I SPECIAL PROJECTS

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# Invest In SA Mining

## Mine investment made easy with Investec

NOTWITHSTANDING the attention that certain calls for nationalisation have received and the existing obligation to comply with empowerment requirements, South Africa's mineral endowment means that it remains an attractive destination for mining investment opportunities.

That's the view of Anton van Dalsen of Investec Capital Markets. "But investors do need assistance in understanding the environment. We are able to assist our clients through this process, playing either an advisory or a financing role, or both.

"Although alternative destinations are not free of problems, South African regulatory requirements and infrastructure constraints are often seen as hurdles and need to be put in context by those close to it."

With substantial sector experience and an understanding of the risks, Investec's strategy is to focus on projects where it can provide significant support to investors.

This translates into a focus on financing small to medium sized projects (R200m to R500m) on their own or to underwrite larger ones, with a subsequent partial sell-down of exposure, whereas established operations could be funded at higher levels.

"One of our principles is to avoid the euphoria that leads to chasing projects at the top of the commodity cycle. Rather, we aim to support projects at the lower end of the cost curve, which remain sustainable even in tough times."

When looking to invest in the South African mining industry, there are a number of issues for outsiders to consider as part of their decision making process.

While a buoyant commodity cycle has helped to attract interest, resulting in an increasing number of transactions in the mining sector over the past 12 months, South Africa has probably not received its fair share of investment in the mining sector, when viewed on a global basis.

This is largely due to issues of perceived risk and constraints placed by available infrastructure.

The increasing global interest in bulk commodity projects (especially coal, manganese and iron ore) has not been adequately reflected by investment in such projects within South Africa, since the available transport and export infrastructure is currently unable to meet the demands of new projects.

Van Dalsen points out that one of the dynamics of the South African market is the absence of a substantial junior mining sector, which, alongside limited locally available risk capital, has constrained the development of mining in South Africa. This is in stark contrast to a vibrant junior mining sector in Australia, for example.

"In our context, it is particularly exploration and early stage development activities which have suffered, and in spite of the best of intentions, the legislative guidelines have not always succeeded in advancing the local industry at this early stage."

In the spirit of enabling development, van Dalsen therefore suggests that consideration could be given to applying empowerment requirements to a larger degree to the operational environment, instead of early stage exploration and development.

This would provide some leeway for early stage activities, which involve exploration and which are by their very nature seen as high risk ventures.

"The obligation to support a minority shareholder's stake in a company at such an early stage constitutes yet another burden to funding what is already a high risk undertaking and which is difficult enough in itself."

# Sustainability will secure long term investor confidence

FAILING to engage with project stakeholders on mining sustainability risks from the first stages of design and pre-feasibility can be detrimental to a project both from a feasibility and investor confidence perspective.

James Brice, head of Sustainability Services at Grant Thornton, says that mining companies need to highlight from the outset how the pre-feasibility study and mine design process should be integrated with the environmental and social risk assessment so as lower project costs in the long term.

Says Brice: "By bringing the ESG – or environmental, social and governance - issues into the project design phase from the word go, mining companies will reap the long term rewards of improved stakeholder inclusivity, lower surface infrastructure and closure costs and a stronger project brand in the longer term.

"A company always reports higher than expected closure or remediation costs which, simply put is a result of poor initial planning."

Brice advises that planning for these risk benefits means inclusivity – i.e. involving as many stakeholders as possible to achieve true collective decision making.

Publicly listed companies, particularly those in the Western world, have learned the benefits of having open dialogues with stakeholders and balanced, sustainable reports.

"It is our recommendation that even exploration companies, privately-held businesses and Chinese and Indian developers, for whom external reporting is not mandatory, would benefit," says Brice.

"They would do well to embark on these programmes voluntarily because research indicates that sustainability reporting is critical to building a social license to operate and protection of shareholder value."

In most cases Indian and Chinese mining companies are privately held or have a state ownership structure which means they are not subject to reporting requirements that publicly listed and externally-funded companies are subject to.

Africa has a window of opportunity to use its mineral wealth to build sustainable communities. Unfortunately opportunities are being missed even without considering the benefits of beneficiation.

"Of course, government plays a critical role in disseminating this wealth to the broader community, but the role of the mining company itself is vital too," says Brice.

"Hiring and procurement policies, CSR projects, effective closure and post-closure social and labour plans are vital to ensuring a lasting legacy."

Integrated reporting further enhances credibility by communicating a holistic picture of the business.

Reporting on financial performance and reserves should be woven into the overall sustainability of the business, from exploration and mineral tenure, right through to the environmental and social context.

Given the recent debates surrounding mining rights, indigenisation and nationalisation of mines, legitimacy is critical to building a good case for investment.

"Our experience has shown that the earlier a mining project begins building its story, and telling that story in a balanced and credible fashion, the more informed and comfortable its stakeholders and shareholders are.

"In business in general, but especially in mining due to long lead-times, surprises are not well received. Investors and stakeholders want to know that there are no uncertainties in a project.

# Invest in the right technology now for future economic growth

SOUTH Africa is a world leader in mining and the industry remains a cornerstone of the South African economy in that it contributes significantly to economic activity, job creation and foreign exchange earnings.

The country's wealth is built on its vast abundance and production of its resources. Indeed, the local mining industry is the largest producer of gold, and with the manufacturing of its precious metals, contributes significantly to mineral export earnings.

Greg Vercellotti, executive director of software development firm Dariel Solutions which supplies solutions to the mining sector, says this demonstrates the important role that the mining sector plays with regards to the upliftment and development of the country's economy.

"As such, it is essential that mining organisations operating in the country take the necessary measures required to drive new projects and continually improve implementations – whether technologically or operationally inclined – to continue to bring new opportunities to the fore and remain a cornerstone of the economy."

In fact, it's this exact forward thinking investment outlook (which Vercellotti will be examining from an IT investment perspective), which will see mining houses flourish in the years to come.

"While many mining companies are looking to take advantage of newer technologies in the hopes of improving their competitiveness and internal processes, a large number of mines are still beholden to traditional legacy systems which often do not allow for the implementation and integration of newer, more innovative technologies.

"Due to the cost and time invested in such legacy systems, there is strong caution to simply retiring the technology which - while understandable – is problematic and will end up costing far more than an upgraded or newly implemented IT solution."

Vercellotti adds that legacy systems can no longer serve mines efficiently and as markets and market conditions change, mining companies need to adapt to the changes accordingly.

# Outsourcing the way to go

MANY South African companies are under enormous pressure to lower their variable costs, increase their profits and improve quality – the answer to which can be found in outsourcing non-core business activities such as catering, maintenance, cleaning, security and related services.

"The outsourcing of these services can save companies millions of rands in costs, and increase productivity and employee morale by allowing them to concentrate on their core business," says Fiorella Mugari, Chief Operating Officer for RoyalMnandi, a leading food service solutions company.

Mugari says the growth in many of the exploratory mining developments, particularly in Africa, has provided an investment opportunity for specialist outsourced companies that have the experience in providing successful services, especially within complex industries such as mining.

RoyalMnandi's Remote Site Service Division, which has extensive experience within the mining sector, provides a full risk-assessed catering and support service to clients operating in remote sites or those requiring support services in extra-ordinary conditions.

The service extends far beyond just ensuring miners experience an exciting eating environment in extra-ordinary conditions. Many of the services have nothing to do with food and everything to do with logistics encompassing full Village Management at remote sites across Southern Africa.

Mugari says many of these contracts can extend from anything between two and seven years. The service therefore extends quite broadly and includes a variety of different elements including:

- Assisting with the clearing and demarcating of land where construction camps need to be erected;
- Layout and planning of the construction camps including the construction and erection of the following units in the construction camps: accommodation units (permanent and semi-permanent) kitchen units, ablution units, entertainment units, security units (gate offices as well as guard accommodation), administration office units (including kitchens, toilets, boardrooms and storerooms), laundry units and dining rooms.

Other specialist services would cover anything from registration of camp residents to postal services, inventory, fuel supply, sewerage disposal, and even pest and malaria control.

On the catering side, Mugari says there are usually a variety of different options available. The most formal is a restaurant type concept offering freshly prepared meals.

One can then also include a take-away kiosk concept where the mine workers can purchase quick meals such as toasted sandwiches, burgers, hot chips, pap and vleis.

Convenience store concepts sell items such as toiletries, chips, cold drinks and chocolates, as well as dry and frozen goods.

Most of the camps these days include a games room and sports bar concept to provide migrant workers with some form of entertainment when they are not hard at work.

"It's important to be able to offer a full food service solution and understand that each client's needs are different. Not only does the offering need to present correctly but it also needs to balance the growing requirement for healthier options which assist in managing productivity and miner fatigue.

# Insure for acid mine water risk

THE acid mine water threat has gone quiet but it has not gone away. The good news is that there are insurance and risk management options to consider say risk managers and insurance brokers Aon South Africa.

Acid Mine Water (AMW) falls under the category of an environmental catastrophe and typically such risks have short term and long term impacts on the environment, people and society in terms of injury and disease as well as property and financial loss says Aon's Russell Davis.

Those affected could include private individuals, companies, non-government organisations, society, insurers and government – all of which are potentially exposed to one degree or another to insured and uninsured risks arising from AMW.

Policies that could have a bearing on the situation include: property insurance (assets, interruption), liability insurance (negligence), life and health insurance and social insurance such as Compensation for Injury and Disease cover, (COID).

Points out Davis: "All these policies have sections of cover that either include or exclude effects. However it must be made clear that most insurance policies exclude inevitable, non-fortuitous and gradual losses."

The special Perils extension under an assets insurance policy for instance covers damage by water but does not cover 'gradual deterioration' and insurers expect the insured to take all reasonable precautions for the 'maintenance and safety of the property insured and for the minimisation of damage.'

"AMW risk is not deemed by insurers to be fortuitous. Unless the situation is brought under control the insurance sector understandably views the risk as being inevitable, i.e. it's not a case of if it will happen, only of when.

"There are moves afoot to find answers to the problem. The South African Insurance Association (SAIA) has formed committees incorporating insurance specialists to discuss possible insurance solutions and reportedly Government and the insurance sector are examining the feasibility of a cell captive insurance structure which would underwrite the risks.

"The current plans also include a short term remedy to pump the water out and put it through treatments to make it useable again.

"Pending such measures however, it makes sense that those at risk think about the potential exposures and how to overcome and minimise them. In other words, everyone in an organisation needs to be aware of the exposures that they have to AMW and to risk manage to ensure business survival.

"Be aware that there is no cover for gradual pollution and that while there is cover for environmental liability, it's restricted, it's expensive and only on a spread loss basis under certain conditions.

"These exclude 'pre-existing/intentional/fines and penalties/bankruptcy of insured' and the insurers also have conditions of regular audits.

"Liability policies are on a loss occurrence or claims made basis. It's therefore a question of checking whether cover is still in place, the insurer is still operating and that sufficient limits are in place. Also, statutory legal defence costs will possibly cover legal costs only, but not fines or penalties.

"The most promising solution is the formation of company cell captives as opposed to the SASRIA like structure we referred to earlier. These would presumably receive compulsory contributions from corporates.

"However, such a structure would no doubt prove controversial and would need to overcome a lot of hurdles before it became a fact, if ever."

Basically in terms of private cell captives, a company puts its capital at risk in the cell structure, thereby automatically creating a risk transfer. The cell captive operates as a cell of the insurance company accepting premiums, paying claims, creating reserves, etc.

Simply put, the company elects to retain additional risk and then provide for the exposure through the payment of a self-insurance premium. Risk in terms of the company's own exposures and in terms of third party claims is retained but is transferred and a calculated amount of money is set aside to compensate for the potential future loss.

The company is required to account for their investment in the cell captive and any increase or decrease in reserves will be reflected in their financial statements. The premiums into the cell captive qualify for tax deductibility.

"Self-Insurance Programmes of this nature have provided a key element of risk management for many years. However they are an option mainly for larger companies with adequate resources to set up such a structure.

# Digging for opportunity

**And unearthing potential.** Investec Resources is a focused and entrepreneurial group of professionals who provide a comprehensive service to the Resource sector. These services include **debt finance, equity participation, BEE transactions, analytical research and advisory,** and are offered out of South Africa, Australia and the U.K.

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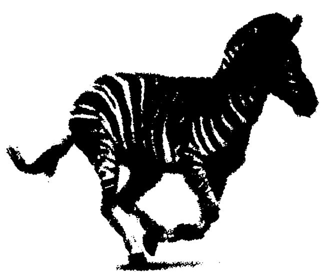

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