The changing face of a gold investor

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• **Mine production** has peaked

• **Costs** have decreased significantly but appear to have bottomed

• **Capital expenditure** has been a focus area in the cost cutting drive, but has the industry cut too deep?

• **Exploration** has focused on brownfields projects and near-mine development
  - Greenfields exploration all but dried up

• **Funding** is harder to source. Passive/index funds comprise a larger portion of gold companies’ share registers
  - As these funds do not provide equity funding, companies have to rely more on internal/debt funding to fund projects or acquisitions
Production peaking, costs bottoming

- Production:
  - Growth in global mine supply has slowed significantly – mine supply increased only 0.2% in 2017 compared to 5.5% in 2013
  - 30% of global reserves are currently associated with assets where a construction decision is yet to be made
  - The World Gold Council estimates an incentive price of US$1,500/oz to maintain global production at current levels

- Costs:
  - In 2013, the World Gold Council introduced the All-in Sustaining Cost (AISC) measure to show all costs associated with producing an ounce of gold
  - From 2012 to 2016, industry AISC costs decreased at a compound annual growth rate (CAGR) of 6.2% whilst All-in Costs (including growth capital) fell by a CAGR of 10.7%
  - In 2017, both AISC and AIC increased YoY, the first annual cost increase in five years

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Source: World Gold Council

Source: Company records
Has the industry cut too deep?

- **Capital expenditure**
  - Capital expenditure has been one of the ‘low hanging fruits’ targeted by gold miners in their cost cutting drives
  - Of concern is the notable decrease in sustaining capital (SIB capex) from US$310/oz in 2012 to US$160/oz in 2016. This increased to US$176/oz in 2017

- **Exploration:**
  - After peaking in the 1980’s, the rate at which gold is being discovered has declined over the past three decades
  - There has been a lack of ‘world-class’ (5Moz +) discoveries capable of producing 250koz pa or more
  - Exploration budgets were slashed in the wake of the gold price crash in 2012
  - The bulk of exploration over the past five years has focussed on brownfields projects and near-mine development. Greenfields exploration all but dried up
  - Exploration spend increased in 2017 for the first time in five years, but was still significantly lower than levels seen in 2012
Alternative gold investment options have grown significantly over the past decade and a half.

Physically backed gold ETFs have grown significantly since inception in 2003:
- There are currently 69 Moz backing ETFs, with a value of US$84.6bn (peak of 83 Moz and US$143.7bn in 2012).

Assets under management at gold equity ETFs:
Changing gold investor landscape

- Five to seven years ago, there were a lot more generalist investors investing in gold stocks
  - Market cap of NA gold companies has decreased to US$130bn from US$250bn seven years ago
  - Far fewer generalist investors showing interest in the sector today (2016 was the exception)
- Passive or index funds now hold a much bigger proportion of the gold sector’s free float
- Assets under management at traditional gold funds have fallen almost 40% over the past two years
- Traditional gold investors are being a lot more selective about what stocks they invest in compared to five years ago
  - Investors will own selected stocks as opposed to any and all of them
- What don’t investors like in a gold company:
  - Declining production profiles that need to be filled
  - Poor capital allocation and/or non-delivery
  - Low shareholder returns
  - High management compensation
- What are investors looking for in a gold company:
  - Low or declining costs
  - Increasing free cash flow
  - Positive exploration results – finding new deposits with good grade
- ESG issues are increasing in importance in investors’ decision making processes
Passive investing has grown in significance and now accounts for a far larger share of publicly traded assets.

Global assets under management at traditional index funds have grown to US$8.1tn from US$1.8tn 10 years ago.

- This represents 25% of all fund assets, up from 12% a decade ago.

The shift to indexing has been most notable in the US where 36% of funds are passively managed compared to 17% 10 years ago.

Source: Morningstar Index Manager Stewardship Study

Source: Morningstar Index Manager Stewardship Study
Increased focus on responsible investing

- Associated with the rise in index investing is a growing consensus that the integration of ESG factors into an investment process and active ownership practices (voting and engagement) reduces risks and leads to superior long-term performance.
- Evidence of this is the adoption of stewardship codes.
- UN Principles of Responsible Investments (PRI) signatories commit to be active owners and incorporate ESG issues into their ownership policies and practices.

*Source: UN Principles for Responsible Investments*
Evolving share registers of gold producers

- Passive shareholding in the top 11 gold companies increased to 26% in Q1 2018 from 12% in Q1 2008
- Over the past 10 years, the ratio of passive funds to active funds invested in the top 11 gold producers has increased from 13% to 35%

<table>
<thead>
<tr>
<th>Fund Manager</th>
<th>2008</th>
<th>2018</th>
</tr>
</thead>
<tbody>
<tr>
<td>Active/Passive</td>
<td>% Ownership</td>
<td>Active/Passive</td>
</tr>
<tr>
<td>Fidelity Mgt. &amp; Research Co</td>
<td>Active</td>
<td>8.2%</td>
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<tr>
<td>Capital World</td>
<td>Active</td>
<td>6.0%</td>
</tr>
<tr>
<td>BlackRock Inv. Mgt.</td>
<td>Active</td>
<td>6.0%</td>
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<tr>
<td>NWQ Inv. Mgt.</td>
<td>Active</td>
<td>4.3%</td>
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<tr>
<td>Capital Research &amp; Mgt. Co</td>
<td>Active</td>
<td>2.1%</td>
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</tbody>
</table>

Source: BNY Mellon

Gold industry represented by investment in all listings of Barrick, Newmont, Goldcorp, Kinross, Newcrest, Agnico Eagle, Yamana, Eldorado, Gold Fields, AngolGold Ashanti and Randgold Resources
Implications of an increase in passive ownership

What does the increase in index shareholders mean for a gold company?

1. Unlike active managers, index managers cannot sell poorly run companies if they fall in the index and therefore tend to hold positions for long periods.

2. They have a fiduciary duty to investors to push for change that will increase shareholder value. This is done through voting and engagement – index managers are stepping up engagement efforts despite the associated cost.

3. Index managers focus on issues that could impact shareholder returns in the long-run, including board composition, management compensation and effective oversight and disclosure of relevant risks.

4. Shift to index investing has not led to an abdication of stewardship responsibilities. In fact, stewardship teams have grown significantly over the past two to three years.

5. Index managers are increasingly committed pushing companies to improve ESG activities.

<table>
<thead>
<tr>
<th>Asset Manager</th>
<th>2014/2015</th>
<th>2017</th>
</tr>
</thead>
<tbody>
<tr>
<td>BlackRock</td>
<td>20</td>
<td>33</td>
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<tr>
<td>Vanguard</td>
<td>10</td>
<td>21</td>
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<tr>
<td>Legal &amp; General</td>
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<td>11</td>
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<tr>
<td>State Street</td>
<td>8</td>
<td>11</td>
</tr>
<tr>
<td>UBS Asset Management</td>
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<td>11</td>
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<tr>
<td>Amundi</td>
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<tr>
<td>Deutsche Asset Management</td>
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<td>3</td>
</tr>
</tbody>
</table>

Source: Morningstar Index Manager Stewardship Study
Has the pool of capital been impacted?

● Equity funding does not appear to be as readily accessible as it used to be
  - Despite gold equities appreciating markedly in 2016, the majority of funding used by the producers in 2017 and 2018 has been debt
● Is this an indication that the pool of capital available to gold companies is drying up or at least becoming smaller?
● Index funds will not provide funding but will look to impact how a company is run through voting and engagement
● With equity funding proving harder to access, where will producers source capital to fund projects?
  - Debt has been the funding source of choice for gold producers over the past 18 months but this is starting to become more costly – US interest rates have increased 1.5% over the past two years
  - Some producers have ventured into non-traditional funding sources such as streaming deals
How have producers funded recent capital expenditure?

![Total capital raised (debt and equity)](chart1)

- **Period of balance sheet deleveraging**

![Funding breakdown](chart2)

Source: Dealogic, Bank of America Merrill Lynch
• Counterintuitively, Gold producers have tended to use equity financing after recent periods of share price depreciation, and debt financing after recent periods of share price appreciation.

• Is this a sign of the changing market conditions and shareholder profiles?

• What does this mean for how producers meet funding requirements in the future?

Source: Bloomberg
Hedging to manage near term risk

- With gold price volatility and the tighter funding landscape, should judicious hedging be back on the table as a means of managing risk and enhancing risk adjusted returns?
- Given the decreasing availability of equity funding together with the reluctance to take on too much debt, producers are employing short term hedging in order to protect cash flows.

![Gold producer hedging chart]

Source: Metals Focus
Concluding remarks

**Capital is not as easily available to gold producers as it used to be**
- The sector is competing with other sectors and gold-linked alternatives for investment and capital

**Gold producers can no longer rely on equity as a guaranteed means of financing projects or addressing balance sheet gearing**
- Share registers of gold companies have evolved. Passive/index funds that do not provide equity funding make up a bigger proportion of share registers and traditional gold investors have sharpened their focus on where they invest
- Internal or debt funding has far outweighed equity funding in the past 2 years
- Producers will have to consider non-traditional funding sources (e.g., streaming deals)

**Gold companies have had to adjust their approach to growth:**
- Producers are embarking on smaller, more affordable projects that are scalable
- There has been an increase in collaboration (JVs) – this trend is set to continue

**Do gold equities need to become high dividend yield stocks, do we need to change our dividend policies?**
- Alternative gold investments such as ETFs continue to grow in popularity. Gold equities need to offer attractive risk-adjusted returns in order to remain a competitive investment proposition

**Index funds will have an impact on how companies are managed by focusing on the ESG side of the business**
- Companies need to have a fully integrated approach to managing the business

**Gold companies need to balance near term cash flow and long term sustainability**
Thank you

Questions