Beyond Asia

Global Mining & Metals

Profile of respondents

Beyond Asia: strategies to support the quest for growth is based on a survey of 617 business executives based in East and Southeast Asia, conducted by the Economist Intelligence Unit in March and April 2012. Companies were headquartered in mainland China, Hong Kong (SAR), Indonesia, Malaysia, Singapore, South Korea, Taiwan, Thailand and Vietnam. In addition to the survey results, qualitative interviews were conducted with several Ernst & Young sector and country leaders and senior executives from companies across the region. Oxford Economics provided analysis of current and projected trade and foreign direct investment flows among individual Asian markets and between Asia and the rest of the world.

About this survey

In this report we explore the practical issues — and ways to resolve them — that both regional and global Asian companies will need to consider in order to succeed in the next few years. The report contains challenging and thought-provoking insights for all businesses that are developing strategies for global expansion.

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Strategies to support the quest for growth

Asian companies’ expansion patterns

There has been accelerated growth in mining asset ownership in the Asia-Pacific because of demand for raw materials from countries such as China, South Korea and India, making it the most acquisitive region in 2011 and the second most targeted region in deal value terms. This trend accelerated in 1H 2012 where the Asia-Pacific region was both the preferred destination and the most active acquirer, with China dominating deal activity. Chinese mining companies acquired domestic and cross border targets in equal measure, completing deals worth a combined $17b.¹

"The attraction of the target markets includes the availability of raw materials, lower barriers to entry or favorable risk and tax environments. There can be a distinct difference between expansion into developed vs. growth markets. The primary reasons are:

• Developed markets – access to raw materials with low political risk and access skills needed for growth
• Rapid growth markets – new customers for their product and access to new raw material products"

Taking into account the huge capital investments required for mining and metals projects, political stability and legal protection in a country are seen as far more critical for mining and metals companies than for players in other sectors.

¹. Mergers, acquisitions and capital raising in mining and metals, 2011 trends, 2012 outlook, and Mergers, acquisitions and capital raising in mining and metals — 1H 2012, Ernst & Young.
Fast facts

- Rapid-growth markets from Asia represent the fastest-growing economic region in the world, with annual growth forecast at more than 6%
- The IMF expects advanced economies to grow by just 1.4% in 2012 and 2% in 2013. The corresponding figure for East and Southeast Asia in 2013 is 7.9%
- Since 2000, Asia has been the fastest growing source of foreign direct investment (FDI). Its businesses currently produce a quarter of the world’s exports (US$3.77t in 2010) and form 87 of the Fortune Global 500 largest firms
- FDI outflows from East and Southeast Asia recorded a compound annual growth rate of 22.9% in jumping from US$70b to US$242b
- Investors from East and Southeast Asia are major drivers of growth in global FDI outflows, making up 16% of the world’s total FDI (up from just 7% in 2005) and driven by increased outflows from mainland China, Hong Kong, Malaysia, South Korea, Singapore and Taiwan
- Inter-regional trade is expanding rapidly, reflecting the shift toward higher consumption in Asia

Global Mining & Metals Center

Analysis of the survey identified marked differences in the challenges and approaches to international expansion between two groups of respondents:

- **Globally focused (global) companies** – 177 companies with operations in two or more of the following markets: Australia and New Zealand, Brazil, Eastern Europe, India, Japan, Latin America, Middle East and North Africa, Russia, Sub-Saharan Africa, US or Canada, Western Europe.
- **Regionally focused (regional) companies** – 316 companies with operations in only East and Southeast Asia. Here we summarize four key business challenges as well as the responses that we recommend mining & metals.

### Key challenges

1. **Choosing the right investment structure**
   - Whether to invest in wholesale, via a joint venture or a minority stake holding all depends on the organization’s risk appetite, global know-how, as well as a country’s investment regulations. The wrong decision can have a large effect on capex, and can swing shareholder sentiment.

2. **The nuances of local markets are difficult to understand or control**
   - Political instability, sudden regulatory shifts, and increasing resource nationalism can change the risk/reward equation dramatically and have an effect on future investment decisions.

3. **Top management often lacks an international outlook**
   - Leadership teams need a better understanding of global markets and a more strategic approach to international hiring. For some companies, finding the required local talent can be a challenge given the level of competition for skills.

4. **Skills shortage impacting production output**
   - There is a risk that insufficient skills may limit current and/or future planned output as a lack of strong local talent can cause project delays and over-runs.

### Industry recommendations

**For globally focused companies**
- Put in place robust risk management
- Ensure strong project management which helps to achieve successful transition from a company’s investment to profitable operations
- Take steps to make the corporate culture more international
- Create compelling incentives to recruit and retain key staff
- Be flexible
- Seek government support
- Adapt to local cultural norms
Focus of expansion methods in the next three years

Those companies with a bullish outlook on China and that can work with volatility will be the dealmakers over the next three years. The following factors are likely to drive future deal flow:

- Lower equity valuations, which may drive opportunistic deal activity
- A prevailing focus on M&A in familiar territory during volatile times; this may take the form of domestic consolidation or companies seeking to build on their minority holdings and joint venture positions
- Synergistic, ‘one chance’ deals if valuation metrics permit
- Increasing costs of organic projects driving a greater focus on M&A by producing companies

Joint ventures were as common in both developed and developing markets (at 20%) due to both foreign direct investment restrictions, as well as a risk mitigation strategy. Different legal structures in Asia have led mining & metals companies to consider minority equity investments and partnerships with State Owned Enterprises as an avenue of entry into a project or a market (45%). Greenfield investment in Asia was prolific at 30% in markets which are relatively unexplored.

Chasing the right method of entry is key, and given the levels of resource nationalism in the sector, it is critical for companies to understand the political and regulatory regime. A minority equity investment/partnership may be a good way to gain a foothold in a country without taking on too much risk. It also means a company can gain access to skilled workers.

45% of mining and metals companies consider a minority equity investment

Q. What are the most important benefits you would be looking to achieve through international expansion in developed markets and rapid-growth markets. Select up to three.
Knowledge gaps in top management teams

Top management plays a key role in an organization’s strategic direction and identifying and plugging knowledge gaps are especially important when organizations’ operations are progressively offshore. Given the increased internationalization of the sector and the need to have multinational supply chains, an understanding of international taxation and compliance is critical. The knowledge gap (at 58%) appears larger than the general sector gap (of 41%) which may reflect the more complex taxation and compliance requirements for mining and metals assets, as well as the fact most management are based in countries outside of where the asset is based. Uncertainty caused by resource nationalism — such as in-country tax policies which are frequently changing — can have an adverse impact on companies. There is also an uncomfortable knowledge gap in the understanding of different global markets, however, the complexities that come with the cultural aspects of doing business, attaining a social license to operate and various arrangements in each country make it a more complex environment to understand. The other two notable areas for improvement include the strategic hiring process (45%) and retaining these staff (45%).

A ‘local’ understanding of the business environment in which the organization operates means that the right investment decisions are made, especially given the large capital investment needs of mining and metals projects. Ensuring that the right people are attracted to, and retained by, these operations ensures that targets are met and over-runs are minimized.

50% of top management in mining & metals companies need an increased understanding of global markets

Q. Where does your organization’s top management team need more knowledge or insight to be successful in today’s global marketplace? Select up to three.

- International taxation and compliance
- Understanding of global markets
- Strategic hiring process for international markets
- Ways to incentivize employees in different markets
- Local culture and ways of doing business
- Global supply chain issues
- International accounting and reporting standards
- Regulatory compliance in global markets
Effective talent management

Over 34% of companies have 40% or more of their workforce based in countries other than where their headquarters are based and this trend is expected to rise to 50% of companies over the next three years. As a result, effectively managing your workforce has never been more critical, especially as this is exacerbated by the skills shortage being experienced in the mining & metals sector where the acute skills shortages seen in Australia has spread to projects in Indonesia and Mongolia, and other countries outside of Asia such as Brazil, Chile, Peru and Mozambique. And risks associated with skills shortage include impact to production, project delays, and increasing labor costs. This is why skills shortage and talent management is ranked as the second biggest risk for mining & metals organizations globally in Ernst & Young’s risk report 2012-2013.

Identifying, attracting and retaining critical operational and construction skills remain a top priority for the mining and metals sector. While mining & metals companies seem to be actively engaged in recruiting and developing key talent, there seems to be a large gap in planning for future needs across markets (14%), evaluating and rewarding high performance across markets (14%) and motivating employees across cultures (a woeful 5%). If sector players want to attract and retain key talent across an increasingly global organization, they will need to focus on these areas.

Q. How effective is your company at the following aspects of talent management? 1–5 point effectiveness scale, shown as percentage of very effective.

<table>
<thead>
<tr>
<th>Aspect</th>
<th>Mining &amp; Metals</th>
<th>All respondents</th>
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<tr>
<td>Recruiting and retaining key global talent</td>
<td>34</td>
<td>43</td>
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<td>Developing an internal pipeline of management talent with the necessary skills and capabilities</td>
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<td>Aligning business strategies with an individual’s performanceobjectives</td>
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<td>Planning for your future talent needs across all markets</td>
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<tr>
<td>Evaluating and rewarding high performance across different markets</td>
<td>14</td>
<td>18</td>
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<tr>
<td>Identifying talent gaps and responding quickly to fill them</td>
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<td>18</td>
</tr>
<tr>
<td>Motivating employees from different cultures</td>
<td>5</td>
<td>7</td>
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</tbody>
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2. Growing Beyond, Talent survey, Ernst & Young, 2012.
Ernst & Young’s Global Mining & Metals Center

With a strong but volatile outlook for the sector, the global mining and metals sector is focused on future growth through expanded production, without losing sight of operational efficiency and cost optimization. The sector is also faced with the increased challenges of changing expectations in the maintenance of its social license to operate, skills shortages, effectively executing capital projects and meeting government revenue expectations. Ernst & Young’s Global Mining & Metals Center brings together a worldwide team of professionals to help you achieve your potential – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively. It’s how Ernst & Young makes a difference.

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