Mining in South Africa – was once great, but is now a cemetery for capital

B. Williamson

Investment Analysts Society of South Africa

Email: bruce.williamson@integralasset.co.za

Synopsis

South Africa was blessed with many world-class mineral systems whose exploitation greatly contributed to the building of the country's infrastructure and the development of highly competitive manufacturing and service industries. Foreign capital readily flowed into mining projects and by 1980 the mining sector accounted for around 80% of the JSE market capitalisation.

In the 1980s the investment community was highly knowledgeable and heavily invested in listed mining stocks. That is not the case today. The South African mining industry was recognized by global investors and contributed significantly to the JSE All Share Index (ALSI) outperforming the US S&P 500 for nearly 45 years. However, since 2015, the ALSI has performed poorly as reparation-loaded policies, SOE failures and burdensome investment policies imposed on the mining sector have taken their toll.

Under the current circumstances, local mining projects will not attract capital. Mineral exploitation is potentially the greatest economic multiplier available to any government. We need to urgently introduce investment and taxation policies that will render our mineral resources payable and attractive to investors. If that were to happen, then the representatives of SAMCODES have an important role to play in marketing mining projects and re-educating the investment community as to what mining is all about.

The South African economy was built on mining - don't give up

At this juncture, It is worthwhile to step back and acknowledge the unbelievable role that mining played in the development of the South African economy. After all, South Africa is still largely a country of mining and farming towns. Members of the various disciplines underlying the SAMCODES will fully appreciate the following phenomenal mineral systems and ore-bodies with which this country was blessed:

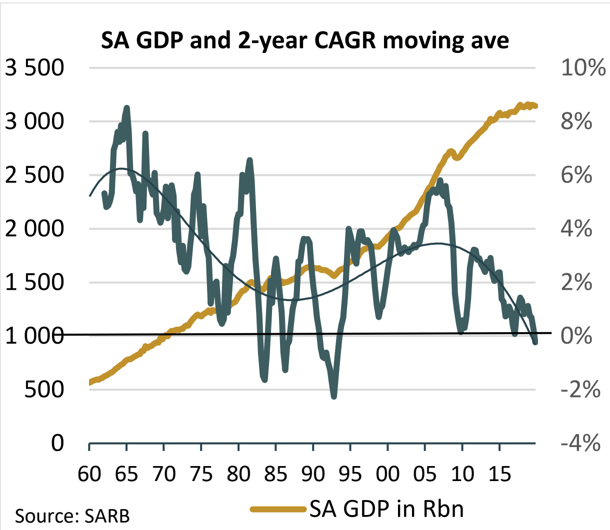
- The Goldfields of the Witwatersrand Basin (associated uranium);
- The Barberton Greenstone Belt (gold);
- The Bushveld Complex (PGMs, Chromitite and Vanadiferous Magnetite);
- Diamonds (kimberlite pipes, alluvials and marine deposits);
- The Coalfield (Mpumalanga, KZN and Waterberg);
- The Iron ore and Kalahari Manganese Field of the Northern Cape;
- Heavy Minerals Deposits - Richards Bay;
- The Phalaborwa Complex (copper, phosphate);
- The Murchison Greenstone Belt (antimony);
- Northern Cape base metal deposits; and
- Tin, zinc and asbestos deposits.

Mining greatly contributed to the development and growth of the JSE

Back in the early 1980s, the local investment community was highly knowledgeable around mining and heavily invested in JSE-listed mining stocks. The intense interest was because of the incredible range of individually listed mining companies, Mining Houses and Mining Holding companies. By the early 1980s, mining stocks contributed just over eighty percent to the JSE market capitalisation. Yes, this contribution is somewhat exaggerated. Post the 1976 sanctions local Mining Houses invested massive amounts into a wide range of businesses within the economy. This boosted the market capitalisations, in particular, of Anglo American, Gencor, Anglo-Vaal and JCI. The point not to be missed is that the non-mining sector grew to the extent it did, because of the unbelievable multiplier-effect generated by the mining industry.

South African Gross Domestic Product

The next chart depicts the annual GDP in constant Rand billions since 1960 together with a 2-year Compound Annual Growth Rate (CAGR) line graph. Since 1960 annual GDP has grown by 2.9%. Across the sixty years, there are two distinct periods of GDP growth: from 1960 - 1990 when annual growth averaged 3.62% and from 1990 to date when annual growth averaged only 2.2%.



The CAGR line chart and trendline highlights the dramatic slowdown in growth in recent years and we know that growth in the final two quarters of 2019 fell, respectively, 0.8% and 1.4%. The economy is thus already in recession. This, of course, is before considering any further damage that will be caused by COVID-19.

Over the past sixty years, the best two consecutive decades of growth, respectively 5.8% and 3.3% per annum, were during the 1960s and 1970s. This was during the post-WWII years when new mines across the full range of minerals outlined above were being brought into production in quick succession.

The mining multiplier precipitated the growth of many world-class businesses beyond mining

The contribution of mining to the development of the South Africa economy is in many ways inestimable. The massive increase in mining output post-WWII spurred the need for more appropriate road, rail and airline systems, for ports capable of exporting bulk commodities, and for services such as telecommunications, fuel, water and power. A reliable source of steel was a necessity and so Iscor was born, which in turn added impetus to the development of the Northern Cape iron and manganese deposits.

The unprecedented growth in mining output also precipitated the need for light and heavy engineering, general industry such as electrical and construction and great volumes of chemicals and explosives. Besides, the mines and Mining Houses also had an increasing need for a complete range of quality services such as:

- Accounting and auditing;
- Short and long-term insurance;
- Actuarial and taxation;
- Banking (debt, bonds, currency, etc,) and project finance;
- Retirement planning and pension funds;

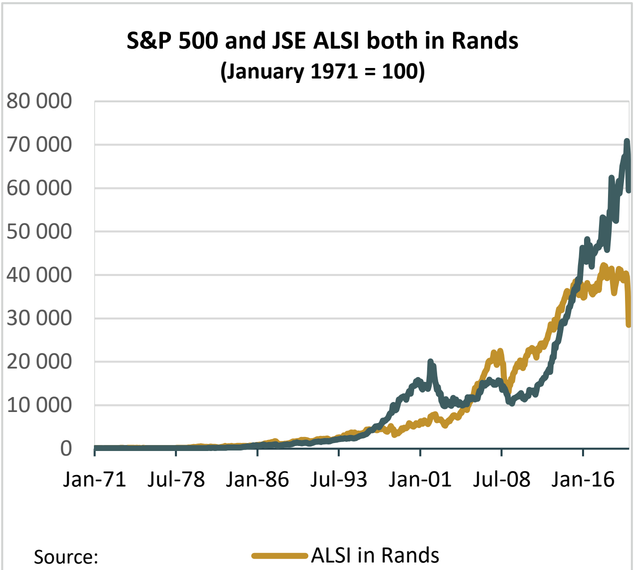
- Investments and stock-market;
- Research and development;
- Legal and healthcare.

The sheer size of the mines that were being developed demanded excellence and it is fair to say, that all of the above industries and services outlined above achieved world-class status. The chart below shows that as the contribution of mining to GDP grew to a peak of nearly 20% in 1980, labour employed within the mining industry increased to an all-time high of 763,000 in 1987. The fall since then has been dramatic, as has been the knock-on effect.

The performance of South Africa as measured by the stock market

Lest we be considered biased or over-zealous for the achievements of the mining sector, the chart below confirms our opinions. **Most readers will probably be astonished to know that measured in common-currency terms, the JSE All Share Index (ALSI) outperformed the famous S&P 500 Index over the period January 1971 to April 2015**. During this period the rand depreciated by 6.2% pa against the US Dollar. However, the ALSI has significantly underperformed since then, as has the Rand (-7.7% pa). The actual performances of the ALSI and S&P 500 were:

- 1971 to April 2015: ALSI = +14.4% pa and S&P 500 = +14.3% pa; and
- April 2015 to 20 March 2020: ALSI = -6% pa and S&P 500 = +10.5% pa.



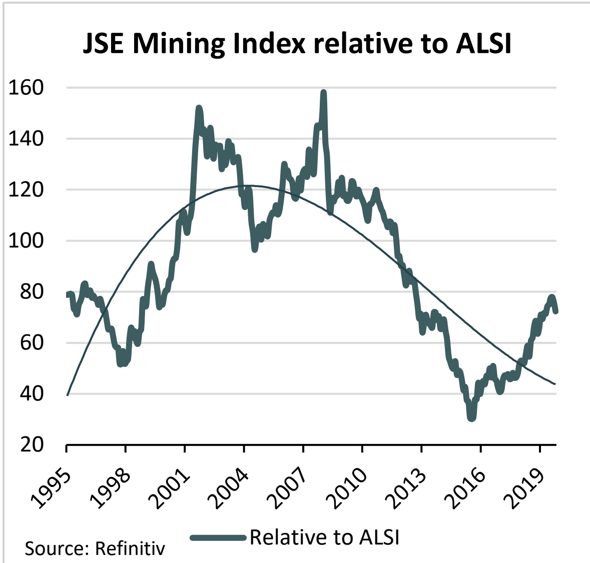
Minerals lie wasted in the ground due to bad investment and tax policies

Mining made South Africa great, we need to get back on track. The analysis provided should spur all interested South Africans to find solutions to why the economy and the ALSI has performed so badly after decades of outperformance. There is a compelling solution. There are still minerals in the ground that can be exploited which would create growth and employment via the economic-multiplier. There are existing mines whose lives can be extended, substantial mining infrastructure, labour, management skills and a massive skill base within the representatives of SAIMM and GSSC. What is lacking are investment and taxation policies that will render our mineral resources payable and projects sustainable. It makes sense to drop the tax rates sufficiently to create employment and grow the mining supply chain. Whilst this may seem radical, it might even make sense to not impose taxes on new mining projects if it creates jobs and additional tax-paying businesses. IT IS TIME FOR HARD TALK AND ACTION!

Mining - a troubled sector

It is little wonder that local and foreign investors take a dim view of the South African mining sector. The following chart shows that the JSE Mining Index fell 80% against the ALSI from February 2002 to December 2015. Thereafter, the Mining Index has performed strongly, mainly boosted by runaway iron ore, palladium, and rhodium prices and more recently by the gold price. Over the past two decades, much has unfolded to chase investors away. Apart from the volatility in commodity prices and the rand, investors have had to deal with:

- Uncertainty around mineral right ownership;
- BEE shareholding and the funding thereof;
- Additional taxation by way of royalties and carbon taxes;
- Undue attention from the DMR inspectorate;
- Challenging labour negotiations, absenteeism and strikes;
- Having to parent and support local communities;
- Procurement pressures;
- General security issues, physical attacks on infrastructure and staff and gold theft, in particular;
- Illegal mining;
- Untold issues with Eskom;
- Rail and port constraints and inefficiencies,
- Above inflation cost increases for services such as rail, ports, water and power; and
- water licences and closure certificates issues.



The above are issues that mine management deal with daily before even facing the difficult tasks of safe mining and processing. Mining can still play an important role in creating new jobs and economic growth. Nothing else comes close to unexploited minerals in terms of an economic multiplier. If there is any hope of attracting investor capital then all these troublesome issues need to be dealt with once and for all in a single policy framework for investment and taxation.

SAMCODES - it is all about marketing to the investor

If the ideal mining policy framework were to be enacted, then the members underlying the SAMCODES have a serious marketing role to play to the local investor community.

The South African Mineral Reporting Codes (SAMCODES) "*set out the minimum standards, recommendations and guidelines for Public Reporting of mineral related issues in South Africa*. *They currently comprise three Codes and two Guidelines":*

- **SAMREC**: The South African Code for Reporting of Exploration Results, Mineral Resources and Mineral reserves;
- **SAMVA**L: The South African Code for the Reporting of Mineral Valuation;
- **SAMOG**: The South African Code for the Reporting of Oil and Gas resources; and
- **SAMESG** Guideline: The South African Guideline for the Reporting of Environmental, Social and Governance parameters within the mining and oil and gas industries; and
- **SAMREC** Diamond Guidelines: SAMREC Guideline Document for the Reporting of Diamond Exploration Results, Diamond Resources and Diamond Reserves (and other Gemstones, where Relevant).

The **Code** abides by three important principles: Materiality; Transparency and Competence and "*the Public reports* ***are prepared for informing investors or potential investors and their advisers*** *on Exploration Results, Mineral Resources and Mineral Reserves".* And yet if you an investment analyst or fund manager who SAMCODES is, their answer could easily be an ancient Secret Society. This is not a flippant comment. What existed in the 1980s is gone. There needs to be a meaningful collaboration between the mining industry, Government and the investment community - not just "*ships that pass in the night*".

The representatives behind SAMCODES are not part of a secret society. Their hallmark is competency and "*the Public Reports are produced by suitably qualified and experienced persons who are subject to an enforceable Code of Ethics by their Recognised Professional Organisation* (RPO)".

The private sector will not invest in mining projects without SAMCODES

SAMCODES's *raison d'être* is to prepare reports for investors. A positive change to the mining investment and tax policies will require the representatives of SAMCODES to urgently engage with the investment community. For those investment analysts that still bother to read mining reports and interrogate the data, the table below (Sibanye Stillwater financial results 2018) is typically what they look at when considering the assets of a mine.

Readers will know that the numbers representing the assets in the balance sheet or statement of financial position tell you very little about the true assets (reserves, resources, shafts, processing plants, etc.) of a mining company. The side view plan below (Kloof Gold Mine) depicting the reef horizons and their orientation, shaft positions and x-cuts to the reef is a far more useful starting point to understanding the intricacies of mining and ore transportation. There is just so much knowledge and information that needs to be passed on to the investment community.

Figures in million - SA rand	Notes	2018	2017	2016
Assets				
Non-current assets		**69,727.7**	64,067.3	34,018.1
Property, plant and equipment	12	**54,558.2**	51,444.6	27,240.7
Goodwill	14	**6,889.6**	6,396.0	936.0
Equity-accounted investments	15	**3,733.9**	2,244.1	2,157.4
Other investments		**156.0**	-	-
Environmental rehabilitation obligation funds	17	**3,998.7**	3,492.4	3,100.5
Other receivables	18.1	**314.4**	284.0	355.3
Deferred tax assets	9.3	**76.9**	206.2	228.2
Current assets		**15,195.3**	12,004.5	7,703.2
Inventories	19	**5,294.8**	3,526.5	676.8
Trade and other receivables	20	**6,833.0**	6,197.6	5,747.9
Other receivables	18.1	**35.2**	35.2	310.6
Tax receivable	9.4	**483.2**	182.8	-
Cash and cash equivalents	21	**2,549.1**	2,062.4	967.9
Total assets		**84,923.0**	76,071.8	41,721.3

Environmental, Social and Governance (ESG) and climate change matters are now integrated into investor checklists. The end game is that investors need to be educated and will not invest without a full-house of the SAMCODES. More to the point is they need to get to know and trust the professionals that sign off on mining projects. Alas, this will all come to nothing if the government does not see the light.

Maybe post-COVID-19 there will be good reason for the mining industry, government and the investor community to collaborate on mining projects for the greater benefit of South Africa.