MINING FINANCE HOUSES - CHANGES IN THE 80's

An Address by
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'What is a mining finance house'? It is far simpler to nominate a list of companies which are commonly thus classified than to define the characteristics they have in common. The closest I could come to a definition was of a mining company which operates internationally and predominantly, but not exclusively, through partly owned subsidiaries and affiliates. Normally it would have a history of promotion of new mining ventures through new companies in which it would retain effective equity control with the balance of the equity being sold or floated at the highest price the market would bear. It was not uncommon for M.F.H's to sell down their equity in aging mines. It was also common practice for a mining finance house to support the market in the shares of its subsidiaries and affiliates when it judged it desirable or necessary to do so. However the introduction of insider trading rules has limited these practices.

The traditional M.F.H's saw themselves primarily as miners, and generally speaking, resisted the temptation to attempt diversification. When they did seek to diversify it was with only patchy success.

One strong common characteristic of M.F.H's was and still is that, except in rare moments, their market capitalisation invariably is at a discount to their asset backing.

As I said at the outset it is easier to nominate a list of mining finance houses than to define precisely what they are. Most people here would, I'm sure, accept on any such list the traditional London houses – RTZ, Consolidated Gold Fields, Selection Trust and Charter. In fact Charter should not now be classified as a mining house after its complex restructuring last year. In South Africa Anglo American and De Beers obviously qualify, as does that rapid developer of recent years, General Mining. In North America companies which fit the rough definition I gave you are rare. U.S. mining companies historically chose to operate through wholly owned ventures but there are a few – notably Amax – who might be classified mining finance houses. In Canada, perhaps as part of their British heritage, some companies have developed along classic mining finance lines. Names which come to mind are Cominco and Noranda and the less obvious but highly successful Placer. Here in Australia we have our own group of establised or developing mining finance companies and the stock market has known for years that this is a growth sector — witness the established CRA and Peko, and the 'emerging' W.M.C. I have not included CSR or BHP as mining is not their principal business.

For all the companies named on my list successful growth has been a function of their ability to find or buy new orebodies.

Among them some have been more successful than others. For instance W.M.C. will very likely become one of the great mining companies of the world through the matchless skill of its exploration group. But the twin colossi of that list Anglo American and De Beers derive their strength from their dominance in the two commodities that all of us in the mining business would like to have — gold and diamonds. As a statistical aside, those two companies in their 1979 annual accounts, reported holding between them a cash balance R.1523 million. While no other company on my list can match that sort of performance, at the business core of all of them is a rich mine or group of mines generating profits and cash and supporting the growth initiatives they all have.

Before I turn to where I think they are going in the 80's, I'd like to comment on where they have been.

It is a truism to say that the world environment for mining venture capital has changed profoundly, but let me mention just four of the more important influences affecting that change.

1. There has been a unique upsurge of political and economic nationalism which has brought with it enormous changes in the traditional patterns of mineral development and ownership.

   These changes are most startlingly illustrated by the world copper mining industry. At the beginning of the 1960's governments had an interest in only 2.5% of the copper producing capacity of the market economies. Twenty years later 43% of copper capacity was owned in whole or in part by governments. From another viewpoint it has been estimated that in 1947 four private mining firms accounted for 60% of world copper output and eight firms accounted for 77%. By 1956 these percentages had declined to 47% and 70%. By 1974 the four largest copper producers controlled only 19% of mine copper output and the share of the ten largest privately owned companies had dropped to 35%.

2. There has been in democratic nations a near universal proliferation of government regulation which seems to me to have singled out the mining industry for especially rough treatment. I had occasion, for a talk I gave last year, to check statistics for Australia and was able to identify 50 separate pieces of legislation affecting new mineral development. And if that seems bad, the U.S. is worse.

   A U.S. Congress study published October last year presented four significant facts (i) domestic zinc processing capacity has been reduced by 50% and imports of zinc metal have increased by 89%. (ii) Imports of chrome and manganese ores have declined while imports of ferro alloys have increased substantially. (iii) No new copper smelting or refining capacity is likely before 1985 and over the past ten years refined copper imports have increased from 6% to 19% of consumption. (iv) Annual aluminium demand is forecast to grow at about 7% yet domestic capacity is expected to grow at only 1.4%.

   While the causes for this decline are complex it is clear that the major factors are the growing limitations to access to public lands, environmental requirements, anti-trust regulations and health and safety requirements.

3. There has been the sharp growth of economic disorder, by which I mean the uncertainty we now have in many of the basic economic factors affecting mineral investment. The industry understands and accepts that metal prices fluctuate and we can generally live with that. What makes this era particularly awkward is the compounding effect of uncertain exchange rates, uncertain interest rates and uncertain inflation rates.

4. And finally there has been the entry into the hard minerals scene of the international oil companies with their bulging cash flows.

   What then do I see for the mining finance houses in the 80's –

Firstly I reject the notion that the world's resources of metals will be exhausted by the year 2000 — or any other year. While economic incentive to do so persists and governments permit it, new sources of minerals will continue to be discovered and developed. But these new sources will be more expensive and not necessarily located in places we would choose. I would make the bold suggestion that the developing world increasingly will learn to make the compromises necessary to reach an accommodation with the international miners. There is encouraging evidence already of this trend — examples are the Philippines, Mexico, Chile, Indonesia and PNG.

Secondly, mining houses will of necessity develop new approaches to the funding of new mines. The cost of individual projects has become so large as frequently to be beyond the capacity of a single company. So I expect to see an acceleration of the trend towards multi-participation ventures. The oil companies successfully learned that lesson long ago. I think we may also see increasing participation in resource ventures by large non-mining financial institutions. I think we can also expect to see an intensification of concern in consuming countries for the security of their long term supplies of metal. Some Europeans already provide remarkable incentives to their nationals to search for and develop new sources of supply. Low cost funding assistance for new projects by governments therefore seems certain to increase.

Thirdly, and inevitably I think, we may expect to see more mining company mergers and take-overs. This is a difficult subject and I am not here to speculate on names, but the need for bigger financial resources and stronger balance sheets seems certain to lead to some further coalescing of interests.

Fourthly, and again perhaps excessively boldly, I do not expect the oil companies to achieve instant success in hard minerals development. Their record to date has not been good and I think it may still take some time for them to learn economic reality and that the techniques of success in oil will not necessarily translate directly to hard minerals. Notwithstanding, in the end sheer weight of money must tell, and oil companies undoubtedly will acquire a significant share of world mining.

Fifthly, and on a technical note, the energy component of mining costs has, of course, leapt alarmingly in recent years, transforming the fundamental economics of many mining properties. Probably more effort is currently being applied to the development of energy saving techniques than any other engineering aspect of the industry. This will continue.

Sixthly, while there will be fluctuations in metal prices in the next ten years I do not expect to see prices fall to the levels approaching the deep depression of 1975–77. For most metals the fundamentals have changed. Over-hanging stocks have been eliminated or reduced, high cost producers have shut down and the supply demand equation is generally much more stable. It also seems reasonable to expect that in a time of heightened world political tensions demand for metals will hold up better than would otherwise have been the case. In addition the agony of the recent difficult years had the salutory effect of forcing producers to examine their cost structures most critically and I believe that most of us are leaner and fitter as a consequence.

This brings me to my final point which is that everything that I have said to date points inexorably to a long continuing growth pattern for the mining industry in Australia. While we in the industry are prone to complain about the internal and external problems we have to cope with, the general outlook for the industry in Australia is vastly better than for most of our competitors. The only serious threat to the future of the industry in Australia seems to me to lie in the possibility of a resurgence of high inflation rates. If we were to suffer another bout of galloping inflation similar to 1974–76 it would be an enormous setback, not merely to our cost competitiveness but to the confidence with which we and the rest of the world view our mineral prospects. But if I may make my final prediction, it is the optimistic one that it won't happen and that we will remain a lucky country.