

**Living with the low gold price:
Some South African Responses**
An address by Bobby Godsell, CEO, AngloGold
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For several months, many of us have been arguing that a gold price below \$300 simply does not reflect market fundamentals. The evidence suggests that the market disagrees - at least for the present. I want to return briefly to the gold price at the end of these remarks, but immediately I will suggest some South African responses to a low price regime - which, we must allow, may well continue for some time.

The closing years of the 20th Century have seen dramatic change in South Africa: the end of white minority rule, the advent of democracy, and South Africa's return to the community of nations. These changes have been echoed in South Africa's gold mining industry. The collective leadership of this industry - in government, unions and management - is preparing for the new millennium. The response to the challenges of new times, especially those of a low gold price combined with the current state of global markets - especially capital markets, can be captured in three areas.

MINING EXCELLENCE

Gold companies cannot set the price for their product. They must, therefore, control the costs of mining if they are to continue to mine at a profit.

Enhanced technology

Whilst a decisive advance to non-explosive mining continues to elude those who seek wealth from South Africa's Witwatersrand Basin gold reserves, significant technological advances in other areas are evident. Those incremental advances in the information technology field perhaps hold out the greatest promise of more profitable mining. In mining, as elsewhere, almost every aspect of work is feeling the impact of the microchip. This is especially true of mineral resource management. Here, three-dimensional modelling creates the capacity to update mine plans continuously in the light of a constant stream of stoping, sampling and survey information.

Through this software development, mining resources can be redirected in the light of daily geological and economic data. This new planning flexibility makes the mining machine hugely responsive to an actual experience quite different to the assumptions on which the original plan was drawn. In a related development, a combination of new models in rock mechanics and a capacity to flex these models with vast amounts of seismic information has produced both a better understanding and a much reduced response time to patterns of energy release. This, too, has had an impact on mining strategies which certainly favour more selective mining methods such as sequential grid mining, at least at depth.

In AngloGold, seismic information is derived from a sophisticated monitoring system developed in-house. This image, captured from the system, shows the development of a seismic "hot spot".

A third area in which advanced information technology has made for much better mining is in the area of materials management, and the management, movement and control of stores.

These three examples indicate the efforts made by South African gold miners to squeeze profit out of reduced costs, where it could not be obtained from higher prices.

Skills development

The four Apartheid decades from 1948 to the late 1980s represent a tragic neglect of South Africa's human capital. Nowhere is this more evident than in our gold mining industry:

- Until the early 1980s, black South Africans were prevented by law from becoming artisans;
- until the late 1980s, law prevented blacks from becoming skilled production workers;
- and racial segregation and funding neglect resulted in a significant proportion of the economically active population being illiterate.

Very important advances are now being made in all three of the above areas. A number of companies, including AngloGold, have specific programmes to ensure full functional literacy throughout the workforce. Black South Africans have made major advances into the ranks of skilled workers. This graph gives an indication of the progress that has been made in advancing blacks into skilled jobs in the engineering and mining disciplines by AngloGold in recent years.

New job structures

A third area of mining excellence now being widely embraced is that of fundamentally changed job structures. For over 100 years, the industry job structure has been that of two functional chimneys - one production, one engineering. Superimposed on this has been the job fragmentation that racist job demarcation has produced. In AngloGold companies, these two unproductive structures are being replaced by work organised around the three key processes of rock breaking; moving broken rock to the shaft; and then moving the ore to the surface.

Multi-skilled, self-directed work groups are undertaking these three processes. Significant production related rewards motivate these teams to better their output targets.

These changes have seen major advances in labour productivity and have produced significant reductions in working costs.

TOWARDS A VALUE INVESTMENT

The second major area of South African response to a sustained low gold price has been change in company structure and strategy. The legacy of the past has created two different kinds of company in the South African gold mining industry:

- the mining house, which raises money to explore for and acquire gold ore bodies;
- and the mining lease-defined current gold producer.

The investor in the mining house purchased the prospect of capital appreciation and future earnings resulting from successful exploration. Those who chose to invest in the mining lease-defined current producer essentially purchased earnings stream and an option on the gold price. Given that the mining lease-defined company did not conduct exploration beyond this lease area, its gold production potential was defined by an inevitable and indeed predictable depletion of its economic ore reserves. Shareholders in this type of South African gold company could therefore expect that their initial purchase price would be repaid via dividends, which then assumed the dual quality of earnings and capital redemption.

As the character of both the South African mining house and global capital markets has changed, the structure outlined above has become unsustainable. Firstly, as a consequence of the growth of the South African economy and the application of strict exchange control for much of the past 40 years, mining houses have become diversified conglomerates. Their gold earnings form only a part of total earnings. In the case of Anglo American Corporation, this share has fluctuated in recent years between five and 15 per cent. This has meant that the mining house offers more of an exposure to a national economy rather than to gold.

Over the same period, those mining lease companies established to exploit the Free State, Klerksdorp/Orkney and West Wits sections of the Witwatersrand Basin gold region have reached a mature point in the exploitation of their finite ore reserves.

As these two domestic developments have taken place, so the world has moved towards a borderless world of fund manager capitalism. Here, professional managers - faced with the need to profitably invest vast streams of contractual savings - have looked for diversity of asset category or risk, and of return. This is the background against which the emergence of the new South African gold company must be seen. This new company structure seeks to combine the growth activities of the mining house with the earnings stream of a current producer. Companies like Gold Fields Limited, Avgold and AngloGold are seeking also to raise capital, explore for gold, and mine gold profitably on a global basis.

Speaking for AngloGold, we offer the prospective investor both an earnings stream and the prospect of at least the replenishment of production ounces today with reserve ounces for tomorrow. We offer an earnings stream combined with capital replenishment, if not capital growth. If we are able to maintain a significant dividend yield, of the order of six per cent, we will have a stock that can indeed be called a value investment, capable of offering its holder both capital and earnings value.

And the expansion of our exploration, acquisition, and mining activities to a global stage enables us to put the technical competencies of (relatively) deep underground mining to global geological benefit.

CREATIVE AND ENTREPRENEURIAL MARKETING

One of a number of unique aspects that mark the gold industry is that gold producers are just that. Their interest and activity stops outside of the smelt house. In South Africa, a world-class gold refinery – the Rand Refinery - was established by the industry organisation, the Chamber of Mines. But the product that this refinery produces carries no further gold company activity.

No doubt, in South Africa's case, the law that required gold mining companies to sell gold produced to the South African Reserve Bank is one of the reasons why gold companies have been almost entirely inactive in marketing their product. The one major marketing campaign occurred in the early 1970s, when the South African Chamber of Mines created a marketing company to promote the bullion coin, the Krugerrand. For several years, this company was remarkably successful, moving some six million ounces of gold in this medium before bullion coins in general - and the Krugerrand in particular - landed on hard times in the late 1980s.

Several years ago, South African producers gained the right to sell one third of their production themselves. This resulted in significant sales of value-added gold bars by the Rand Refinery. On December 12th last year, South African producers gained complete freedom to sell their product. Indeed, the South African Reserve Bank has given notice that it may withdraw altogether as the selling agent of South African gold.

Outside of South Africa, I am not sure what has constrained entrepreneurial activity to the finding and mining of gold ore bodies. Whatever the cause, in these new times gold companies can clearly no longer ignore the markets for their products. For gold - in the end - is a product and a commodity, albeit a product with some very special characteristics. And, as with any other product, gold has both present and potential customers.

Central banks

Clearly, the world's central banks and a number of multi-lateral financial organisations like the International Monetary Fund are gold customers. The central banks hold some 31 900 of the 134 800 tons of above-ground gold stocks - some 24 per cent.

In current circumstances, gold plays two roles in central bank hands:

- Firstly, it constitutes a category of reserve asset in a world where no challenger to the US dollar as the world reserve currency seems on the horizon.

- Secondly, many central bank holders have become active lenders of the metal in the futures/derivatives gold market, a market which - we should note in passing - now vastly over-shadows physical supply and demand.

The central banks are major participants in gold markets, both physical and forward. It seems extraordinary, then, that gold producers have little understanding of the needs and intentions of this important holder of our product. The most initial and exploratory of dialogues began earlier this year around the subject of the emergence of the continental European Central Bank in initiatives led by the World Economic Forum and Peter Munk respectively. The ignorance and mystique surrounding central banks seem to have given these initial discussions greater significance than they deserve. It is quite clear to me that no grand plan can or should be cooked up by central bankers and producers to "fix" (in any sense of that word) the gold price. On both sides of this equation, central banks and gold producers will continue to pursue their individually defined economic interests, both vis-à-vis each other and as banks and producers. However, it is a very unusual marketplace where producers have neither contact nor knowledge of one of their major customers.

Jewellery

If central banks constitute one important category of gold customers, the jewellery trade constitutes another. Jewellery accounts for 85 per cent of fabrication demand or some 3 000 tons per annum.

Jewellery demand has seen double digit growth for the last decade. Growth has been most pronounced in Asian markets, helped both by increased prosperity in the developing economies of this region and by the World Gold Council's achievements in the deregulation of many of these markets. Here, the impact of property, banking, equity and currency crises is already apparent. Thus far, demand has held up well in the two vital markets of India (currently the largest jewellery offtake market in the world) and China. There can be no guarantee that these two economies will entirely escape the contagion of their regional neighbours.

Two questions in particular suggest themselves with regard to gold jewellery markets:

- Firstly, does the Asian crisis represent a pause in Asian growth, or does it mark a long-term stagnation or even reversal of Asia's gallop to developed economy status? Time will tell. To me, the view that the crisis has occurred in Japan and in the South East Asian economies - in just those sectors least ready for globalisation and world competitiveness - suggests that appropriate responses will see these economies return to their growth path.
- Secondly, is the distinctive nature of Asian gold jewellery markets sui generis to the region, or could at least some elements of these markets be exported? Asia markets jewellery as if everyone should have some. The trade is a high volume, low value trade. Gold jewellery is part of the accoutrements of modern living, like designer tracksuits, walkmen and health and racket club membership. In comparative terms, Asian jewellery has located itself in the boutique chain (along with the Nexts, the Gaps and the Banana Republics), rather than in the designer salons.

Institutional investors

A final category spans both customer and investor. As we enter the 21st century, so we have already entered the world of fund manager capitalism. The vast majority of capital formation now has an institutional character. The contractual savings of pension funds and insurance policies, as well as the individualised contractual investment plans, are the source of new investment funds in all developed economies.

Fund managers, who must ensure a proper balance between risk and return, must allocate the massive flow of new capital that comes from contractual savings. It is a world of global markets, characterised by high volatility. Surely the arguments about asset diversification which we have used - I think, successfully - to persuade central bankers to hold gold, can be deployed with fund managers to ensure that they have exposure in one way or another to the

yellow metal? Surely we need to break out of the confines of gold, commodity and emerging market funds, and present ourselves as a value investment for general funds? These, amongst others, are the marketing questions gold companies should be asking themselves. I have no idea how far producers can and should go down a value chain. I do know that, if we fail to interrogate these questions and these opportunities, we will be surrendering the fate and future of our industry into the hands of others.

ONE MORE TIME: THE GOLD PRICE

I cannot conclude without returning to the issue of price. Everything I have said thus far is predicated on a continuing low price scenario. After some flickering hopes earlier this year, gold bulls have fallen silent, and bearish sentiment abounds. Is, then, the gold price condemned to continue forever on a downward path, or linger forever where it is now? I doubt it. I do not believe that we have arrived at the end of economic history. All asset categories have followed cycles of upward and then downward movement. More importantly, gold has engaged both the hopes and the fears of humanity for over 5 000 years. It seems to me that the very crises now being experienced in Asia have already borne testimony to gold's qualities as a store of value. The events in Russia equally point to the value of physical wealth: anonymous, easily transportable, and everywhere capable of being exchanged for value. And if Asia does indeed return sooner or later to the path of increased national and individual prosperity, I can see no reason why gold should not continue to play its role as a prosperity index.

Gold companies, which can combine production excellence, investment value, and a new knowledge of and engagement with customers will survive the current low price scenario. And they will be set fair for the day when the bull market returns – as return it must.

The effect of these actions would be to access the ore resource earlier at Taung North Shaft, thus impacting positively on the mining flexibility and allowing the production increase to 150 000 tons per month to be expedited.

The use of Taung North Shaft to access reserves on 110 level and 117 level will reduce working costs. The ore will not need to be moved up the inclines and hoisted at the Taung South Shaft.

These options will also reduce the capital expenditure program.

The disadvantages of these options include a reduced ore resource / reserve access from Taung North Shaft without additional capital expenditure in the future, and a reduced mining efficiency towards the end of the mines life, assuming a decline is sunk to access the deepest reserves.

In closing, the extent of the Klippan washout is greater than was initially envisaged, and is causing a strategic review of the Taung North Shaft project at Joel Mine. Evaluation work is currently underway and a recommendation to AngloGold will be made in the near future.

The sinking operation is progressing well and is on schedule.