Submission to the Parliamentary Inquiry into Resources Exploration Impediments

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Submitted by:

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INTRODUCTION

Background

I am a minerals exploration geologist with over 25 years experience since graduation from the University of Adelaide with my first degree, but with 30 years experience overall in the mining and minerals industry.

I received my Masters Degree in Mining and Exploration Geology from James Cook University in 1985.

During my career I have explored for uranium, tin, tungsten, tantalum, gold, copper, lead, zinc, gemstones, gold, and ceramic clays.

I have explored in remote areas and near major cities of all mainland States, as well as West Africa and Sri-Lanka.

I have strived to raise the professional standards of my colleagues by running seminars, workshops and technical conferences over the last 6 years, and I am well known to my peers in the Victorian minerals industry.

I am currently unemployed.

I have been out of full time work for over 2 years. In that period I have not worked for more than 10 days at a time. I have had no paid work since March, and there is no indication of near future employment.

With the employment flow-on effect, this means that at least three other people are out of work. (*As Chief Geologist, I was directly responsible for the full time employment of 2 project geologists and one field technician, and up to 9 casual field appointments*).

I am contemplating a career change, and am seeking work in other industries which I will enter as an inexperienced candidate. My exploration and geological skills would then be lost to the community.

For these reasons I am making a submission to the Standing Committee on Industry & Resources Inquiry into impediments to increasing investment in mineral and petroleum exploration in Australia.

Exploration and Commodity Cycles

The minerals exploration industry is dependent on commodity prices, which are notoriously cyclic. As prices fall, investors place funds in other sectors of the economy and exploration wanes. Within a few years, due to commodity shortages, prices rise, investor confidence returns and mineral exploration increases. I am sure that other submissions have presented graphs illustrating the cyclic nature of the industry, but my purpose with this submission is to present a personal perspective of how these cycles can affect an individual's career.

In the past I have accepted downturns in exploration activity as a normal cyclic event. My first experience of downturn was on graduation in 1977, when I was unemployed for 3 months during the 1976 – 1978 slump in commodity prices.

The next downturn came in mid 1982 – I had no full time employment until 1986, but in that period I, like many others, managed to obtain long term contracts of 3 months or more. This was an exciting and dynamic period, professionally.

I thought the worst downturn was during the 1990 – 1993 slump. I was retrenched in December 1990, had absolutely no work during calendar 1991, but obtained medium term contract work during 1992 and 1993, and I was fully employed in a staff position at the commencement of the 1993 upturn.

The current downturn in mineral exploration was being felt in mid 1998. I was retrenched in April 2000, and have only acquired paid work of no more than 10 days at a time – mostly reports, assessments, etc. And not through lack of trying, I assure the committee. The recent improvement in the gold price gave hope that the current downturn is at an end, but other indicators (eg ABS figures on mineral exploration for the March 2002 quarter) show otherwise.

Many of my colleagues are in similar positions, or have left the industry. Figures compiled by the Australian Institute of Geoscientists indicate that over 50% of geologists working in 1997 have left the industry – what a waste of skills! Of the remaining, around 17% are unemployed.

Why is it different this time?

The Mineral Industry has changed.

TERM OF REFERENCE 2

The Structure of the Industry, and Role of Small Companies in Resource Exploration

Prior to 1990

Historically, one could view the minerals exploration industry as being 4 tiered, comprising:

1. Large mining companies, with strong revenue stream
2. Small mining companies, with short or medium term revenue stream
3. Exploration companies, with no internal revenue
4. Prospectors, syndicates with private sources of funds

The large mining companies had large reserves of capital, and had a philosophy of replenishing resources as they were being extracted. This they did through near mine exploration and development, regional exploration and acquisitions of advanced or developed properties.

The smaller mining companies husbanded their cash reserves, investing any spare capital back into exploration with the hope of locating sufficient resources to enable them to secure a profitable future. Rarely was there sufficient capital for acquisitions.

Exploration companies relied on investor support. In order to survive beyond their initial public investment (float) these junior companies had to have dynamic management, strong conceptual skills and a commitment to exploration. Those that did, could return to their shareholders for additional funds if initial exploration was not successful in locating a profitable resource.

Prospectors and syndicates undertook low levels of exploration, as they were constrained by low levels of capital.

This structure was very successful, as mineral resource discovery was driven by the large numbers of prospectors and small exploration companies. Individuals or companies with a prospect that required capital expenditure greater than their financial resources approached larger companies for sale or Joint Venture.

Example 1: *The Yandal Belt gold mines Bronzewing and Jundee in WA, initially explored by a lone prospector, now held by large and medium mining companies.*

Example 2: *The Earnest Henry copper/gold deposit in north Qld, initially held by a junior explorer (Savage Exploration P/L), now held by a large company (Mount Isa Mines).*

At all levels, expenditure of risk money was matched to the exploration risk. That is, investors inclined to high risk / high return investments put their money into smaller exploration and mining companies for higher risk exploration.

Investors seeking a secure investment, put their money into the larger mining companies with secure cash flows. But, while the larger companies did undertake high risk exploration, funds allocated to such exploration were a well defined fraction of the total exploration & development expenditure.

The Current Situation

There has been a number of company takeovers, mergers and acquisitions in the past 5 years. Large companies are now global operators, and medium companies have been absorbed into national or multinational companies.

With these takeovers or mergers and other pressures in the stockmarket has come a fundamental change in the objectives of management.

- The mining industry has been rightly criticised for providing a poor return to the shareholders. Shareholders now expect short to medium term gains on their investment.

- Management of global companies are encouraged to match US corporate expectations of a minimum 25% return on shareholder funds.

- Shareholder base has shifted to a predominance of fund managers, particularly the superannuation funds, which require a greater security of investment.

- Management tenures are on short term contracts (5 years or less) and thus managers are encouraged to meet short term gains without considering long term viability.

This means that the larger companies are encouraged to return profits to shareholders in the form of dividends – funds otherwise allocated to high or medium risk exploration are now retained as profit. Exploration is confined to near mine or brownfields exploration, being low risk.

Regional exploration suffers.

<u>Example</u>: *The CRAE – Rio Tinto merger in 1996 resulted in the closure of the mineral research facility at the Bundoora campus of La Trobe University, and the loss of hundreds of exploration jobs around Australia. Research and exploration were not considered as core business of the new company.*

Mergers and takeovers have had a devastating affect on mineral exploration. In all cases, the expenditure on exploration by the combined entity is less than the combined expenditure of the two pre-existing entities. Total staff numbers are reduced, leading to unemployment and loss of geological skills.

<u>Example</u>: *The current takeover of AurionGold by Placer Dome. Sources inside Placer Dome have stated that following the successful takeover, many lower ranked exploration projects will be dropped from both companies' portfolios.*

Total expenditure on exploration is reduced.

In previous years, the vacuum left by mergers and takeovers has been filled by small to medium sized companies and new company floats entering the scene. Smaller projects not required by the combined new entities are sold or ventured to the smaller companies, and after a short hiatus, exploration continues.

But this is not happening now.

Small and medium sized miners and exploration companies are the engine and driving force of regional and grass roots (greenfields) exploration. These companies do not have the backing of a strong cash flow, so rely on investor support for exploration funds.

But few small companies have the funds to undertake exploration at a level sufficient to bring a prospect to the attention of a major company.

Why?

TERM OF REFERENCE 3

Impediments to Accessing Capital, Particularly by Small Companies

Over the last 5 to 10 years there has been significant changes in the cost of exploration.

1. Most of Australia has been lightly explored. This means that most of the near surface or visible mineral deposits have been located. Current exploration plays are targeting deep or obscured mineral deposits requiring higher expenditure levels.

2. Easier to find targets are in remote areas, with increased logistics costs.

Example: *Minotaur Resources (a small exploration company) is exploring for copper+gold deposits in the remote Gawler Craton of SA. The depth to the top of the target is 200 metres, and drilling to 500 metres is common. Compare with the similar Earnest Henry deposit, discovered in 1991 not far from existing infrastructure at Charters Towers and Mt Isa, with depth to top of 100 metres. Drilling for a Minotaur type target costs from $150 to $200 per metre, while drilling to depths of less than 200 metres costs from $50 to $120 per metre.*

Labor has to be flown in to the Minotaur prospect, and contractors are sourced from Port Augusta or Adelaide (600 to 900 kilometres). Labor and contractors for Earnest Henry are sourced from Charters Towers and Mt Isa (150 to 200 kilometres).

3. The cost of raising capital has increased:

   - Mineral exploration is no longer the sole province of high risk – high reward investment. Info-technology stocks and bio-technology stocks are new avenues promoting high returns on investments. Small miners and mineral exploration companies must now compete with these for investors' funds.

   - Corporate scandals are eroding investor confidence. HIH, Enron, Arthur Anderson, Ansett have failed to stimulate interest within the general public towards corporate investments.

   - Even with the requirement for a larger exploration capital base, exploration companies are still setting targets of $3 to $5M as Initial Capital Raisings. These levels of ICRs are the same as in 1986, when exploration costs were lower, and capital raising was easier.

Result of these three factors is that there are no small companies stepping into the vacuum created by mergers and acquisitions, as either:

existing companies have limited funding, with little prospect of further capital raising, or

Initial Public Offerings (IPOs or new floats) are failing due to lack of investor interest.

What is needed

The Federal government can encourage investors to fund exploration programs within Australia by allowing tax deductions on exploration expenditure.

Under the present system, companies can claim exploration expenditure as a deduction against current and future income. However, if a non internally funded company reduces its capital to a non-sustainable level through exploration, shareholders are unlikely to receive the benefits of these tax deductions. More often than not, the company will change business direction or shareholder base, thus forfeiting any tax credits that may have accrued. Shareholders lose their investment.

If shareholders were to receive tax deductions on their investment in mineral exploration (after all, it is an investment in Australia's economy, and intrinsic wealth), then they will receive at least a partial return.

A similar scheme operates in Canada, resulting in large amounts of funds being available for mineral exploration. While the scheme has been good for the industry in Canada, it has had some effects on Australian companies.

- Australian companies wishing to explore offshore (because of perceived land access problems within Australia) must compete with better cashed-up Canadians when applying for mineral tenure.

- Canadian companies are now beginning to enter Australia, taking up tenements in their own right, or through joint venture arrangements.

<u>Example 1</u>: *Junior Canadian miner Inmet Mining is spending $3.5M over 4 years to earn an interest in (Australian) Pilbara Mines Ltd's Teutonic Bore prospect in WA.*

<u>Example 2:</u> *Placer Dome Asia Pacific with the backing of Canadian parent Placer Dome Inc is mounting a takeover of Australian owned miner and explorer Aurion Gold Ltd.*

Australia is in danger of having most of its mineral resources partly owned and controlled by overseas interests. This could have an effect on the Aus$ exchange rate with the US$, which is linked to Australia's gold and mineral inventory. (Compare the movements in the US$ price of gold to movements in the Aus$ exchange rate).

If Australian companies are to compete with the Canadians both nationally and internationally, then the cost of raising capital in Australia must match that in Canada.

Otherwise, Australia will lose its position as the world leader in mining and exploration technology and expertise.

But please ignore calls by some (including ex-Normandy Chairman Robert Champion de Crespigny) to apply a Flow-Through Share Scheme only to projects in remote areas. This ignores the potential of mineral discoveries close to existing infrastructure, or in the more populated areas of south-east Australia (many areas of which have chronic unemployment problems).

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SUMMARY

The mineral exploration industry is in the worst state of affairs for over 25 years.

Unemployment rates within the industry are high, and with flow-on effects, this does not help to ease the unemployment problem in the wider community.

The structure of the mining and minerals exploration industry has changed. Larger mining companies are reducing high risk expenditure in order to maximise profits, thus satisfying the needs of a changed shareholder base.

Mergers and takeovers have resulted in a decrease in exploration expenditure, and consequent unemployment.

The engine of greenfields mineral exploration is sputtering through lack of fuel.

Exploration costs have risen in the past decade, due to inflation, lack of easy targets, and remote area exploration.

Smaller mining and exploration companies lack sufficient capital to tackle greenfields exploration projects, and have either changed business, disappeared, or are conserving capital until better economic conditions arrive.

Exploration companies are unlikely to realise the tax benefits of exploration, as funds are running out before projects can be developed. Shareholders receive no taxation benefits (a return on investment) if the company changes direction, or if the shareholder base changes.

Australian companies cannot compete with overseas companies which have access to lower-cost capital.

Overseas companies operating in Australia see little benefit in supporting Australian research & development institutions, resulting in loss of the innovation and expertise within the Australian Mining Industry that is currently recognised globally.

Instead, funds generated from Australian operations are likely to support R&D in their home countries.

There needs to be a culture change within all government departments that accepts mining as a necessary industry.

I have not addressed the other terms of reference, as I feel that professional and industry organisations can make a better submission on many of these.

However, it is generally accepted among industry professionals that the current Native Title provisions are an impediment to exploration. If one takes the view that holders of native title are to be compensated for financial loss due to activities of explorers and miners, the same as other land title holders, then many problems can be resolved.

Explorers should be able to estimate the financial loss to holders of native title during the exploration phase, and enter into a standard compensation agreement as applies to private land holders. In nearly all cases, the financial impact on title holders would be positive, or zero.

The removal of the Right to Negotiate during the exploration phase should be removed from existing legislation. The Right to Negotiate should only apply if exploration leads to mine development. Exploration is carried out under different land tenure to that of mining, in all states and territories, so the differentiation between exploration and mining is already recognised in legislation.

RECOMMENDATIONS

That the Federal Government recognise that small and intermediate sized mining and exploration companies are the engine of greenfields exploration, and thus the precursors for the development of Australia's resources and wealth generation.

That the Federal Government act to implement a scheme where investors in mineral exploration receive an immediate tax deduction on their investment.

That the Federal Government urge all states to streamline their approval processes for mineral projects, and seek to address negative attitudes towards mining.

That the Federal Government remove the Right to Negotiate from exploration projects (as held by Exploration Licences, Exploration Permits, etc as defined in each state).

Thank you for the opportunity to make this submission,

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