Why competitiveness matters

July 2018
### Mining in South Africa today 2017

<table>
<thead>
<tr>
<th>Description</th>
<th>Value</th>
</tr>
</thead>
<tbody>
<tr>
<td>Foreign exchange earnings</td>
<td>R328,1 bn</td>
</tr>
<tr>
<td>Corporate taxation</td>
<td>R19.3 bn</td>
</tr>
<tr>
<td>Minerals Royalties</td>
<td>R7,5 bn</td>
</tr>
<tr>
<td>Fixed investment</td>
<td>R81 bn</td>
</tr>
<tr>
<td>Skills development (Mining Sector Commitment)</td>
<td>R6,2 bn</td>
</tr>
<tr>
<td>Skills Development (Skills Levy)</td>
<td>R1,2 bn</td>
</tr>
<tr>
<td>Skills development (Charter)</td>
<td>R6.6 bn</td>
</tr>
<tr>
<td>No of direct employees</td>
<td>465 000</td>
</tr>
<tr>
<td>Employee wages</td>
<td>R126 bn</td>
</tr>
<tr>
<td>PAYE collected on behalf of employees</td>
<td>R10 bn</td>
</tr>
<tr>
<td>Procurement expenditure</td>
<td>R430 bn</td>
</tr>
<tr>
<td>Procurement with SOEs (Eskom)</td>
<td>R16 bn (16% of Eskom’s Sales)</td>
</tr>
<tr>
<td>BEE procurement</td>
<td>+R100 bn</td>
</tr>
<tr>
<td>Returns to shareholders</td>
<td>R13 bn</td>
</tr>
<tr>
<td>Dividends to PIC</td>
<td>R390 million</td>
</tr>
</tbody>
</table>
Mining contribution to GDP (%)

Mining GDP in real terms has been stagnant for 24 years.

Source: StatsSA
Growth in net investment has been on a downward trajectory for two decades, and is set to continue declining. In real terms, net investment decreased by nearly 60% between 2008 and 2016, reflecting a significant volume drop in net investment.
South African mining industry value distributed 2017 (%)

- Funds reinvested: 16
- Employees: 40
- Dividends to shareholders: 2
- Contribution to government: 19
- Community investment: 1
- Borrowings: 5
- Funds retained: 17

In 2017, shareholders only received 2% OF VALUE created by mining projects.

40% of value created to labour for their direct efforts, 19% to government.

Shareholders not only get the smallest share but stand last in the queue to get any share - despite their capital enabling the project to happen in the first place.
Comparison of stock exchanges

- Comparison of resource indices in global stock exchange peers, shows that **South African performance has been extremely poor**
- Stock exchange performance is a function of investment in and out of a jurisdiction:
  - A negative performance indicates declining investment levels and confidence in an industry.

<table>
<thead>
<tr>
<th>Measured period</th>
<th>Johannesburg Stock Exchange (resource index)</th>
<th>Australia Stock Exchange (resource index)</th>
<th>Toronto Stock Exchange (resource index)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Stock exchange resource indices</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Month to date (During June 2018)</td>
<td>1.96</td>
<td>0.94</td>
<td>-0.93</td>
</tr>
<tr>
<td>Quarter 2 to date (Calendar Quarter)</td>
<td>16.32</td>
<td>13.68</td>
<td>5.59</td>
</tr>
<tr>
<td>Year to date (Jan to June 2018)</td>
<td>11.24</td>
<td>6.93</td>
<td>2.24</td>
</tr>
<tr>
<td>1 year</td>
<td>37.08</td>
<td>38.29</td>
<td>20.73</td>
</tr>
<tr>
<td>3 years</td>
<td>-2.98</td>
<td>8.51</td>
<td>5.76</td>
</tr>
<tr>
<td>5 years</td>
<td>-8.78</td>
<td>3.61</td>
<td>2.88</td>
</tr>
<tr>
<td>10 years</td>
<td>-44.20</td>
<td>-4.04</td>
<td>-5.19</td>
</tr>
</tbody>
</table>

Source: ShareNet, S&P at 21 June 2018
More than 90% of mining company shareholders are

PENSIONS AND OR INVESTMENT FUNDS.

They are led by professional fund managers whose responsibility it is to ensure that their investments will make a positive return for investors.
Fraser Institute Investment Attractiveness Index ranks South Africa in top quartile for mineral potential.

Yet, South Africa is ranked in bottom quartile for best practice policy, legislation, regulation and operating environment.
What could happen if the mining sector grows

A growth rate of between 3% AND 5% could result in a doubling of most mining outcomes in 12 TO 15 YEARS
WHAT IF?

We asked what could happen if the policy, regulatory and governance environment improved substantially?

Estimated currently planned capital spend over next 4 years of R145 billion (stay-in-business)

capital could increase
by R122 billion (84%)
With R122 billion more investment,

- **48,000** direct jobs
- **150,000** direct and indirect jobs created

Potential investment per commodity (R billion)

- **Coal**: 51.4
- **Diamonds**: 0.4
- **Energy**: 30
- **Gold**: 37.5
- **Uranium**: 3.1

Additional potential of R122 billion capex
Mining requires long term investment and significant capital

To build a new underground mine costs between

**R3 billion** and **R10 billion** before any ore is mined

**Mining is a long-term investment**

- **Exploration:** Up to 10 years
- **Feasibility studies and funding:** 3-5 years
- **Construction:** 2-10 years
- **Steady-state and break-even:** 20-50 years
- **Life of mine:** 10-50 years
Exploration and junior mining is the lifeblood of any successful mining sector.

It is at the exploration stage that significant investment is needed, and where returns are not guaranteed.
South Africa attracted only 1% of global exploration expenditure in 2017
South Africa's share of African exploration budgets 2000 - 2017 (%)

South Africa's exploration budgets 2000 - 2017

- 2000: 20.3%
- 2017: 8.3%

- 2000: 52.8
- 2017: 87.1
DMR needs to make allowances for JUNIOR MINERS AND EXPLORERS, by taking a graduated approach to the application of the Charter.
The mining industry supports
30% black ownership
for new mining rights, for black entrepreneurs, communities and employees
Investors can choose where to invest – by country, sector or commodity
Public policy choices have consequences.

An uncompetitive charter will have significant economic costs.
A 10% TOTAL FREE CARRIED INTEREST ON NEW MINING RIGHTS WILL MATERIALLY UNDERMINE INVESTMENT, by pushing up investment hurdle rates and ensuring that many new projects become unviable.
Free carry interest (FCI) and investment

- Investors will choose to invest where they get the highest returns
- Investors are willing to fund a project if they can get higher returns than from a bank
- Any measure that decreases returns will make investors less inclined to invest in a project
- FCI has the same impact as a tax and diminishes investor returns
- The lower the returns, the less capital will be available for the project
- Mining companies sell shares on stock exchanges to raise funds to fund mining projects
- FCI means that investors fund 100% of a project, but only own 90% and only receive 90% of returns
- This 10% shortfall makes it less attractive to invest in a project
- Projects without FCI are more attractive because they offer more returns
- This means that investors would choose to invest in projects without FCI
- FCI will only apply to new mining projects which means that there will be few or no new mining projects
The mining sector’s tax liability is more than its contribution to GDP.

But, the mining sector’s contribution to GDP (real and nominal) has been declining over the decade owing to several factors, while exploration and construction of new mines have both declined.

Chart indicates that tax burden as a share of total corporate income tax rises to 27% in 2011 and 20% in 2016.
Tax liability of the mining sector (2)

- Proposed trickle dividend equal will lead to a further escalation of the total share of taxes paid by mining companies in relation to total CIT.

![Graph showing tax liability percentages from 2011 to 2017*]
Table illustrates actual key taxes paid by mining companies – last two colR480 million as a trickle dividend; R1 billion in 2011; R1.2 billion in 2012; and R950 million in 2017.

<table>
<thead>
<tr>
<th>Year</th>
<th>Company tax (Rm)</th>
<th>Royalties (Rm)</th>
<th>1% of EBITDA (Rm)</th>
<th>Total taxes paid</th>
</tr>
</thead>
<tbody>
<tr>
<td>2006</td>
<td>16 364</td>
<td>-</td>
<td>-</td>
<td>16 364</td>
</tr>
<tr>
<td>2007</td>
<td>20 658</td>
<td>-</td>
<td>-</td>
<td>20 681</td>
</tr>
<tr>
<td>2008</td>
<td>32 490</td>
<td>-</td>
<td>-</td>
<td>33 330</td>
</tr>
<tr>
<td>2009</td>
<td>10049</td>
<td>-</td>
<td>-</td>
<td>10 899</td>
</tr>
<tr>
<td>2010</td>
<td>17 597</td>
<td>-</td>
<td>-</td>
<td>18 007</td>
</tr>
<tr>
<td>2011</td>
<td>26 159</td>
<td>5 612</td>
<td>840</td>
<td>32 781</td>
</tr>
<tr>
<td>2012</td>
<td>20 468</td>
<td>5 015</td>
<td>1 230</td>
<td>26 713</td>
</tr>
<tr>
<td>2013</td>
<td>20 563</td>
<td>6 420</td>
<td>920</td>
<td>27 903</td>
</tr>
<tr>
<td>2014</td>
<td>16 062</td>
<td>5 422</td>
<td>910</td>
<td>22 394</td>
</tr>
<tr>
<td>2015</td>
<td>11 017</td>
<td>3 708</td>
<td>750</td>
<td>15 475</td>
</tr>
<tr>
<td>2016</td>
<td>17 114</td>
<td>5 802</td>
<td>650</td>
<td>23 566</td>
</tr>
<tr>
<td>2017</td>
<td>19 326</td>
<td>7 500</td>
<td>950</td>
<td>20 276</td>
</tr>
</tbody>
</table>
Proposed 1% EBITDA trickle dividend to community and employees shareholders would effectively disadvantage 90% of shareholders – most of them pension funds
How the trickle dividend will affect real net fixed investment in mining

- **Real net investment in the mining sector** peaked at R40 billion in 2008 when the global financial crisis began. The crisis resulted in the global economy shrinking by 1.7%. Since then the world economy has expanded and in some aspects demand for commodities picked up.

- Our domestic mining industry has remained in the doldrums, evidenced by the lack of improvement in net investment.

- Between 2008 and 2016, depreciation of capital stock in the mining sector, on average, grew faster real net investment at 6.4% and 5.6%, respectively.

- This means that production has been dependent on mainly existing stock of capital.

- Investment in new machinery & equipment has predominantly been for replacement.
How the trickle dividend will affect real net fixed investment in mining (2)

- The components of investment, on a net basis, have also contracted on average.
Econometric analysis: The impact of the trickle dividend (1% of EBITDA) on real net investment in the mining sector

- Trickle dividend as a cost to mining companies was modelled as a 1% increase in tax
- Findings:
  - Trickle dividend will reduce real investment by 0.3% annually
  - Graph shows levels of real net fixed investment (GFCF) in mining sector had the trickle dividend been introduced in 2010, compared with actual levels of real investment
  - Clearly, trickle dividend would have driven real net investment to even lower levels compared to what was realised. In 2010, real net investment was R25.4 billion. With the compulsory dividend investment this would have been R24.6 billion.
  - In 2017 net investment would have registered R16.8 billion instead of R17.3 billion.
Econometric analysis: The impact of the trickle dividend (1% of EBITDA) on real net investment in the mining sector

Assumption: We assume that the transmission mechanism through which jobs are created (and retained) in the mining sector is via higher net growth in real fixed investment.

Findings: A 1% increase in real net investment in the mining sector generates 0.2% jobs. Had the trickle dividend been introduced in 2010 it alone would have resulted in the loss of almost 10 000 jobs. Cumulatively this would have resulted in the loss of over 69 000 jobs (from 2010 to 2016), affecting as many as 1.4 million dependants.

<table>
<thead>
<tr>
<th>Year</th>
<th>Actual mining employment</th>
<th>Simulated mining employment</th>
<th>Jobs lost on account of the ‘trickle dividend’</th>
</tr>
</thead>
<tbody>
<tr>
<td>2010</td>
<td>498 907</td>
<td>488 929</td>
<td>9 978</td>
</tr>
<tr>
<td>2011</td>
<td>512 874</td>
<td>502 617</td>
<td>10 257</td>
</tr>
<tr>
<td>2012</td>
<td>524 869</td>
<td>514 371</td>
<td>10 497</td>
</tr>
<tr>
<td>2013</td>
<td>509 909</td>
<td>499 711</td>
<td>10 198</td>
</tr>
<tr>
<td>2014</td>
<td>492 931</td>
<td>483 072</td>
<td>9 859</td>
</tr>
<tr>
<td>2015</td>
<td>481 516</td>
<td>471 886</td>
<td>9 630</td>
</tr>
<tr>
<td>2016</td>
<td>457 291</td>
<td>448 145</td>
<td>9 146</td>
</tr>
</tbody>
</table>

Cumulative no. of jobs lost: 69 566
Being an owner of a mine – free carried or not –

DOES NOT GUARANTEE BENEFITS
The Mineral Council urges the DMR and other stakeholders to take on board the significant need to improve the competitiveness of the industry.

Ultimately, we are all seeking a Mining Charter that all stakeholders can support and defend.

The challenge is to balance new transformation targets and competitiveness to ensure new investment.
#MakingMiningMatter

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