12/5/03. # 114

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9 May 2003

House of Representatives Standing Committee on Industry and Resources

Submission No: 114

Date Received: 12 May '03

Secretary:

Committee Secretary
House of Representatives
Standing Committee on Industry and Resources
Parliament House
Canberra ACT 2600

Dear Secretary

RE: INQUIRY INTO RESOURCES EXPLORATION IMPEDIMENTS

In reply to your letter of the 26 June 2002 advising that the Minister for Industry, Tourism and Resources, The Hon Ian Macfarlane MP, had requested the House of Representatives Standing Committee on Industry and Resources to conduct an inquiry into any impediments to increasing investment in mineral and petroleum exploration in Australia we are pleased to make this submission on behalf of Adelaide Resources Limited.

Adelaide Resources is an Adelaide based minerals exploration company which listed on the Australian Stock Exchange in 1996. It has about 1,100 shareholders holding 55 million shares . The Company has gold and copper exploration activities in the Gawler Craton of South Australia and the Tanami Province of the Northern Territory.

As Executive Chairman and major shareholder in the Company I have over forty years experience in minerals exploration in Australia and overseas with both major mining companies and junior explorers.

PROPOSITION

By far the greatest impediments to increasing mineral exploration in Australia are the inability of publicly listed companies to raise the substantial levels of risk capital necessary to reverse the alarming downtrend in exploration expenditure since 1996; and the substantial reduction in global exploration expenditure resulting from the merging of the world's larger mining companies to form mega mining companies

While it is most important to address issues such as land access, public provision of pre-competitive geoscience information and geoscience education, improvements in these areas alone will not arrest the dramatic slide in expenditure and the disturbing decline in discovery rates which has resulted

There is an urgent requirement for Government to institute fiscal measures to stimulate investment in exploration especially at the "greenfields" end of the process. This can be achieved by providing taxation incentives to investors in non-profit generating exploration companies. It is proposed that Government introduce a flow-through share scheme similar to the successful Canadian model and to contemplate increased tax deductions for greenfields exploration which would apply industry wide.

No other single measure, or combination of measures, has the capacity to turn the tide within the necessary time frame.

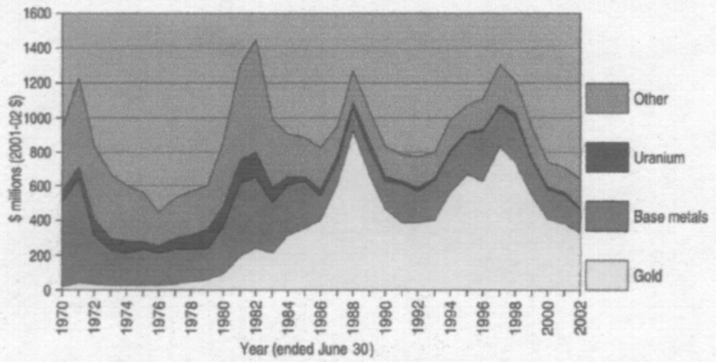
The minerals industry has shown that it has a tremendous capacity to help itself given the necessary investment stimulus.

Background

Australian minerals exploration expenditure has fallen 44 per cent from a peak of $1,148 million in 1996/97 to $641 million in 2001/02.

Expenditure in 2001/02 was the lowest current dollar result since 1992/93 and, in constant dollar terms, the lowest level of exploration spending since 1978/79.

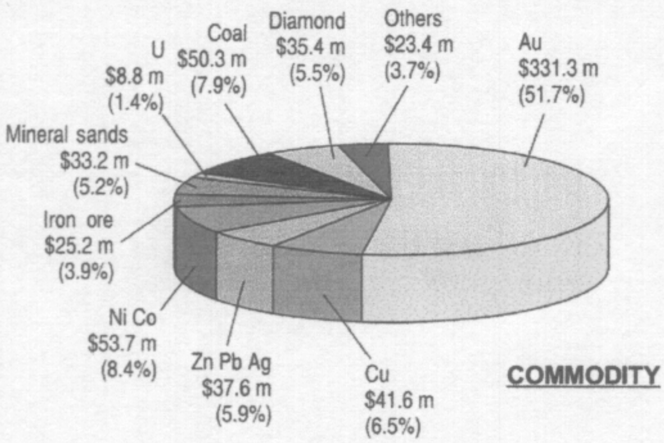
Australian Mineral Exploration Expenditure in Constant 2001-02 Dollars



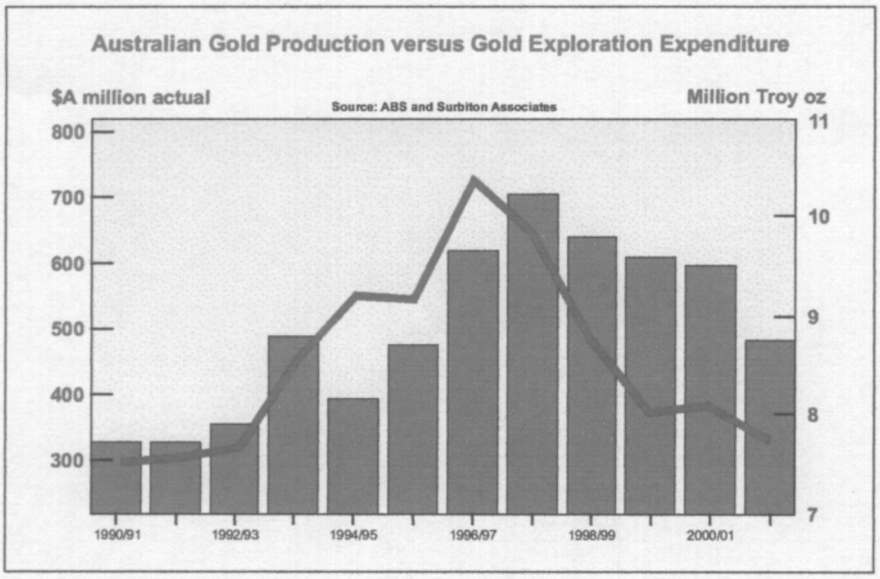
Based on Australian Bureau of Statistics data deflated by a Consumer Price Index provided by ABARE.

Exploration expenditure for gold, the nation's primary metal commodity export, has been hardest hit. It fell from $728 million in 1996/97 to $331 million in 2001/02, an alarming drop of 54.5 per cent in current dollar terms. This fall is clearly linked to a pronounced decline in the number of gold discoveries and declining production which is becoming apparent after the predictable time lag.

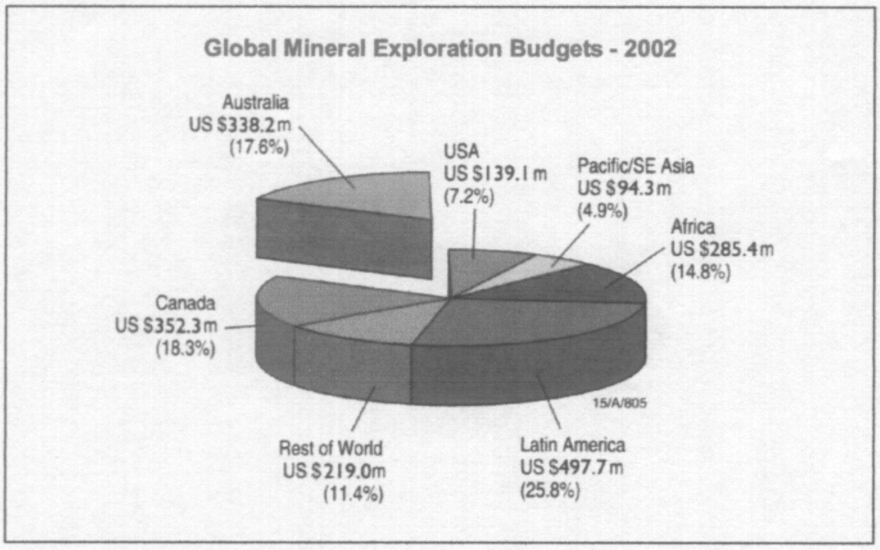
Distribution of Mineral Exploration Expenditure in Australia for 2001-02



After being the world's leading exploration destination for over a decade Australia lost its pre-eminent position to Canada in 2002. Statistics for 2002 show Canada receiving 18.3 per cent of the global exploration budget totalling US $1.9 billion whereas Australia's share was 17.6 per cent.



This sharp decline in exploration expenditure is not unique to Australia, it is part of a global downtrend which has seen worldwide exploration budgets slide 63 per cent to $1.9 billion in 2002 from their peak of $5.2 billion in 1997 (Source: Metals Economic Group).



Reasons for the global decline include:

- Merging of the world's larger mining companies to form mega-companies.
- Weak prices for gold and base metals most of which were deeply depressed in 1998 / 99 and are now slowly and selectively recovering.

- Depressed investor confidence in the speculative sector of the stockmarket which has created greatly increased difficulty for junior exploration companies to raise equity capital.
- Increased competition for risk capital at the junior end from other investment sectors such as information technology, biotechnology and telecommunication.

The ongoing process of mergers leading to the formation of mega-mining companies has had a profound negative impact on global exploration expenditure.

GLOBALISATION

In an address to the PDAC 2003 International Convention, Davidson stated that:

- In 2002, before their merger, Newmont and Normandy had combined exploration budgets of US $111 million. In 2002, post merger, the total budget was $73 million.
- Pre-merger, BHP and Billiton, had a combined exploration budget of over US $200 million. Post-merger, it was down to $136 million.
- Pre-merger, Barrick and Homestake had combined expenditure of US $149 million. Post-merger, the budget was $104 million.

Pre-mergers, all six of these companies were active in Australian exploration as are the three merged groups now. However the three much larger companies have a global focus and Australia's share of their exploration budgets will continue to be a function of these companies' perception of its prospectivity, fiscal and regulatory regimes and sovereign risk. With increasing globalisation the exploration dollar is very mobile.

There is no doubting the prospectivity of Australia but there is room for improvement in the fiscal and regulatory areas if we are to be as attractive an exploration destination as possible.

EXPLORATION BY MAJORS AND THE ROLE OF THE JUNIOR EXPLORER.

Resulting from the mergers the significant exploration budget reductions, the downsizing of exploration teams and adjusted risk profiles have seen the majors become increasingly adverse to "greenfields" exploration and increasing their emphasis on "brownfields" exploration (see definitions of "greenfields" and "brownfields" in footnote).

Greenfields exploration is an activity which can lead to the discovery of new mines in established mineral belts, or even the definition of new mineral districts divorced from established belts in which discoveries can result. It is a high risk endeavour which has the potential to result in the discovery of new mines and world class deposits which will enable Australia to maintain a premium mining position on the world scene.

GREENFIELDS EXPLORATION

"Greenfields" (grassroots) exploration is that form of exploration which is conducted away from established operating mining centres.

The contrasting "brownfields" exploration is undertaken by mining companies near their operating mines with the objective of discovering ore reserves of the same metals being mined, thereby extending the operating lives of these mines and taking advantage of the established infrastructure

The Bowler Report defines brownfields exploration as being within 5 km of an operating mine.

Greenfields exploration can be defined as that exploration which is not of a brownfields nature. It has as its objective the discovery of new mines whether they be in well established mining districts or in geological provinces which have little or no mining history. Modern Australian examples of the latter case could include the Gawler Craton of South Australia, the Ashburton and Musgrave Provinces in Western Australia, and the Arunta Province in the Northern Territory.

Development of a greenfields discovery usually requires separate permitting processes and entirely new infrastructure.

This deviation from greenfields exploration has seen the majors having:

- An inclination for dealing into projects which have progressed beyond the greenfields stage to a point where their overall potential is more clearly evident and where they are preferably drill ready.

- An expectation that junior exploration companies will be the early risk takers and that they will progress greenfields projects to a stage where they are attractive joint venture opportunities ie the higher risk, time consuming, early stage seeding of greenfields of projects will be undertaken by juniors at their expense.

Ultimately this strategy has lead to majors selectively joint venturing or forging strategic alliances with junior exploration companies which have generated projects of interest to them.

The majors are prepared to offer relatively generous terms for such service and, in certain cases, because their exploration teams are now quite small, they are even willing to have the junior manage the ongoing exploration funded by the farm-in arrangements.

There are now numerous examples of such major / junior relationships on the Australian exploration scene.

This fundamental change in operating relationship has largely occurred in the last five years.

Juniors are able and willing to undertake this very important pathfinding role but the question posed is:

In the prevailing financial environment how can junior exploration companies continue to fund greenfields exploration at current or ,in the context of this inquiry, increased levels of expenditure?

The answer is that it is extremely unlikely that the necessary continued funding will be forthcoming without the introduction of incentives for investors to more willingly provide equity funds for mineral exploration companies.

Recommendation

It is recommended that the Commonwealth Government introduce a flow-through share scheme similar to that which is operating very effectively in Canada. Such a scheme would provide tax deductions for those investors who subscribe capital in the circumstances where the company does not have profits against which it can offset exploration expenditure.

This would prove a great incentive for shareholders to more freely subscribe the risk capital which is essential to bolster declining expenditure on the all important greenfields exploration from which the country's next generation of mines will come.

The benefits to the nation from increased exploration and resultant discoveries leading to mine development will include taxation income, royalty income for the states and the Northern Territory, employment (both direct and indirect), and regional development.

The scheme should be equitable, administratively simple and contain appropriate measures to ensure that it has integrity. It should apply only to Australian greenfields exploration; have clear definitions of allowable deductions which will ensure the expenditure is clearly in–the-ground; and be in effect for at least five years before its review to allow for the lead time of discoveries and thus ensure that its effect is measurable. The experience of Canadian authorities will be invaluable in drafting suitable legislation.

There are precedents in Australian taxation legislation for the deduction of monies subscribed to exploration companies and state government subsidies for drilling have previously existed.

Yours sincerely

Keith Yates

Keith Yates

Executive Chairman