Insights into Mining

Issue #6

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Welcome to *Insights into Mining*, a periodic e-newsletter focused on current topics relevant to the Mining Industry.

KPMG's mining practice is committed to the industry and will periodically publish a series of insightful articles authored by leading KPMG Mining professionals and advisors. The articles are designed to inform and stimulate debate amongst those involved in the industry. If you have any questions, please contact your local KPMG representative or click here for a list of KPMG's Mining leaders across the country.

Heather J. Cheeseman
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Survey says: Mining looks to the future

"Now this is not the end. It is not even the beginning of the end. But it is, perhaps, the end of the beginning"

Winston Churchill

Most industry insiders would describe the past three years as anxious for mining companies, as commodity prices continued to slide down from record highs reached earlier in the century. Softening commodity prices diminished revenues and chased away investors. At the same time, many perceived that operating and capital costs were spiraling out of control. Now it appears that some of the psychological weight may be lifting. A survey recently conducted by KPMG suggests that the fear that has gripped the North American industry may be fading, even though most external business conditions for mining are not yet in recovery.

Every September at KPMG's Mining Executive Forum in North America, attendees are asked to complete a short survey that ranks their perceived risks to the mining industry. The size of the group and the rate of participation help to ensure that we have a statistically representative sample. We are confident that the results represent a valid reflection of the state of the North American industry from an executive point of view, and we keep the survey similar through the years to help identify emerging trends.

This year's survey results were particularly interesting from an emerging trends perspective. For several years, executives have given priority to fundamental financial risks such as liquidity, controlling capital costs, controlling operating costs, capital allocation and resource nationalism.

While commodity price risk still lead the ranking for the second year in a row, the number two ranked risk was significantly changed: ability to replace reserves, including access to new projects. This issue rose from number ten in last year's survey to second spot. Also increasing in importance were the third- and fourth-ranked risks this year: permitting risk and community relations (or the 'social license to mine') respectively. Both of these issues climbed three spots to enter the top five in

Top 10 Risks in 2015 vs. 2014

2015		2014	
Commodity price risk	1	Commodity price risk	—
Ability to access to replace reserves, including access to new projects	2	Controlling operating costs	↑
Permitting risk	3	Controlling capital costs	↑
Community relations-social licence	4	Resource nationalism-fiscal and political risk	↑
Liquidity risk	5	Liquidity risk	—
Environmental risk	6	Permitting risk	↑
Controlling operating costs	7	Community relations-social licence	↓
Capital allocation	8	Environmental risk	↑
Controlling capital costs	9	Capital allocation	↓
Economic slowdown	10	Ability to access to replace reserves, including access to new projects	↑

Source: KPMG in Canada

the rankings. Previously, the top five were mainly financial risks that are now clustered between numbers five and ten.

These results suggest to us that companies may be ready to broaden their singular focus on financial survival, and start preparing for growth in the future. It is also possible that companies see a declining production profile as an emerging risk due to reduced spending on resource development in recent years. In any case, efforts by companies to control costs, rationalize their asset portfolios, and strengthen their balance sheets have shown results. Many believe these risks have been addressed through robust cost management programs and are no longer as worrisome. However, it is most interesting that companies could be lifting their gaze to future-oriented issues at a time when trends in economic growth, commodity prices and the equity markets do not lend any certainty to the outlook for growth in their businesses. This may herald a future period of stability in the industry, allowing companies to position themselves for an eventual upturn in global economic growth and commodity prices.

Mitigating the new top risks

If our survey does accurately reflect a desire for mining companies to move past the darkest days, what does this mean for risk management in these companies to prevent the mistakes of the past being repeated?

First of all, the fact that companies have developed strategies and executed plans for mitigating serious financial risks does not mean that these issues can now be ignored. They are still among the top ten risks and must be continuously managed. However, as expressed by presenters in a risk management session at this year's Forum, many companies are adopting an advanced view of ERM that includes using it as a strategic tool rather than just a compliance effort.

Companies leading in this area are linking risks to corporate objectives and strategies, taking deliberate strategic risks, and embedding risk management perspectives into existing processes. These methods are championed in the executive suite by directors and senior managers who believe that embedding ERM in the business is critical to success. The appearance of future-oriented non-financial risks in the top five may reflect a strategy of identifying and addressing emerging risks early, when they can be turned to the advantage of key business goals.

The new priority given to future-oriented issues such as access to new projects could spark a revival of the M&A market. One speaker at this year's Forum called M&A strategy "the defining feature of who succeeds over time." Ore cannot be discovered as fast as it can be mined, he stated, so it must be acquired.

Even though the share prices of most companies have been soft or declining over the past several years, M&A activity has not generally responded to the opportunity to buy low. Deal volumes and values have flagged over the past several years. To move strongly into the next growth phase of mining, companies must find ways to make acquisitions despite the continuing challenges of obtaining major equity or debt financing on desirable terms.

Fortunately, the recent low levels of M&A activity have driven extraordinarily creative approaches to deal making. We have seen many more mergers of equals and all-share deals. Consolidations of multiple junior companies are occurring, as well as strategic investments in development projects by majors. Newer types of transactions that involve metal streaming and royalty contracts are increasingly common. The seeds have been sown for a very open and innovative M&A market that can get a deal done in a wide variety of ways. An inventive M&A strategy could help companies improve access to new projects, and now may be an ideal time.

South Africa's Top 10 Risks vs. Canada's

South Africa		Canada
Access to energy and water	1	Commodity price risk
Increased unionization and high wage demand	2	Ability to access to replace reserves, including access to new projects
Commodity price risk	3	Permitting risk
Community relations, social license to mine	4	Community relations-social licence
Economic slowdown	5	Liquidity risk
Productivity	6	Environmental risk
Controlling operating costs	7	Controlling operating costs
Capital allocation	8	Capital allocation
Infrastructure access	9	Controlling capital costs
Ability to access to replace reserves, including access to new projects	10	Economic slowdown

Same ranking
Only South Africa
Only Canada
Different ranking

Source: KPMG in Canada and KPMG in South America

South Africa: A surprisingly different perspective

Following on the success of KPMG's North American Mining Executive Forum, KPMG in South Africa launched its own Mining Executive Forum in September 2015. The South African Forum looked at what companies should consider to be "Fit for Future" in a challenging African mining environment, and covered topics such as social responsibility, African energy supply, ethics, and the impact of technology and other changes on the future of mining companies.

As part of their inaugural event, KPMG South Africa conducted the same survey as North America with mining executives in attendance. Comparisons between the South African and North American survey results show how different perceptions can be between regions in a global industry. While six of the top ten risks overlapped between the two regions, they appeared in a very different order and there were some major differences. For example, the number one issue for North America was commodity price risk, but number one for South Africa was access to energy and water, which ranked 12th in North America. Access to energy and water is a critical challenge across Africa, where shortages affect households as well as businesses. South Africa's current electricity crisis was a focal point at the South Africa Forum.

**Source:* KPMG in Canada and KPMG in South America

The number two concern for South African executives was increased unionization and high wage demand, which ranked 24th on the list for North American executives. The number six and eleven ranked risks by South African executives were also related to concerns about the workforce—productivity and labour shortages—which were ranked 16th and 18th by North American executives respectively. Clearly, labour issues are a current hot button for South African miners. Many companies have recently experienced lengthy and challenging union negotiations, some of which resulted in violent strikes and protests.

Turning things around, the number two and three issues for North Americans (access to new projects and permitting risk) ranked 10th and 19th for South Africans. North America's number five and six (liquidity risk and environmental risk) ranked 17th and 12th in South Africa.

Why the differences? Both regions shared major concerns about commodity prices and economic slowdown, two factors that are essentially beyond management control. However, when considering specific strategic and operating challenges, it seems that risk is in the eye of the beholder. South African executives were more focused on immediate challenges related to labour demands and scarce inputs, while North American executives placed more emphasis on permitting risk and access to new projects—suggesting they are beginning to divide their attention between immediate and future challenges.

In both regions, the survey results reinforce the importance of having a robust enterprise risk management process that identifies emerging risks, in order to deal with a complex web of issues at the company level.

Summary and conclusions

Survey results from KPMG Canada's 11th Annual Mining Executive Forum in North America revealed a change in trend from the past few years. The survival instincts of North American mining executives, top of mind over the past three years, showed signs of abating as some future-oriented issues rose into their top ten ranking of risks. Executives may be starting to look toward the future even though external business conditions such the global economy, commodity prices and equity markets remain volatile.

This slight shift in attitude may have occurred because many mining companies have addressed their major financial risks and are beginning to see positive results. The survey shows that these financial issues are not yet off the table, but they are of less concern than they were last year and the year before. Also, the practice of risk management at mining companies is becoming more strategic. It is possible that some future-oriented risks are rising to priority early for examination of their strategic possibilities. In any case, the survey results may indicate the potential for a period of relative stability in the mining industry awaiting improvement in external business conditions.

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