

## Investment Insights



## Power, Permits and Politics

Analysts at RBC bravely dig out nine SA gold and platinum stocks that could still perform.

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After a recent visit to 11 mines or projects across the gold and platinum spectrum in South Africa, Royal Bank of Canada analysts have concluded that nine selected stocks could still offer attractive returns, despite specific obstacles posed by power outages, upcoming royalties, and an increasingly concerning political climate.

Following a plethora of issues at State-owned Eskom, RBC analysts heard that the significant losses caused by power outages and the expected longer-term impact over the eight year time-frame required to build up new electrical capacity may see government relax proposed royalties, and pay particular attention to a hugely backlogged permitting system. All mining companies are to pay a royalty from May 2009; RBC analysts find that the impact on the earnings base of gold companies is a reduction of about 20% on average, compared to roughly 15% on the PGM (platinum group metal) companies.

As things stand now, the RBC analysts reckon that the SA mining industry will likely see a reduction in output and a major constraint on any potential for growth in output for at least the next five years. Gold Fields (GFI US, \$13.19 a share) has indicated an expected reduction in South African production in the order of 20%, whilst Anglo Platinum (AMS SJ, R1148.00) today reported an expected reduction in the order of 6%, directly related to the power issues. Costs, moreover, are expected to escalate at alarming rates due to the significant decline in efficiencies and the added cost of having to part-generate electricity.

As to new order mining rights, all mining companies must have applied for conversion of old-order rights to new-order rights by April 2009. While the majority of mining companies have all applied for these conversions, very few have in fact been granted these rights. These rights are given only once the government accepts that all the requirements in relation to Black Economic Empowerment (BEE) have been met.

Many of these are at the discretion of the relevant minister - a situation that has seen most companies opting to exceed all the demands by some margin. While the RBC analysts see little chance of any new-order rights application being refused, a high probability of a continuing significant backlog in the granting of these rights is anticipated.

In a discussion on backlogged statistics, the analysts note that during June and November 2007, only one out of a total of 1,163 prospecting license applications was approved, and only five out of 456 mining license applications were approved.

Overall, mining in South Africa is seen as facing "a significantly difficult period over the next five years, with the rump of all the problems potentially having a large impact over the next two years".

The RBC analysts believe that such a scenario calls for an investment thesis where the mining company offers low electricity demand (shallow, with little need for hoisting and/or refrigeration and either in production or close to production) high grades or high margins (to cope with cost increases), bottom quartile costs (a function of being shallow with high grades), good ore (in the case of the PGM companies, high sulphide ore that would be sought after by the smelters as this reduces smelting temperatures) and finally, having the potential to expand, even in a constrained electricity environment.

"Companies that fit all or most of these parameters will likely also become very highly sought after by those that have none or very few of these attributes" the analysts argue. If electricity problems are the central driver for the analyst's "stock picking" attempt, good value is found in Platmin (PPN CN, C\$7.44), Eastplats (ELR CN, C\$3.21), Platinum Group Metals (PTM CN, C\$3.61), Anoroaq (ARQ CN, C\$3.15), and Platinum Australia (PLA AU, A\$2.66) on the PGM side, plus Great Basin Gold (GBG CN, C\$2.91), Pan African Resources (PAN LN, £0.07), Mintails (MLI AU, A\$0.57) and Simmer and Jack Mines (SIM SJ, R5.71) on the gold side.

Once these stocks are filtered for EV/oz (enterprise value per ounce) of production (taking into account time to production), the analysts find that all four of the gold picks appear to remain undervalued, but that Platinum Group Metals falls off on the PGM side due to its longer lead time to delivery. Finally, when both size and grade are considered as an important potential indicator of corporate activity, Simmer and Jack Mines and Great Basin Gold continue to feature well, with Eastplats and Anoroaq standing out for the PGM juniors.

RBC SA gold & PGM picks			
	Stock price	From high*	Value US\$m
Simmer & Jack	R5.71	-27.7%	805
Great Basin Gold	C\$2.91	-16.4%	590
Mintails	A\$0.57	-40.0%	346
Pan African	£0.07	-35.4%	140
Eastplats	C\$3.21	-2.4%	2148
Anoroaq	C\$3.15	-41.4%	584
Platmin	C\$7.44	-34.3%	820
Pt Australia	A\$2.66	-8.3%	494
PGM	C\$3.61	-24.6%	222
* 12-month			

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