INVESTMENT IN THE AUSTRALIAN MINING INDUSTRY - WHAT IS THE FUTURE?

By J.W. Foots

(An address given by Mr. Foots, Chairman of M.I.M. Holdings Limited, to a luncheon meeting of the Society in Sydney on 3 July 1973.)

Introduction

When I nominated the title of my talk "Investment in the Australian Mining Industry - What of the Future", I thought the Federal Government's policy would have been spelled out in some detail, and it would have been a relatively easy task to build my remarks around it. However the position, except in broad principle, is still obscure, and today I join the army of gazers into crystal balls who are having an exciting time trying to forecast what is in store for the industry.

The subject is so vast that it is not possible to review it in depth in the time available, so I propose to comment briefly on the extent of Australia's mineral resources, the marketing arrangements for thie products and the role of foreign capital, and then to leave with you some thoughts on the part each will play in determining investment in the future.

In a sense all of you here could be regarded as a part of the mining industry. Access to capital is essential for all industry, but especially so for mining. A major factor in capital raising is the provision of liquidity for the investor. That liquidity is provided by the existence of a continuing market for securities, built on firm foundations and subject to critical analyses and review. That, in turn, is made possible by the industry of which you are part.

It is scarcely necessary for me to catalogue the series of events leading to the present and from which with some difficulty we now attempt to look ahead.

The steady inflow of overseas capital into this country, a high proportion of it directed towards the mining industry, the new discoveries, the development which followed these discoveries, the expansion of export income from minerals both in absolute terms and as a proportion of total exports, and finally the recent alteration to the pattern of this nation's current account - these events and their sequence are quite familiar to you. Concurrently with these developments there has been growing concern for the extent of foreign ownership of Australian industry and particularly of the mining sector.

More recently there has developed concern on a world wide scale for the total volume of demand for minerals likely in the future and the extent to which, increasingly, the so called developed nations are relying for mineral supplies on the developing and underdeveloped nations.

It is amidst the controversies associated with these two issues - development of Australia's mineral resources to be sold mainly overseas and use of foreign capital - that the Australian mining industry now finds itself centre-stage. In fact it will be the shape of official policy as it resolves itself around these issues that will largely determine the industry's future.

Extent of Resources

Australia is a well endowed country as regards mineral resources. She is a major producer of a wide range of metals and minerals, - and where there were gaps, in say, oil, gas, nickel, phosphates, - discoveries of the last decade have greatly reduced her dependence on imports.

These discoveries were the result of an intensive, extensive and I might add expensive exploration program.

The classic example of extent of known reserves changing with the changing pattern of exploration is that of iron ore. In late 1960 a policy of embargo on iron ore exports was replaced by one of approval for limited exports depending on the size of the deposit. Exploration was greatly stimulated and important discoveries took place in 1961 and 1962. In the following year restrictions on export were further modified and this was followed by further discoveries. Finally the whole picture was changed from one where reserves appeared barely sufficient for domestic needs to one where known deposits could support current rates of export for several hundred years.

Unfortunately in other cases the link between search and discovery cannot be drawn so neatly. I do not know how many of you will remember this, but between the premature excitement of Rough Range in 1953 and the Moonie strike of 1962 there was a good deal of despondency in this country about the possibility of ever finding a commercial oil field of any really worthwhile dimensions.

On the subject of concern for reserves of natural resources the Australian Treasury has put its views in its recent White Paper "Economic Growth: Is It Worth Having?". Referring to the subject of reserves it says, and I quote__

> "Many of these fears spring from comparisons of known reserves of minerals with their present and prospective rate of use. Such comparisons appear to "show" that many of this planet's mineral resources will be exhausted in a few decades if economic growth is maintained.
>
> It is therefore crucial to recognize that known reserves, or even multiples of those known reserves, are no more a guide to what ultimately usable reserves might be than they were 25,100,200 or 1,000 years ago. The real question is not <u>how</u> known reserves compare with the prospective calls upon them, but <u>why</u> total known reserves are what they are.
>
> Rising demands for a mineral (so long as its price is free to move in line with that rising demand) will lead to investment in new extraction facilities and treatment plants, and to a sufficient exploration effort to satisfy the producers concerned that reserves exist to employ the facilities and feed the plants during their economic life. It will not lead to any interest in finding deposits that will lie idle for thirty years. That would be little more sensible than installing treatment facilities that will not be used for many years ahead."

Maintaining the long term perspective that this quotation implies is not always an easy task, but it is essential if we are to have a viable industry and is especially so if Australian capital is to play a bigger role in the industry in the future.

At any given time the current level of mineral production is carried out against a backdrop of proven orebodies, marginal reserves and sub-economic deposits. As time goes by many of these marginal and sub-economic deposits may well become economic, but to maintain even the present rate of production of metals and minerals, in the long term each ton from each of these types of reserve must be replaced by a newly found ton, and this demands a vigorous exploration program.

From a national point of view, I believe that to have such a program is more important than who it is precisely that undertakes it - whether it be foreign company, Australian company or some government agency or commission.

The present downturn in exploration expenditure concerns me as an Australian, and I sincerely hope that the climate may soon again be such that Australians and others are prepared to invest risk money in the search for minerals. Whether we like some of the side effects of mineral production or not, there is no gainsaying that minerals are a major determinant in the standard of living, nationally and internationally.

Market Arrangements

I would like now to turn your attention to the marketing scene.

Through its constitutional control over exports, the Federal Government has from time to time exercised control over the price at which minerals may be exported. Although this attention may not have been welcomed at the time, solutions have usually been reached on an amicable basis and there have been occasions when Government intervention in negotiating overseas contracts have strengthened the industry's hand. Lately the Government has been taking a more detailed and active role in this sphere and we expect these more detailed investigations to set the pattern for the future.

Where the contract is a short term one and the product is reasonably standardised there is little room for argument. The prevailing market of the time dictates the price.

It is when we come to arrangements for long term contracts that differences of opinion arise. This is understandable in view of the large number of imponderables on which judgement must be made. If there is an acceptable terminal market such as the London Metal Exchange, or a widely used producer price, such as the European producer price for zinc, this then can be used as the basis for the metal price. But normally the metal price component is only one factor in a complex equation, and many other terms must be decided on - treatment charges, rate of escalation, prices for desirable by-products and sometimes penalties for impurities. In fact it is rarely that refined metals become the subject of long term contracts. The existence of a ready market makes it unnecessary. It is the least standardised commodities, iron ore, coal and mineral concentrates that are negotiated for a long term basis because for both parties, buyer and seller, there would be difficulties in dealing with these products in any other way. In a long term contract, the seller has the advantage of a ready outlet for his product because he knows its peculiar features are acceptable to the buyer, while the buyer in gearing his facilities to the known quality of his long term supplies obtains maximum control over the quality of his own production.

In undertaking there long term commitments the seller, that is the mine producer, is assured of a cash flow, while the buyer, that is the smelter or refiner, is assured of supplies, usually at a known price. The arrangement is not without risk to buyer, however, in that cost of stocks, to him, are a very large proportion of total costs. Thus a commitment to continue buying over periods when his own sales may be slow can prove quite a burden.

The willingness of buyers to help underwrite the success of a mining venture by entering into long term contracts has led to much greater use of loan capital.

Thus large scale mining enterprises have been able to reduce their dependence on the raising of equity capital and so have reduced their cost of finance. The main asset comprising the security for the lender of the loan becomes the sales contract rather than the ore-body.

Foreign Capital

Perhaps the greatest uncertainty for the future lies in the subject of overseas ownership or control of the Australian mining industry. Australians are certainly not prodigal in their spending habits. Savings as a proportion of total income amount to some 25% - and this percentage compares very favourably with those of other countries. Some 90% of capital investment in this country comes from wholly domestic sources, and thus Australians do a very good job of providing for their own capital structure. The problem is that this Australian investment is not spread evenly - if it were there would be no cause for alarm today - but it has gone in one direction while foreign investment in Australia has gone in another. As the gap left for foreign investment was small - just over 10% of Australia's total investment needs in recent years - this has led to a heavy concentration of foreign ownership in certain sectors. Before we move too rapidly to bolt the doors against this inflow perhaps we should enquire as to what purpose it has served in the past and as to whether we can have any use for it in the future. I think it is generally acknowledged that it has been useful in the past, but do we need any more of it?

Flows of capital, defined by their source and direction of flow, tend to acquire certain characteristics. These characteristics are associated with the knowledge, perspective, preferences and expectations of the people and organisations behind them. The problem is that these preferences change only slowly, so that investment decisions tend to be habit forming.

Investment funds from Australian domestic sources have been directed via the public sector into transport, schools, water supplies and other such infrastructure needs. Funds invested directly by the private sector have gone mainly into the building of houses and flats and to a lesser extent into industry.

Foreign capital coming into Australia has been attracted in the past mainly into mining, oil, chemicals and car manufacturing - industries that are either capital or technology intensive. A major characteristic of this type of capital is acceptance of a long duration between initial outlay and return on investment. If Australian investors, private, institutional or government, are to move increasingly into mining, the same kind of perspective will be needed.

If we look at the flow of trade we will note that the bulk of foreign equity investment has been purely investment oriented and like any other type of investment the expected rate of return has been the incentive. This means that commercial considerations have been the deciding factor in the marketing of products rather than capture of supplies for final consumption in the host country of the investor. Thus we see a major Australian mining company, U.S. controlled, selling its products in Europe and Japan. Another large company, U.K. controlled, sells its products in the United States. Japan has invested very little equity funds to ensure the supply of raw materials for her industries, relying rather on the marriage of loan funds with long term marketing arrangements.

In the context of the Australian mining industry I believe that, from the foreign investors point of view, control, in the sense of majority voting control, may have become rather a superfluous asset.

Its only usefulness in the past would have been due to lack of faith in the commercial and technical competence of Australian management. This lack of faith may have had some validity some years ago, but it has little today. Today, the great majority of senior executive positions in the Australian mining industry in both Australian and so called foreign controlled companies are held by Australians, and they have the responsibility for the technical and financial efficiency of their companies. The major concern for the foreign shareholder, therefore, is for the value of his asset, and in this his interests are no different from that of the Australian shareholder.

Thoughts for the Future

The Prime Minister - Mr. Whitlam, and the Minister for Minerals and Energy - Mr. Connor, have drawn attention to the fact that at present some 62% of our mineral resources known and proven are either owned or controlled by overseas interests and that it is the intention of the Government that this figure be not exceeded.

I am sure that a majority of Australians hope that this figure can be somewhat reduced. But with a policy that aims at no further increase in the foreign held proportion, there is scope for a great deal of flexibility.

A policy of restrictions on foreign capital at the "permit-to-explore" stage would have the virtue of simplicity from the administrative point of view, and it would almost certainly lead to a change in the foreign to domestic ratio in the desired direction. It might also result in the long term in Australia losing its prominent position in the world's mineral industries. There seems no reason, however, to regard percentage ownership as fixed and unchanging throughout the whole life of a company or throughout the whole life of an ore-body.

The history of my own company, M.I.M. Holdings, offers a good example of growth of Australian shareholding. Beginning as an Australian company in 1924, because of lack of Australian finance, when the first dividend was paid in 1947 the Australian share had reduced to a bare 5%. Since then there has been a steady growth in the Australian component until it reached 40% in 1971, some 24 years later.

Why should there not be frequent interchange of capital, foreign and domestic, at any stage of development of a mineral deposit depending on the circumstances and needs of the time? There has been a proposal, from an industry source, that predominantly foreign owned companies, with Government inducement, increase the percentage of Australian ownership gradually over a period of years. It has also been pointed out that with a continuation of restriction on capital inflow such a program would be a considerable financial cost to the community. Is it possible to combine a program of a reasonably liberal inflow of foreign capital into the exploration sector, with at the same time strong incentive that at the development stage Australians be offered substantial equity? In such a way this country would capitalise on the nature of foreign capital, which for some while yet is likely to be rather more venture oriented than Australian capital. Such a policy would not be easy to administer. We would have to tread warily that fine line between inducement and expropriation.

If administered flexibly, however, this proposal would seem to offer the advantage of making some use of overseas capital while at the same time ensuring it is spread in the mining sector a little more thinly than at present.

The result of this over the buy-back period - and I am sure that you in your profession will have already seen this quite clearly - is that share prices would be likely to be somewhat restrained.

During the sixties Australians who were eager to have some equity in successful Australian-based mining companies often found themselves bidding for a very small proportion of a company's total outstanding shares. A higher percentage of Australian ownership would mean the end to the so called "scrip shortages" of that period and that would be no bad thing.

It has been proposed that the vehicle for mobilising Australian capital for these purposes be a remodelled Australian Industry Development Corporation. It is not clear at this stage whether securities issued by the new A.I.D.C. will be at fixed interest or on a profit sharing basis. In view of the uncertainty we face as regards future rates of world inflation, a profit sharing basis of investment would seem to offer the greater attraction.

Some of the greatest mobilisers of investment funds in this country at present are superannuation funds and life companies. A relaxation of the 30/20 rule which makes these organisations captive to proportionately large investment in government securities would release more funds for investment in mineral resources. This would appear to be quite an appropriate type of investment because if would be consistent with the essentially long term nature of superannuation schemes.

These, perhaps, are not very precise thoughts but for any of them to be successfully applied there must be public confidence in the mining industry.

Despite the uncertainty of the present time and what may have been said by various people from time to time, members of the Australian mining industry remain basically optimistic.

We put some store in the words of the Prime Minister spoken recently at the Annual Dinner of the Australian Mining Industry Council-- "it is not our intention to bring to an end the truly magnificent achievement of the past decade or so. Rather it is our firm intention to help your industry, not hamper it; to encourage trade, not frustrate it".

At the same time we do not seek, again taking some of the words of the Prime Minister spoken at another time and in another place,-- "a certificate of immortality and changelessness guaranteeing us a safe and easy life".

We believe the industry's basic worth comes from its efficiency, measured on an international as well as national scale. It has been and will continue to be one of the greatest contributors to decentralisation, bearing the burden of heavy infrastructure costs for many of which it gets no taxation deduction. In the past the industry has expanded vertically as far as possible into further processing and refining and this trend will continue. Because of the need to diversify our economy, it has been government policy to maximise this trend. We endorse this policy, our only proviso being that each stage of processing be viable on its own from the point of view of efficiency. Problems do arise here from the pattern of the world's tariff structure. The large investment in processing that has taken place overseas has for the most part resulted from government encouragement by the way of direct and indirect assistance. This has given the foreign refiner a substantial competitive advantage.

One way in which this tariff penalty could be overcome would be to invest Australian capital in processing facilities abroad. Thus trade barriers would be hurdled by the export of capital rather than the export of higher value trade goods. It is true that value added represents a contribution to our national income but each case must be considered on its merits. Leaving aside for the moment whether the resources used in adding value - i.e. labour, power, etc. - might not be better employed elsewhere in the economy, what will be the effect on the environment and so on, there is the question of which alternative, further local or overseas processing, will give the best return to shareholders and the Australian community. If Australian capital is to have any particular role internationally, selective investment in mineral processing overseas is surely an appropriate avenue. If other countries benefit by investment in Australia's mineral industry, it seems logical to me that Australia should benefit by investment in their areas, particularly as we have the technological skills necessary to ensure success. Depending on political climate abroad investment could take the form of controlling interest, joint venture or large minority interest.

I am afraid I have not spelt out the future in any fine detail, but you will appreciate the industry is in little better position to do this just now than anyone else who is interested in reading the signs. If we ignore those periods of speculative fever in the past, when in the words of Lord Keynes, "the bubbles on the mainstream of investment" became themselves the mainstream, across the board investment in Australian-based mining companies has proved worthwhile. If shares ownership available to overseas residents is going to be more restricted in future, I think that everything else being equal we can anticipate a period of higher yields ahead. This would in turn bring the earnings/price ratio of Australian mining investment more in line with overseas experience.

If this prediction is correct Australian investors will have no quarrel with the future.

-oOo-

AN INTRODUCTION TO MINING

By L.J. Thomas (Hicks, Smith & Sons) 1973

The Great Australian Mining Boom of 1966-1970 brought forth many books and articles on how to understand virtually overnight what mining and mining investment was all about. By the very nature of the boom, the majority of these "instant"books were superficial, covering only stockmarket aspects, and neglecting much, if not most, of the basic fundamentals of the mining industry.

In contrast, Dr Thomas' book is written "against the background of a vigorous and expanding mining industry" rather than with an ephemeral stockmarket boom in mind. During the boom if the more serious investor wished to study mining in more depth than by reading "hints on how to invest in mining stocks", the only sources of reference were overseas books, which were mainly too compartmentalised, outdated, over-technical or irrelevant to Australian conditions.
In comparison, this book has been written particularly for Australian conditions, and in this respect it is probably the first of its kind on the subjects covered.

After a brief but thorough explanation of the most important mining and geological terms, the book proceeds through a logical, comprehensive sequence of exploration, progressing from geophysical exploration to diamond and percussion drilling, then