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REAL ECONOMY INSIGHT: GOLD

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Real Economy Insight: **GOLD**

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In September 2014, gold mining giant AngloGold Ashanti proposed, and then days later scrapped, a major restructuring plan. The plan was intended to result in the spin-off of a separate Newco, to be listed in London, housing the company's non-South African gold and exploration assets. AngloGold Ashanti would then focus on its South African portfolio and consider developing a multicommodity growth strategy in South Africa and beyond over time.

The abrupt decision to scrap the restructuring plan was largely a result of substantial shareholder opposition, particularly with regard to the inclusion of a $2.1-billion rights issue in the proposal. The rights issue was a necessary component of the deal because the South African Reserve Bank required that AngloGold Ashanti be left debt-free if the restructuring were to proceed.

It is noteworthy to consider the stated motivation behind the proposal – that "separately listed vehicles would allow independent management teams to execute distinct strategies". This echoed the reasons outlined by mining major Gold Fields for the 2013 spin-off of the bulk of its South African assets into Sibanye Gold: that the two portfolios had differing operational and management requirements and divergent strategic demands, and that the separation of Sibanye would enable the two entities to focus on their respective goals and operate more effectively.

At the time of the Gold Fields unbundling, it was largely viewed as an effort by Gold Fields to protect itself against the negative sentiment that existed towards gold miners with operations in South Africa. Similarly, some have described AngloGold Ashanti's attempted restructuring as an effort to mitigate the risks involved in being a South Africa-focused miner.

Such risks include the country's quick-to-strike, yet underproductive workforce, electricity shortages and the threat of illegal miners, as well as the need for new technology to enhance efficiency and effectiveness in

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the industry. These challenges exist in an environment of more general investment limitations, including political risk and uncertainty.

In this context, South Africa's gold output has been declining for several years.

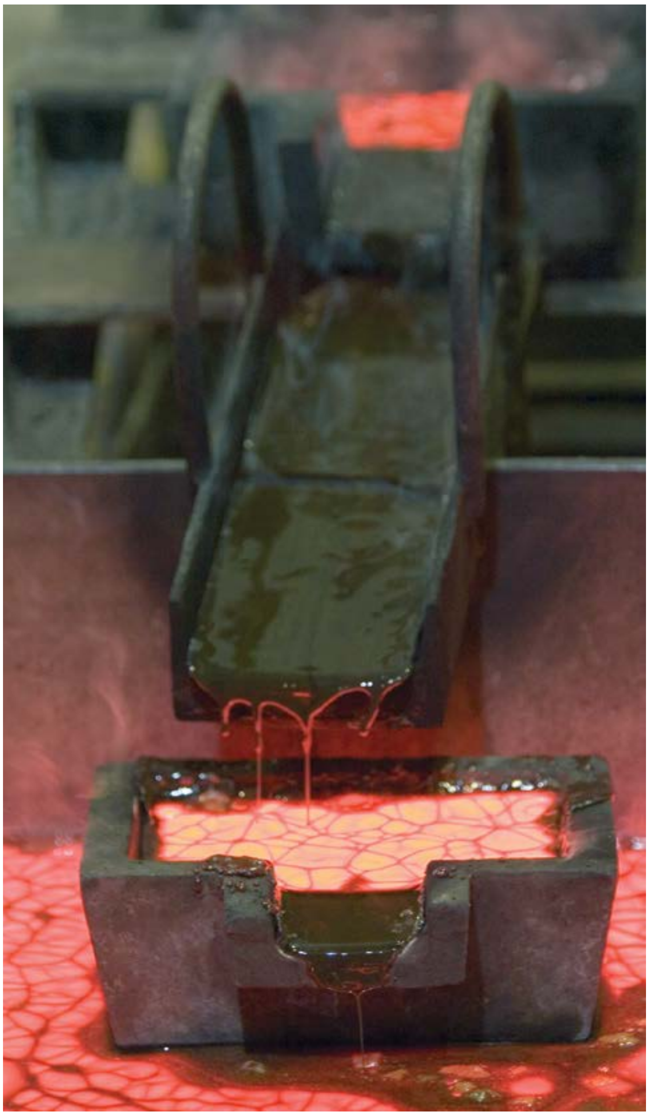
For more than a century, the country had been the world's largest gold producer, but it lost this position to China in 2008 and, since that time, has fallen in the global gold production ranks to sixth position, behind China, Australia, the US, Russia and Peru. South Africa's gold production has declined by an average of 8.2% a year over the past ten years, and its gold production market share has dropped from 13% in 2004 to 5.3% in 2013. The contribution of gold sales to South Africa's total mineral sales has decreased from 30% in 2000 to 12% in 2014. The decline in South Africa's gold production is partially linked to an operating environment that includes ageing mines, rising costs, falling grades and labour-related challenges.

Labour-related challenges

A major challenge facing South Africa's gold mining industry is labour, with strike action in the mining industry not only denting the country's image as an investment destination, but also causing production losses that affect the profitability of operations and the viability of marginal mines.

South Africa's gold sector, for many years, has engaged in centralised collective bargaining with regard to wages and conditions of employment. These negotiations involve the Chamber of Mines (CoM) that represents the majority of gold mine employers, and recognised trade unions, which represent their members. For a union to be recognised, it needs to represent at least 30% of employees at a particular operation. As at the end of January 2015, union representation at CoM gold member companies comprised the National Union of Mineworkers (NUM), with 57% of workers; the Association of Mineworkers and Construction Union (AMCU), with 25%, Uasa, with 7%; and Solidarity, with 2%. Workers who were not members of a union constituted 9%.

The CoM contends that gold mine employees are among the best paid of South Africa's industrial workers. The chamber explains that basic wages in the sector are higher than those of comparably skilled workers in other industries, and that several additional benefits are included in the overall cost of employment for gold mine workers. CoM figures show that the lowest-paid entry-level underground gold mine worker receives,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on average, a basic wage of about R5 700 a month, which compares favourably with basic wage figures for nonmining industries. For example, similar wages in the steel and engineering industry are R4 900, in the motor industry R3 100, in the road and freight industry R4 000, in the civil engineering industry R4 000, in the chemical industry R5 000 and in the construction industry R1 500.

In September 2013, the CoM, NUM, Uasa and Solidarity, which collectively represented about 72% of workers affected by the collective wage negotiations at the time, reached a two-year wage deal. While AMCU, which represented 17% of workers at the time, did not accept the agreement, sections of the Labour Relations Act allow for the deal to be made applicable to all employees in the bargaining unit, thus making the deal applicable to AMCU members. The wage increases were backdated to July 2013.

In January 2014, AMCU served AngloGold Ashanti, Harmony and Sibanye with notice of its intention to strike at those operations where the union was the majority union at the time of the 2013 wage negotiations. This effort was thwarted when the Labour Court issued an interim interdict against the planned action. In June 2014, the Labour Court declared the interim interdict final, and ruled that any strike action by AMCU or its members relating to wages and conditions of service for the duration of the two-year agreement would be unprotected.

As a result of the interdict, the gold industry was spared the fate of the platinum sector, which was subjected to a crippling five-month strike in 2014. Concern exists, however, that the current perception is that platinum mine workers are in a better position than their gold mining colleagues because of that protracted strike.

Gold mining companies have been trying, for some time, to link wage increases to productivity, which will make a portion of employees' pay dependent on the performance of the mine or company. However, collective bargaining makes productivity clauses complex, as an agreement between the largest companies and the majority union is applicable to all employees, but productivity-linked bonuses could be implemented at company level.

The wage agreement reached in 2013 was set to expire at the end of June 2015, and companies and organised labour have been gearing up for new wage negotiations.

Gold Fields has opted out of the CoM's traditional collective bargaining framework for this year's wage negotiations, choosing instead to negotiate an independent agreement with workers at its only remaining South African mine, South Deep. The company has explained that this will enable it to attract and retain the right skills for mechanised mining. Gold Fields subsequently reached a generous agreement in April 2015 with the NUM and Uasa to pay increases of 10% each year for the next three years to the 3 500 people it employs at South Deep.

Meanwhile, the other major gold companies represented by the CoM, including AngloGold Ashanti, Sibanye Gold and Harmony, will enter into collective bargaining.

The 2015 wage talks are taking place at a "delicate" time for South Africa's gold industry, with gold prices about 40% below their 2011 peak, while water and electricity tariffs, as well as wages, are continuing to outpace increases in inflation. The industry has considered ways to absorb these cost increases amid declining grades and diminishing productivity levels, with lower overall employment levels an unfortunate, but inevitable, consequence.

At current gold prices, much of the sector is close to, or below break-even levels, placing more jobs at risk. Harmony has warned that it will not survive high wage increases, with CEO Graham Briggs further noting that, should high increases be granted, the market can expect the company to engage in massive retrenchments. Similarly, Sibanye has cautioned that, "while delivering short-term gains for employees and unions, [inflated wage hikes] will inevitably result in the loss of jobs and destroy value for all stakeholders in the longer term".

Over the past decade, according to the CoM, the average yearly wage in the sector rose by 180% to about R196 298 a year, while the total number of employees in the sector decreased by one-third to about 119 000 people. Over that same period, South Africa's gold production dropped by about 8.2% a year on average.

Gold companies want to reach a new accord with employees and their labour unions to arrest this downward spiral and restore the industry to more sustainable, long-term footing. AngloGold Ashanti has stated that this "is crucial for the future of one of South Africa's key economic contributors, and indeed for individual mines and their employees, given that companies cannot be expected to persist with unprofitable operations".

The companies will this year propose an 'Economic and Social Sustainability Compact', which will comprise a mutually agreed set of binding principles that will determine the rights and responsibilities of companies and organised labour in respect of workplace activities and consequences, including wages and conditions of service.

The fundamental principles of the proposed compact will be sustainability through a partnership approach by the companies, the unions and employees. Proposed wage increases and other terms and conditions of employment will be considered with due regard to their impact on the sustainability of the industry and on employment security.

AngloGold Ashanti CEO Srinivasan Venkatakrishnan (Venkat) has stated: "When you look at the wage negotiations this year and you look at the backdrop of what has happened [in the] platinum [industry], for example, [we saw] really unsustainable wage increases that [were] followed by job losses."

However, sources indicate that the NUM is demanding a wage increase of more than 80% for entry-level underground workers.

The union is seeking to raise basic pay for the lowest wage band to R10 500 a month. The union reportedly also wants all other gold mine employees to get an increase of at least 15% and an accommodation allowance of at least R3 500 a month.

Meanwhile, in mid-May, it was reported that AMCU was demanding a monthly wage of R12 500 for workers currently earning about R6 000 a month.

Electricity-related challenges

South Africa's growth- and confidence-sapping electricity crisis is affecting the gold mining industry. This challenge is twofold – rising electricity prices and unreliable electricity supply.

Several gold companies have highlighted the impact of high electricity price increases on their total costs. For example, Sibanye Gold has noted that, despite slashing its power consumption by 20% since 2007, the company's electricity costs have continued to increase. Electricity currently accounts for about 20% of its operating costs, representing a potential bill of about R3.1-billion in 2015, compared with 9%, or R757-million, in 2014. Sibanye contends that, with labour costs accounting for another 55% of its operating costs, three-quarters of its operating costs are now beyond its control.

Similarly, Harmony Gold has noted that, while it has reduced its energy consumption by 13% since 2012, there has been a 34% increase in the company's electricity costs, bringing its electricity bill to about R2-billion. Briggs has noted that the cost of electricity has increased about 133% over the past five years, describing it as a "massive increase". He says the reality of Harmony Gold's situation is that its ventilation and cooling facilities undoubtedly make the company a big electricity consumer. "There will be further increases in the year ahead. This is certainly a threat to us," he has said, further estimating that the company will spend about R2.2-billion on its utility bill by the end of 2015.

While electricity prices are rising, companies are facing an increasingly unreliable electricity supply. State-owned power utility Eskom has warned consumers to expect power-supply shortages for the next three years as it completes the building of new capacity and deals with a major maintenance backlog.

Picture by Duane Daws

The shortage and unreliability of electricity supply are prompting gold mining companies to consider the viability of generating their own electricity.

For example, Sibanye Gold announced in February 2015 that it had planned to build a R3-billion, 150 MW solar power plant, in the North West. The modular plant, expected to come on line in three 50 MW stages, at a site near Driefontein in 2017, will remove 10% of the company's average daily energy requirements from the national grid. The permitting process for the plant is under way, with funding options being assessed with banks and potential partners for a possible offtake agreement. However, Sibanye has the funds to undertake the project, should it need to be self-funded. It is also planning to undertake an in-depth investigation into the feasibility of its own coal-fired power stations that will contribute an additional 200 MW to 600 MW the company's energy requirements.

Further, Sibanye is trying to turn highly explosive methane gas into electricity at its Beatrix mine, in the Free State. The gas will serve as a completely free fuel for the generation of an additional 2 MW of electricity after being captured and brought to surface from depths of more than 800 m.

The company has said that load-shedding has had a significant impact on its operations, and it does not expect the situation to change as Eskom is battling with higher demand and critical power shortages.

To mitigate the short-term risk, Sibanye is working with Eskom to manage and reduce the impact of load-shedding on its operations.

However, AngloGold Ashanti contends that, despite the electricity challenges, building its own power stations to provide electricity for its South African gold mines does not pass economic muster and is thus not at the top of its current priority list.

Largely through re-engineering mine cooling and refrigeration, the company has managed to reduce its electricity consumption from the national power grid by 20% in the past six years. It is also working closely with Eskom to lower power consumption during peak periods by shifting its pumping and rock hoisting loads. The company has pointed out that load-shedding has accentuated the need to get the best margin out of available kilowatt hours and, on a staged basis, it intends removing supply from nonessential areas, operating its mill sequences differently and prioritising lower margin operations over higher-margin operations.

Venkat has advocated for a long-term solution to be found, but has simultaneously indicated that, for AngloGold Ashanti, "building power stations didn't actually make sense and . . . using power from the grid is perhaps a better solution".

AngloGold Ashanti has generator sets that kick in for safety reasons when the company needs to evacuate staff from underground operations. It is also installing turbines in underground mines to boost energy regeneration as part of a strategy to recover electricity without spending significant amounts of capital. The company will continue to consider alternative sources of energy, particularly renewable energy, including solar and wind farms.

Meanwhile, specialist tailings miner DRDGold, which was subjected to 67 hours of load-shedding in December 2014, has reported that power cuts and load-shedding do not pose as serious a threat for it as for underground gold producers. The company has noted that the installation of back-up generators has significantly derisked its operation and will enable it to keep the thickeners in the circuit active.

Eskom is giving a two-hour warning prior to load-shedding being implemented in any of the four load-shedding zones in which DRDGold operates, which will

Picture by Duane Daws

further counteract power-supply risks for the company. DRDGold has also reached a consumption curtailment agreement with Eskom, in terms of which the company reduces, on request, total consumption by an agreed percentage during load-shedding hours. Subsequently, the company will maintain uninterrupted tonnage throughput, although recoveries might reduce, owing to certain parts of the operating line shutting down during the load-reduction periods.

Prospects

Despite the decline in South Africa's gold production and the ongoing challenges facing the sector, gold mining remains an important part of the country's economy. In 2013, the gold mining sector:

– was the third-largest component of the South African mining sector on the basis of its contribution to gross domestic product,
– employed more than 130 000 people and paid them about R24-billion in salaries and wages,
– was the second-largest mineral exporter with exports valued at R64-billion,
– paid R900-million in corporate tax and
– undertook capital expenditure valued at R11.7-billion.

It is believed, however, that the development of new technologies will be essential for the future of the industry.

The need for new technology is compelling, as only 60% of the gold ore in South Africa's rich Witwatersrand basin is accessible using current drill-and-blast technology, with 40% of the gold left behind in pillars to keep seismicity at bay. The current mining method loses a further 25% to 30% of that 60% because blasting breaks the ore into so many pieces that not all of them can be recovered, particularly as fractured sizes range from fine powder to large boulders. Once blasted, the product is moved up to seven times, which results in more losses. On average, there is 200% more waste than hold in the mix moved with dilution being as high as 1 500%, which means that large volumes of nonpay material have to be transported out of ever-deepening cavities. After extracting only 60% of accessible ore, 100 g of gold in the ground becomes 30 g or 25 g of gold on surface.

Several mining companies, most notably AngloGold Ashanti, are investing in the development of new technologies to deal with this challenge.

If the local mining industry is successful in finding a viable new alternative mining method, it will be able to not only mine all remaining pillars and go to ultradepths but also reopen a large number of closed mine shafts and revive mining ghost towns.

Meanwhile, Gold Fields CEO Nick Holland has indicated that the gold industry needs to make money once more and return to fundamentals if it is to succeed in competing with the gold exchange-traded funds for coveted capital. He contends that the gold industry is at a crossroads, and that the focus must return to investor cash returns, rather than growing output at all costs. To do this, he contends, cost control is fundamental. He cites Gold Fields' ongoing transformation as an example of this, noting that, over the past decade, the company's output has contracted from about 4.5-million ounces to about 2.2-million ounces in favour of generating free cash flow. This was mainly achieved by spinning off the bulk of its South African operations into Sibanye Gold. Holland has indicated that companies must not be "asset huggers", but rather let go of unprofitable assets.

Challenges of the migrant labour system and high levels of worker indebtedness

Globally, many mines, including South Africa's gold mines, are staffed by migrant labour forces. South Africa's migrant workers, however, differ significantly from their counterparts elsewhere in the world in that they constitute a large in number, and are fairly lowly paid and minimally educated, whereas global migrants are increasingly higher paid knowledge workers who generally benefit from fly-in, fly-out transport.

In contrast, South Africa's migrants are hardly ever fully resident in the areas where they work and are rarely present in the places they call home, with the current South African system of 11-shifts-a-fortnight and 12 days holiday a year regarded as a negative factor.

The inability to attend adequately to the economic and social needs of migrant workers in South Africa is increasingly being regarded as a major contributor to the current turmoil in the mining industry.

Recruitment company Teba has been investigating several initiatives on migrant labour reform, including the short-term implementation of a new system of affording migrant mineworkers more time at home with their families in the labour-sending areas. Further, Teba contends that shift reform could potentially facilitate a shared-labour planning exercise that can reduce dependence on skilled mineworkers who live far away, and provide an opportunity to develop skills in surrounding communities.

Another factor identified as an underlying cause of industrial action in the mining industry is the high levels of debt of many mineworkers, with workers seeking higher wage increases to enable them to better service their debts.

Owing to their stable employment, mining employees are being targeted by illegitimate and unscrupulous credit providers who provide easy access to loans. This has resulted in many mineworkers having higher levels of debt than they can settle on a monthly basis.

A study by the University of Pretoria has shown that 12.9% of the mining industry's employees have emolument attachment, or garnishee, orders against their names and are severely indebted. Indebtedness impacts significantly on employees' ability to thrive and fund their future and deleteriously on their wellbeing at work and home.

A task team comprising representatives from the gold majors and unions has been established to work towards teaching employees in the mining sector how to better manage their finances.

Source: *Mining Weekly*

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