KPMG

Insights into Mining

Issue 11: Mining executives identify top risks

What is on the minds of the leaders of Canada's top mining companies?

Every year KPMG surveys mining executives and asks them to rank their top perceived risks for the mining industry. The results give us insight into the challenges that are weighing on the minds of the leaders of some of Canada's largest mining companies.

Top 10 risks in 2016 vs. 2015

	2016		2015
↑	Ability to access and replace reserves, including access to new projects	01	Commodity price risk
↓	Commodity price risk	02	Ability to replace reserves, including access to new projects
↑	Liquidity risk	03	Permitting risk
=	Community relations-social license	04	Community relations-social license
↑	Controlling capital costs	05	Liquidity risk
↑	Resource nationalism – Fiscal and political risk	06	Environmental risk
=	Controlling operating costs	07	Controlling operating costs
↑	Access to energy and water	08	Capital allocation
↓	Environmental risk	09	Controlling capital costs
↑	Health and safety risk	10	Economic slowdown

The 2016 results reinforce that in order to survive in the mining industry, companies need to learn to adapt in the face of scarcity of natural resources, and commodity price cycles whilst still maintaining liquidity. It is also interesting that at a time when the whole world appears to be bracing itself for increased political and economic uncertainty, mining executives are increasingly concerned about resource nationalism, and haven't forgotten the lessons of the past of controlling costs, and earning the social license to operate. These risks set the landscape which drives strategic decision-making.

Rising urgency to replace reserves and resources

Our 2016 survey marks the first time that the concern over the ability to access reserves and resources has replaced commodity price risk as the top concern for mining executives. What's more, the focus on obtaining mineable minerals has increased drastically from 2014, when it claimed the 10th spot on the list. A comparison with commodity price cycles during this period provides important context regarding the potential root cause of this climb; during the recent focus on controlling capital and operating costs, the identification and advancement of high-risk exploration projects have taken a back seat. As the industry trends towards sustainably holding onto these cost savings, the focus again returns to securing access to reserves to ensure growth.

In early 2016, the *World Exploration Trends* report from SNL Metals & Mining highlighted a decrease of 19% in worldwide nonferrous metals exploration budgets between 2014 and 2015. Similarly, the Mining Association of Canada reported a decline in spending on exploration and deposit appraisals in Canada by 18% in 2014 (to CAD$1.9 billion– lower than the spending observed during the 2009 financial crisis), and a further drop to CAD$1.86 billion in 2015.[1] The long-term impact of these efforts to reduce costs through lower exploration spend may have resulted in increased concerns that efforts to regain ground, via both exploration and acquisition, will not come fast enough to replace production.

The focus on accessing new projects may have also led to increased risk of controlling capital costs (moving up four positions since 2015) as companies look ahead at the ever-present risk of developing these projects on time and on budget.

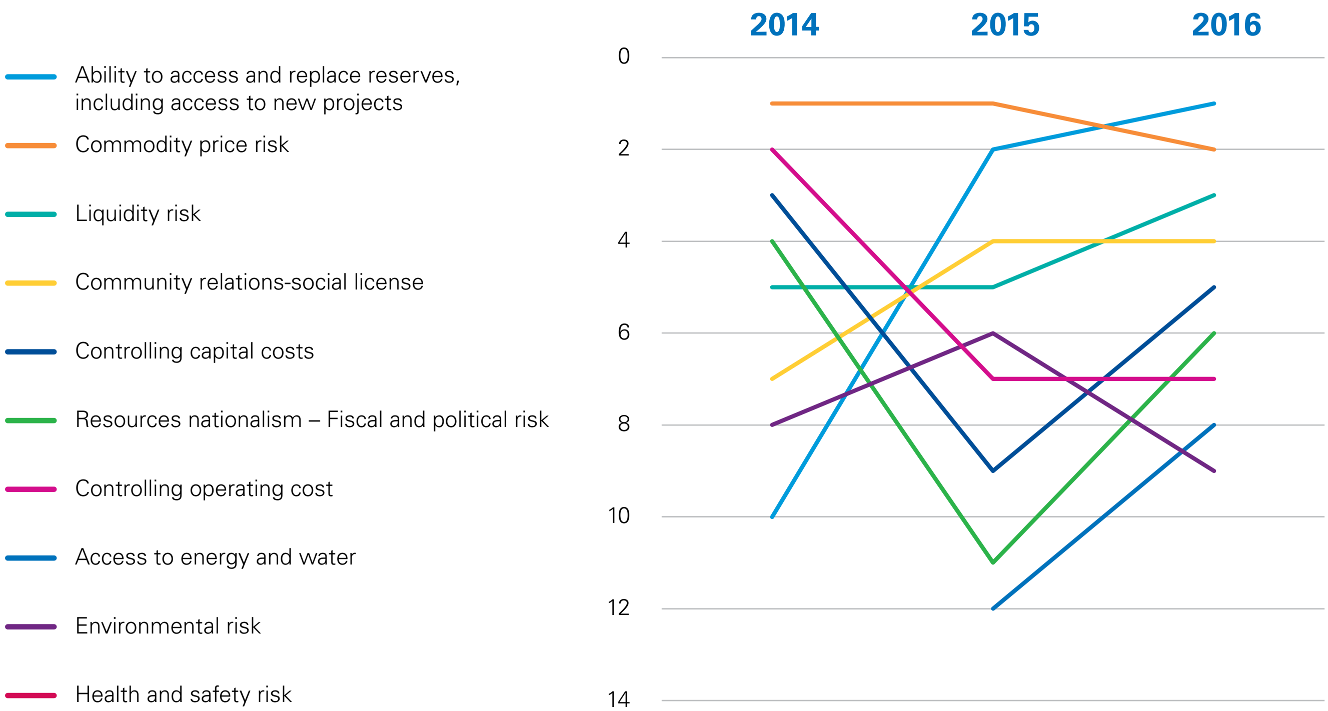
The commodity cycle continues

Fluctuating commodity prices continue to bring variability into life-of-mine planning efforts, and the threat of declining commodity prices has remained a significant risk for mining executives. The focus on cost savings to mitigate this risk remain ever-present on the strategic agendas of global mining companies, overlapping into other risk trends such as liquidity risk (moving up two positions since 2015), and increased risk of controlling capital costs.

Exploring the multi-year trends in perceived risk

In the face of uncontrollable, significant fluctuations in commodity prices, there is a near-sighted danger in examining risks on a year-to-year basis; thereby missing movements that point to a more significant trend. The chart below maps the movements in the top 10 risks from our annual survey from 2014 through to 2016.

Top 10 trend – 2014 to 2016



[1] Facts and Figures of the Canadian Mining Industry (F&F 2015)

In addition to the top two risks previously described, the three-year trend shows a decline in the risks of controlling capital and operating costs from the peak of the commodity crisis in 2014, however both of these risks and liquidity remain consistently in the middle of the pack, revealing the challenge to preserve liquidity in defense of unstable commodity prices. Since 2014, the risks related to health, safety and sustainability have generally increased, which is not surprising given the continued pressure for companies to think beyond the bottom line, and be good corporate citizens, this is only heightened for mining companies, which often operate in remote and hazardous locations.

Fears associated with falling commodity prices, accessibility of reserves and resources, and other operational shortages inevitably trigger reactive strategic responses. The most agile companies will embed risk assessments as a core component of strategic decision making, considering their strategic risks in everything from life-of-mine sensitivity analysis to capital allocation. Such activities could include an increased focus on the following risk responses:

Examples of risks and possible mitigation strategies

Commodity price risk

- Treasury hedging strategies
- Sensitivity analysis/life-of-mine planning assessments

Controlling capital costs

- Project post-mortems and modifications to project delivery models
- Robust capital allocation process
- Contract compliance assessments
- Tendering, bidding and procurement processes
- Contract(or) management
- Sensitivity analysis/life-of-mine planning assessments

Controlling operating costs

- Fuel management and inventory management
- Tendering, bidding and procurement processes
- Contract(or) management
- Sensitivity analysis/life-of-mine planning assessments

Community relations and social license risk

- Corporate social media and community management process
- Project-specific community engagement assessments
- Incident response assessment

Access to reserve and resources

- Acquisitions and investments strategies
- Sensitivity analysis/life-of-mine planning assessments
- Exploration investment policies

For a look at how the risks identified in this survey compare to those disclosed by 25 global mining firms, refer to our **2016 Mining Reporting Survey.**

What's next?

Perhaps even more interesting than what risks ranked in the top 10, are the ones that didn't. These days it seems everyone is talking about disruption and automation. But in our survey, innovation and the risk of disruption only ranked 26th.

In our experience, many mining companies do not focus on identifying emerging risks, and in particular, how to develop a strategy to take advantage of the opportunities they present. For many in the mining industry, it may feel too soon to worry about being innovative in the face of disruption, particularly given all the pressing challenges the industry faces; however, companies that build their strategy to take advantage of this emerging trend may end up ahead of the pack in the end.

If you would like discuss the results of this survey further, or the impacts they may have on your business, please contact us directly.

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