

# SA's lacklustre gold sector holds promise – KPMG

Amidst the challenges facing South Africa's gold sector, the country remains a significant player in the international gold market, echoes Daniel Hooijer, gold commodity lead partner for KPMG in South Africa. By Brindaveni Naidoo

**This position, he adds, is demonstrated by the significant levels of reserves and resources of gold remaining.**

"To capitalise on these we would need to combat the problems of aging infrastructure and rising costs through a focus on free cash flow generation and more near-mine exploration projects.

"Our gold mines in South Africa are largely deep-level gold mines, which results in a perception of higher cost structures, as opposed to open-pit or shallow gold mines found elsewhere in the world."

This, he explains, can be viewed in two perspectives. First, for a deep-level mine there are various challenges, such as safety, transport of ore, cooling systems, water management and significant infrastructure requirements. "These challenges usually translate into high operating costs and larger energy and water requirements."

Second, deeper-level reefs tend to have higher grades, making it more worthwhile to process once infrastructure is in place.

Further, Hooijer says that the trade-off between costs and revenue needs to be closely monitored and is often highly sensitive to various macro- and micro-economic factors.

"This governs the determination of reserves and resources a mine may declare, which is one of the more significant indicators of value for a gold mine. In South Africa, some of the factors currently influencing the gold sector are high electricity costs, labour unrest, investor confidence levels, regulatory changes and the outlook for future capital projects."

Although, he adds that the higher costs can be partly off-set through the natural Rand: dollar hedge which exists.

"Taking into account the sharp decline in the dollar gold price in 2013, the Rand has had a similar



SA's significant gold reserves and resources presents great opportunities for wealth generation.

weakening trend against the dollar, which has softened the blow to a degree for South African miners. This is demonstrated through the Rand/oz gold price performance over the last 17 months versus the dollar/oz gold price."

### Wealth of opportunities

Hooijer says that the fact that we host significant gold reserves and resources means that there are great opportunities for wealth generation.

"The key will be free cashflow. Who can introduce the element of flexibility into mine plans, such that changes can be made to quickly counter act declines in commodity prices and/or rising mine inflation? This will hopefully restore profitability and stabilise free cashflow generation which in turn would begin restoring investor confidence."

He adds that the country's focus would need to be placed on quick-win capital projects, meaning more spend on near-mine exploration and ore development at existing mining operations in the short to medium term. This would increase the life of mines and contribute to production levels.

Further, he stresses that key to success would be stakeholder engagement between government, investors, employees and employers.

"Government needs to partner with mining companies and understand the challenges faced in the current world economy. Mining companies need to be transparent in their reporting telling the real story. Employees need to understand the hugely important impact they can have on productivity and ultimately profitability levels in mining, the role they play in combating



In the last three years, the sector has seen higher than inflation increases in electricity prices and labour costs.



*"Taking into account the sharp decline in the dollar gold price in 2013, the Rand has had a similar weakening trend against the dollar, which has softened the blow to a degree for South African miners."*

mine inflation and the contribution they make to wealth generation in their local communities."

But, underlying all these success factors is innovation. Hooijer explains that flexibility in cost structures and mine plans; efficiencies in mine recovery techniques and production methods; engaged stakeholders; wealth generation in local communities; a mutual understanding of compliance and free cashflow generation are all areas where open opportunities exist to innovate and beat the norm.

"Companies who harness innovation will be rewarded through value generation, and, finally, a confident investor."

Meanwhile, he believes that encouraging news for the local sector is the talk of new exploration and prospecting permits being granted

in the north of the country, where it is believed there are some shallow ore bodies ideally suited to open-cast mining.

### Eroding investment concerns

The challenges in the South African gold sector are well known internationally. Hooijer says that none of these are more telling than the loss of investor confidence in the global gold mining industry.

"This was demonstrated by the massive eroding of shareholder value last year as a result of the large decline in profits and cash generation – a sign of the industry's inability to adjust cost structures to match commodity price movements.

"Mining inflation is well above normal CPI, resulting in a challenge to large operations. In the last three years, the sector has seen higher than

inflation increases in electricity prices and labour costs, which erodes the free cashflow margin generated by a mine."

Adding to this is regulatory compliance, which is proving a difficult task, with numerous statutes for a mine to comply with, many of which require costly interpretation and interventions by mining companies.

"Social licence to operate is becoming more relevant in communities where service delivery and economic growth remains a challenge. Social and labour plans associated with mining rights have proven commitment by mining companies. They have changed how investors and communities see mining from the perspective of no longer extracting and leaving, but investing and uplifting the community in which they operate economically." ■