governments targeting effective transformation.

- Mining GDP is the right pie, especially for resource-rich developing countries.

- In 2010 the economies of 40 countries were driven to a significant extent by mining:
  - Metals and Minerals accounted for >25% of exports.

<table>
<thead>
<tr>
<th>BRICS 2010</th>
<th>7 other resource rich countries 2010</th>
</tr>
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<tbody>
<tr>
<td>Direct mining share of GDP 2% ($200B)</td>
<td>Direct mining share of GDP 10% ($140B)</td>
</tr>
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</table>

Source: ICMM: Mining’s contribution to sustainable development October 2012; Note: Top 7 countries selected from top 20 countries other than BRICS by 2010 production value and where production values is greater than 5% of GDP. These include Australia, Chile, Peru, Ukraine, Ghana, Zambia, Papua New Guinea (South Africa included in BRICS).
The Mining Economy has large multiplier effects

- GDP growth is essential for governments targeting effective transformation
- GDP is the right pie, especially for resource-rich developing countries
- Mining punches above its weight with its GDP multiplier effect

Job and livelihood multiplier effect is significant

- GDP growth is essential for governments targeting effective transformation
- GDP is the right pie, especially for resource-rich developing countries
- Mining punches above its weight with its GDP multiplier effect
- 1 direct mining job supports 1 indirect job and 1 impacted job
- ...in SA, 1 job supports on average around 9 dependents

Number of jobs and livelihoods supported by each mining worker

- Mine worker: 1
- Direct impact: 8
- Secondary and tertiary sectors: 14
- Informal sector: 4
- Total direct and indirect impact: 27

Note: Peru study based on five mines and Ghana study based on analysis of one mine.
Benefits go beyond jobs

- GDP growth is essential for governments targeting effective transformation
- GDP is the right pie, especially for resource rich countries
- Mining punches above its weight with its GDP multiplier effect
- Investing in mining creates jobs, investment and uplifts communities

Multiplier benefits go beyond jobs

<table>
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<tr>
<th>Capital inflows</th>
<th>Skills/ education</th>
<th>Catalyst for other industries</th>
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<tr>
<td><img src="capital_inflows" alt="Image" /></td>
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- Technology transfer
- Infrastructure
- Community development

Resource Nationalism - Statement v2.5...
Growing mining activity has a dramatic impact

- GDP growth is essential for governments targeting effective transformation
- GDP is the right pie, especially for resource-rich developing countries
- Mining punches above its weight with its GDP multiplier effect
- Investing in mining creates jobs... and uplifts communities

- A 1% increase in mining in just 12 countries creates ~$8-9B of value in Year 1...

Source: ICMM: Mining’s contribution to sustainable development October 2012; Indirect effect estimated at 2.5X
Note: Top 7 countries selected from top 20 countries other than BRICS by 2010 Production value and where Production values is greater than 5% of GDP. These include Australia, Chile, Peru, Ukraine, Ghana, Zambia, Papua New Guinea; First figure is weighted average; Second figure is numerical average
Growing this economy can have a dramatic impact

- GDP is the right pie, especially for resource-rich developing countries
- GDP growth is essential for governments targeting effective transformation
- Mining punches above its weight with its GDP multiplier effect
- Investing in mining creates jobs... a uplifts communities

- A 1% increase in mining in just 12 countries creates ~$8-9B of value in Year 1 ... compounded over several years it is even more significant

Source: ICMM: Mining’s contribution to sustainable development October 2012; Indirect effect estimated at 2.5X
Note: Top 7 countries selected from top 20 countries other than BRICS by 2010 Production value and where Production values is greater than 5% of GDP. These include Australia, Chile, Peru, Ukraine, Ghana, Zambia, Papua New Guinea; First figure is weighted average; Second figure is numerical average
Growing GDP through mining is the **win:win pie**

- **Growth** … leads to more investment
- The result: increased employment, development and national **GDP growth**
- How do we get there?
- It has been done before
Chile focused on the ‘win:win’ pie

• Long term investment to establish market economy, strong institutions and transparent and stable fiscal regime
  - Chile has the best risk ratings in South America

Note: South American index includes 12 South American countries (Argentina, Bolivia, Brazil, Colombia, Ecuador, Guyana, Paraguay, Peru, Suriname, Uruguay, Venezuela)
Source: IMF data, March 2013
Peru acted to continue growth

The Humala government recently enacted similar policies to continue growth:
- Proactively engaged with industry and communities in a full review of all the options
- Ended up with a pragmatic focus on rent taxes
- Continued to ring-fence benefits for regions and projects linked to mining to help address sensitive local community issues

Source: World Bank data, March 2013
• **Strong long term partnership** to ensure mutual success
  - 40-year partnership to drive benefits for both Botswana and Debswana
  - Limited government involvement in production
  - Government invested in social transformation including infrastructure and education
Zambia has learned from the past

GDP at PPP USD (Indexed to 100)

- **1964**: Independence
- **1969**: Govt. nationalises two major mining companies to get a higher share of mining revenues
- **1970s**: Copper prices fall owing to Vietnam and oil crisis
- **1974-94**: Prolonged depression; Income fell by 50%; Mining production cut by 60%; lost $45B in mineral rents from 1970-2010
- **1990**: By 1990, 95% of Zambia’s forex going to service debt
- **1991**: Regime change
- **1995**: Privatisation restarts
- **2000**: Direct mining was 24% of GDP in 2010

Source: Penn World Tables, University of Pennsylvania, [https://pwt.sas.upenn.edu/php_site/pwt71/pwt71_form_test.php](https://pwt.sas.upenn.edu/php_site/pwt71/pwt71_form_test.php)
Mining is at a crossroads

- **Long term collaborative partnerships** (Miners, Governments, Labour, Communities, Dev. Agencies)…
- … leading to **more investment**
- The result: increased **employment, development** and **GDP growth**

- **Rising costs of mining….**
  - … combined with a **greater fiscal take**…
  - …jeopardise further investment
- The result: **loss of jobs**, a shrinking pie

How do we grow the win:win pie?
Starting point: Ore bodies

1. They can’t be moved, changed or replaced

2. Development is expensive and inherently risky with long lead times

3. Development has a major impact on communities and the environment
What can you do with them?

You either have ore bodies or you don’t.

If you have them and they’re economically viable, environmentally sound and socially acceptable, develop them.

Determine full socio-economic viability by taking the potential economic multiplier impact into account.

However, this is not possible in the absence of investors.
But how do investors feel about the sector today

- **Equity investors have become frustrated** as miners have spent their money with little to show for it.

- **Cash, not growth, is king:** Miners are cancelling new projects and **closing existing mines:** returns just do not warrant the risk.

- This leaves **ore bodies undeveloped** that are economically and socially viable (when the GDP multiplier is taken into account).

- Moreover, the **full potential benefit from mining** on communities and the environment is **not always being addressed or delivered**.
How to align national interests with investors?

The role of mining companies

1. Acknowledge the role mining companies have played historically in exploiting resources and people

2. Recognise that both a mining licence and a “social licence” are required to operate

3. Develop practices that crack the code on long-term sustainable community development – beyond life of mine

4. Engage with government on how to fund infrastructure development, fuel growth in other sectors and improve social outcomes
Making progress…but more needs to be done

Moving from philanthropy to systematic creation of shared value, recognising the impact of the GDP multiplier effect

Direct Economic contribution

Mitigating the impact on the Environment

Small-business development

Local supplier development

Health, safety and well-being

Socio-economic and community development

Skills/training

Ring-fenced benefits to drive value in host communities and beyond
How to align national interests with investors

The role of governments

1. Seek collaborative partnerships with miners who are better able to operate and develop ore bodies and who are good social partners

2. Put in place stable, competitive tax systems that allow equity investors to earn competitive risk-weighted returns, with governments benefitting increasingly from the upside

3. Ensure full impact of mining is taken into account when assessing economic viability and social acceptability (requires a good understanding of the multiplier benefit as well as the full costs of mining)

4. Create a climate conducive to responsible investment: provide policy certainty (and then stick to the rules); develop infrastructure and the broader economy; partner to manage input costs; help miners to procure locally

5. Adopt a “use it or lose it” approach (within an overall “win:win” context) to ensure all socially acceptable/economically viable ore bodies can be developed
Not easy to do, but the upside is vast

<table>
<thead>
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<th>CHALLENGE</th>
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<td>Partnership</td>
<td>• Working and collaborative partnerships between miners, governments, labour and communities</td>
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<tr>
<td>Balance</td>
<td>• Balance long-term growth strategies with short-term fiscal imperatives</td>
</tr>
<tr>
<td>Transparency</td>
<td>• Total transparency in reporting individual asset performance</td>
</tr>
<tr>
<td>Certainty</td>
<td>• Long-term commitments from governments not to change the rules of the game</td>
</tr>
<tr>
<td>Simplicity</td>
<td>• Simple rules of the game that align interests and can be applied to all assets</td>
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Conclusion: Winning nations will choose the high road

- Engage to **develop collaborative long term partnerships**…
- ... **increase investment** …
- ... **Drive GDP growth**: every 1% increase is worth ~$8-9B in just one year in just 12 developing countries
- **Fight for a share** of declining profits…
- …but **radically reduce investment** in the long term
- **Result**: **loss of jobs, a shrinking pie**

**Governments** who recognise **investors need fair risk-weighted returns**

**Miners** who recognise the need to deliver **full potential socio-economic returns**

**Labour / Communities** who **temper demands** to what can be delivered/ sustained