

2004: A CHALLENGING YEAR AHEAD FOR THE SOUTH AFRICAN MINING INDUSTRY

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**12 MARCH 2004
ANNUAL GENERAL MEETING OF THE ASSOCIATION OF MINE MANAGERS**

Preamble

Before I address you today, I would like right away - and on behalf of the mining industry represented by the Chamber of Mines - to offer my congratulations to the incoming president of the AMM, his vice-president and all the members of the council on their election to this high office. I would also like to thank the Association of Mine Managers for giving me the opportunity to speak to you today - it is certainly much appreciated.

Order of protocol

Mr. President; AMM council members; Members of the Association of Mine Managers; colleagues; (honoured guests); (ladies and) gentlemen.

Introduction

In the world of corporate communications, it is essential that businesses are afforded opportunities to state their case before influential audiences to get their message across to the right people. Cognisant of this fact, it is an honour as President of the Chamber of Mines to stand here before you, perhaps one of the most influential audiences in the South African mining



industry, and state the mining industry's case on a few issues affecting the industry as a whole.

I am sure no one in this audience will disagree with the observation that the country's decade-old representative government is clearly re-writing the statute books, which poses a huge challenge to the mining industry since it has to examine virtually every piece of new legislation, in the minutest detail, simply because each of a multitude of laws will impact on the mining sector to a greater or lesser degree. The opportunity exists for the industry to influence much of the legislative change, which it has done with varying degrees of success. On the other hand, the challenge posed by the HIV/AIDS epidemic has shown that mining can lead the way in corporate treatment of the disease.

We are now on the eve of celebrating 10 years of constitutional freedom in South Africa. We, as South African citizens are all working together to become, to quote President Mbeki, a "winning nation", while the mining industry, as a committed corporate citizen, is contributing wholeheartedly. However, there are a number of challenges that need to be addressed for the industry to play this role successfully. In my view, the biggest challenge is to ensure that race is no longer a factor in sharing in the wealth of our country's mineral resources. Our industry has probably gone further and quicker than most other undertakings in the private sector to ensure that previously disadvantaged South Africans have the tools to empower themselves and become very much part of our mining future. Broad-based black economic empowerment - BEE - is of utmost importance to South Africa as a whole, and



is an overarching target in all current and future developments within the mining sector.

I would like to speak in particular today about three "environments" in which South Africa's modern mining sector has to operate, namely the new legislative, the social and the economic environments, touching on some of the more pertinent challenges in each category.

The New Legislative Environment

Let me start with the new legislative environment.

Preservation and sustainable growth of the mining industry as an invaluable national asset is what the Chamber of Mines seeks to achieve in its interaction with policymakers. These efforts are aimed at ensuring that legislative and regulatory enactments do not have unintended consequences that might prevent South Africa's world-class mining companies from creating wealth that can be distributed to the benefit of all the country's people.

The Minerals Act

As we know by now, the Minister of Minerals and Energy, at the Mining Indaba held in Cape Town last month, announced that it was the government's intention to promulgate the Mineral and Petroleum Resources Development Act, 2002 in May this year.



We are on the brink of a whole new mining legislative dispensation in South Africa and I thought it appropriate to remind ourselves briefly of its development.

Parliament passed the Mineral and Petroleum Resources Development Bill during June 2002. During October 2002 the bill was signed by the President and published in the Government Gazette as the Mineral and Petroleum Resources Development Act, 2002, which I will refer to as the "Minerals Act".

During 2003 the Chamber drew to the attention of the Department of Minerals and Energy - the DME - a number of provisions in the Minerals Act which require urgent improvement for constitutional and other reasons. At the request of the DME, the Chamber submitted to it proposed amendments for the improvement of the Minerals Act. As there was no prospect of preparing a Minerals Act amendment bill in time for consideration by parliament during 2003, the DME took the view that the best course would be for it to defer discussions with the Chamber on the points identified to a time nearer the stage when proper consideration may be given to drafting an amendment bill. Now that the Minister has provided the time frame of May for the Act's implementation, it gave us about a 6 week window at the very most within which to continue with our discussions, bearing in mind that with a general election in the middle of April parliament will have to be dissolved. This would not leave much time for the passing of the bill, never mind enough time for debating it beforehand, so the Chamber views the May date with some concern. The DME has already had the industry's concerns conveyed to it.



Mining Charter & Scorecard

Which brings me to the development of the mining charter and its scorecard.

Negotiations between the Chamber of Mines and government on transformation issues took place as early as the year 2000. The Chamber had developed its own discussion paper around transformation in the sector, while the DME had been working on its own version of a Charter, which unfortunately was somehow leaked to the press, causing alarm in the financial markets, with JSE listed mining companies losing over R50 billion in value within days.

The social partners in the industry, namely the government, the Chamber, the unions, the community and new emerging producers immediately got together to negotiate a Charter that would be acceptable to all parties.

South Africans again demonstrated their ability to sit around a table and negotiate an outcome - and on 11 October 2002, the Broad-based Socio-economic Empowerment Charter was publicly released. The Charter necessarily represented a compromise solution but all parties recognised it as a document of substance in the commercial history of our country. It was viewed as something which was demanding, yet achievable. It succeeded in capturing a number of issues that stakeholders have committed to in terms of human resource development, employment equity, mine community and labour sending community development, procurement, broad-based equity participation and beneficiation.



From the Chamber's perspective, much of the Charter makes generally sound business sense. Over the longer term, the emergence of a more inclusive mining industry will reduce the risk profile of operating in South Africa. The Charter also recognises that it is not the government's intention to nationalise the industry, that the transfer of ownership will take place in a transparent manner and at fair market value and that the targets established in the Charter represent what is practically achievable without value loss from existing companies. In February 2003, a Scorecard, which in essence acts as a checklist for the commitments in the Charter, was agreed between the Chamber, government and labour. The challenge that now remains is one of implementation.

The draft royalty bill

But now on to the more pressing and worrying issue of the draft royalty bill.

In late March 2003, the National Treasury published a draft Mineral and Petroleum Royalty Bill to give effect to the fiscal ramifications of the Minerals Act.

Notwithstanding assurances from government that the draft bill was not a fund-raising exercise and that it would be internationally competitive, the investment and mining community viewed the first draft negatively. The first draft proposed the introduction of an *ad valorem* royalty charge on the gross sales value of mining commodities ranging between one and eight per cent and payable quarterly to the general fiscus. Mining companies would be given no exemption period upon conversion of their old order rights to new order



rights and they would be required to pay a 50 per cent premium above the royalty rate to 'lock-in' the royalty level, the so-called fiscal stabilisation clause.

A detailed memorandum setting forth the Chamber's comments on the draft bill was submitted to the National Treasury in April 2003 and a Chamber delegation met with the Minister of Finance and senior officials of the National Treasury to discuss its concerns.

I must be clear on one point: the Chamber recognises government's right to impose a royalty for the extraction of a non-renewable resource. What it vigorously challenges, however, is the basis on which a royalty would be charged and the proposed royalty rates. In particular, gross revenue royalties are the exception rather than the rule for the world's successful mining countries (Chile, Peru and Canada for example), however, they are prevalent in countries that have little investment in mining activity. The key point is that a gross revenue royalty takes no account of the ability of a mine to pay, nor does it deal with the cyclical nature of the minerals industry. For existing mining operations the imposition of a gross revenue royalty would inevitably raise costs, strain cash flow, raise cut-off grades, sterilise ore in the ground, shorten the lives of mines, and ultimately prejudice investment, employment and other benefits of the sector to the economy, thus negating some of the objectives of the Minerals Act.

At the same time many new mines, particularly low margin investment projects would never get beyond the drawing board.



The Chamber argues that a royalty system must take cognisance of the prevailing taxation regulations of the successful mining countries around the world. If a royalty is to be imposed a type of net royalty calculation should be used - such as the royalty only becoming payable when a company is 'in tax'. In fact, we have taken the issue further, arguing that a formula based on profits would be preferable from an industry perspective.

What the Chamber seeks is a royalty system that does not undermine the competitiveness and benefits of one of South Africa's truly world-class industries.

During his Budget speech on 18 February 2004, the Minister of Finance announced some changes to the proposed Bill. Although it is still revenue-based, the fiscal stabilisation clause has been removed. He also announced that the royalty payment would commence in 2009 and that the Treasury was still studying some of the potential consequences of the Bill. It is unclear when we will see the next draft of the Bill.

Beneficiation

Another of government's legislative and regulatory intentions that has attracted the detailed attention of the Chamber is the proposed Promotion of Beneficiation Bill. The Chamber recognises that an increase in the current level of beneficiation would have advantages for South Africa, and that it should be supported. However, beneficiation should not be perceived as a panacea that will automatically add considerable value to precious metal and



other mineral commodities and to create a large number of new jobs in a country where unemployment has reached unacceptably high levels.

Beneficiation is a commonly misunderstood process with extractive mining operations at one end of the value chain and differently skilled manufacturing entities at the other. Although the proposed bill has not yet found its way into the public domain, the Chamber will find it difficult to support policy enactments that attempt to compel mining companies to diversify radically their primary business focus.

Rather than attempting to force mining companies to move into manufacturing, the Chamber believes that a major focus of the Promotion of Beneficiation Bill should be to create a regulatory environment in which rewarding incentives are offered to manufacturers so that they will be encouraged to invest in downstream activities in South Africa.

However, despite the mining sector's reservations concerning its involvement in downstream beneficiation, it has not entirely ignored the issue and has spent vast amounts of money to find ways to promote beneficiation in minerals as diverse as antimony, diamonds, magnesium, manganese, titanium and zinc - to name just a few.

For example, several mining companies are forging important links and partnerships with the jewellery sector. Some mining houses have acquired a strategic commercial interest in some manufacturers and also sponsor national jewellery design competitions that attract literally thousands of applicants. Companies also are standing behind grass-roots community



development jewellery projects, and are supporting the development of jewellery manufacturing precincts that will combine training, manufacturing and design expertise in a single area or zone.

Importantly, a number of mining companies are also in the process of developing a metal financing facility with other interested jewellery sector stakeholders. This facility will aim to lend metal to manufacturers for jewellery production at internationally competitive rates. If this is achieved it will overcome probably the most important obstacle to accelerated growth in the jewellery sector, which is the cost of working capital.

These and other initiatives promise a new cycle of growth for the jewellery sector with attendant benefits for growth, employment and skills-development.

The Social Environment

As far as the social environment is concerned, this subject on its own could form the basis of my whole address today, so I will touch on only a few of the issues. I must at this point again borrow some words from our country's President. In his speech made during the opening of parliament recently he emphasised the need for human dignity in all walks of life and as such it should therefore be uppermost in every employer's mindset.

As this audience is very aware, mining is probably doing more than most other industries to achieve this goal by improving the lives of its employees and their families by, for example, having given appreciable real wage increases for many years, continually improving accommodation options, expanding health care initiatives to even "off-mine" communities, boosting retirement funding,



enhancing skills development and significantly contributing to rural development, amongst others. There are also many pressing health and occupational health issues in our industry such as HIV/AIDS, pulmonary tuberculosis, silicosis and the improvement in safety rates, to mention a few, but, unfortunately time allows only a cursory reference to some of these issues.

The challenge facing South Africa as a whole, and therefore its mining sector in particular, is the fact that while it is generally agreed that more jobs and additional investment are obviously critical criteria for the achievement of a secure future for South Africa and its people, the country faces a potentially more dangerous menace in the form of HIV/AIDS. As with the wider South African population, mining industry employees have been exposed to HIV/AIDS and the industry identified the virus as a major threat considerably more than a decade ago. Educational campaigns were launched and these have consistently been improved and sustained.

During 2003 two important developments took place in our industry's ongoing efforts to deal with the HIV/AIDS epidemic. First, major mining companies that are members of the Chamber took a decision to provide antiretroviral treatment to mineworkers with HIV/AIDS. This initiative, we are proud to say, was launched well ahead of most similar initiatives in South Africa. Since then the government has announced that it would be rolling-out antiretrovirals to the South African population at large. Secondly, under the auspices of a Tripartite HIV/AIDS Committee for the Mining Industry, a summit was



organised to consolidate and strengthen partnerships in the fight against HIV/AIDS.

The summit was the first of its kind held in South Africa and as a main sponsor and organiser the Chamber believes that a great deal was achieved in bringing together industry stakeholders to adopt a common approach to a debilitating viral infection. The summit ended on a high note with the partners signing a joint declaration dealing with all the important aspects of HIV/AIDS: prevention; treatment, care and support; research, monitoring and evaluation; and socio-economic development.

Another health challenge facing the mining industry is that of further reducing and eventually eliminating silicosis.

Measures have been taken from the early days of gold mining to control dust levels and to prevent disease and maintain the health of workers. The introduction and stringent application of dust control measures in the form of wet drilling, ventilation systems and blasting between, instead of during, shifts resulted in the considerable reduction of dust exposure levels.

In the light of technological developments as far as dust control is concerned, the Chamber has set up a "Dust Elimination Committee" with the task of reviewing and addressing silica dust control, and establishing best practice and research requirements in this regard.



There are long-standing statutory arrangements in place which guarantee compensation for employees who contract occupational diseases such as silicosis. However, the issue of uncompensated ex-mineworkers has been the subject of attention recently, and it appears as if there are ex-mineworkers who have not received benefits from the statutory compensation system. Although the issue of compensation is the State's responsibility in terms of current legislation, the mining industry is prepared to assist the State in finding ex-workers who might not have claimed compensation.

Most of the above initiatives of the Chamber are being undertaken jointly with other stakeholders in the industry, specifically the unions and the government.

Mr Chairman, the final 'environment' I want to speak on today, is the economic environment.

The Economic Environment

The centrality of mining to the South African economy is evidenced by its consistent domination of national export earnings, its provision of direct employment to well over 400 000 people and the fact that it accounts for more than 40 per cent of the market capitalisation of the JSE Securities Exchange South Africa. Additionally, it is a major private-sector supplier of social infrastructure including schools, clinics and other essential facilities in parts of the country where poverty is endemic.



Contribution of mining to the economy

Mining continues to be a key foundation industry for the growth and development of the South African economy. The mining industry's contribution to gross fixed capital formation grew by over 12 per cent in real terms in 2002, to nearly R18 billion, which represents some 11 per cent of total fixed investment in the economy. The high rates of fixed investments enabled the sector to increase its share of contribution to gross domestic product, GDP, to a bit more than 8 per cent in 2002. If one includes the indirect multiplier effects that the mining industry has on the rest of the South African economy - such as the consumptive power of employees - then the contribution of mining to GDP is closer to 12 per cent. The 2003 figures are not available as yet but I do believe they will show a similar picture.

The value of total mineral exports increased to R110 billion, which accounted for just over a third of the value of total South African merchandise exports. Gold exports increased to R41 billion, returning the yellow metal to South Africa's top export earner position. Other good performers were nickel, iron ore, manganese, platinum group metals and coal.

Mineral sales and exports

Driven by the 22 per cent depreciation in the rand/US dollar exchange rate in 2002, the value of South African mineral sales increased by over 20 per cent to almost R140 billion. The stabilisation in gold production and the 39 per cent increase in the rand gold price resulted in the value of total gold sales increasing by nearly 43 per cent to R41 billion and some change, in 2002.



Consequences of the strong rand

Given the current strength of the rand against the US dollar, I wish to briefly touch on the consequence of a strong South African currency on the mining industry. Before examining this issue, I must place it on record that the mining industry considers a stable, more predictable and competitive exchange rate - not a weak currency - to be very much in the national interest.

During the first half of 2003, the 23 plus per cent appreciation in the rand, at a US dollar exchange rate of about R8-00 at the time - which, as we know strengthened somewhat towards the end of last year to about R6.50 - had a major impact on commodity prices. Despite the 10 per cent increase in the average gold price and the 20 per cent increase in the platinum price, when comparing the first half of 2003 to the average prices for 2002, the strong rand actually reflected a decline of 14 per cent in the Rand price of gold and a 7 per cent decrease in platinum. Coal fared no better, reflecting a real loss of about 12 percent, while similar trends were observed for several other minerals.

Platinum group metals, gold and coal are South Africa's three largest export earners. Current projections indicate that their foreign exchange earnings were likely to diminish in 2003 by some R14 billion to a total of R77 billion. While this represents a reduction of some 15 per cent in rand revenues, it represents a much greater percentage of the operating profit of mining companies, in many cases, absorbing most of or even all their margin.

Well, it is now 2004 and whilst some encouraging positive trends have emerged - for example, the price of gold having sustained its level of around



\$400 an ounce and the rand losing some of its firmness - it is still too early to measure whether the rather gloomy picture painted earlier will begin to show the signs of reversal we sorely need.

In the meantime the industry continues doing much to cut costs and improve efficiencies. This process will serve us very well in the longer term. A persistently over-firm rand will have severe negative long-term consequences for employment at existing mining operations, the generation of employment opportunities at new projects and the pace of successful black economic empowerment. It is only a vigorous and profitable mining industry that can deliver on its accepted transformation obligations.

Conclusion

When I began speaking to you today I stated that "there are a number of challenges that need to be addressed for the mining industry to play [its] role successfully." During the course of this address I have concentrated on some of the challenges lying ahead of our industry in general while, as members of the AMM, you have your own set of issues that will keep you occupied as an association over the next 12 months. However, I know that the AMM has over the years approached its duties professionally and with purpose and has racked up many achievements and will continue doing so well into the future. It is my pleasure to wish the AMM, its new President and office bearers every success and may you go from strength to strength in the year ahead.

Thank you very much.