Global Capital Confidence Barometer

Mining & Metals

About this survey
The Global Capital Confidence Barometer is a regular survey of senior executives from large companies around the world, conducted by the Economist Intelligence Unit (EIU). Our panel comprises select Ernst & Young clients and contacts and regular EIU contributors. This snapshot of our findings gauges corporate confidence in the economic outlook, and it identifies boardroom trends and practices in the way companies manage their capital agenda.

Profile of respondents
- EIU panel of over 1,500 executives surveyed in August and September 2012
- 149 respondents from Mining & Metals companies from 41 countries
- Respondents from more than 24 industry sectors
- 754 CEO, CFO and other C-level respondents
- More than 400 would qualify for the Fortune 500 based on revenues

Our Global Capital Confidence Barometer finds that mining and metals companies have become less optimistic about the global economy over the six months to September, with only 21% viewing the global economy as improving vs. 65% in April. Given lower growth forecasts from China and the continuing Eurozone crisis, this is understandable, particularly given the impact on commodity price volatility.

Mining and metals companies’ focus on growth has slipped to 38% (from 53% in April), with almost a third of respondents viewing cost reduction and operational efficiency as key focus areas for the next 12 months. This is not surprising given margins are increasingly under pressure from softening commodity prices and inflation across the operational cost base: management is focused on leaner and more flexible operations.

Confidence in doing deals is improving, with a 10% increase in the number of companies expecting to do a deal in the next 12 months. Companies will be taking advantage of strategic partnering opportunities such as joint ventures, minority investments and consortium formation. The transformational deals appear to be off the table in a nervous market. Given the backdrop of the current inflationary cost environment, we expect the trend of non-core divestitures to continue, although in smaller numbers.

What’s next? Companies are refocusing on the basics: efficiency and cost control, risk management and capital allocation dominate the boardroom agenda. For those companies with strong balance sheets which remain nimble, the opportunity to pick up bargains is now!

The Capital Agenda
Based around four dimensions, it helps companies consider their issues and challenges, understand their options and make more informed capital decisions.
1. Preserving capital: reshaping the operational and capital base
2. Optimizing capital: driving cash and working capital and managing the portfolio of assets
3. Raising capital: assessing future capital requirements and assessing funding sources
4. Investing capital: strengthening investment appraisal and transaction execution

Key findings
Mining and metals executive responses indicated that:
- 38% said their key priority was growth, while 27% prioritized cost reduction and operational efficiency
- 28% expect to pursue an acquisition in the next 12 months, up from 18% six months ago
- 21% felt the global economy was improving
Companies focused on growth declines as global headwinds remain

The focus on growth continues to decline, with almost a third of respondents viewing cost reduction and operational efficiency as the key priority for the next 12 months. With a softening Chinese economy and wider global economic concerns, there is a shift across the sector to make operations leaner and organizations fitter to provide greater flexibility through volatility. Whilst growth remains a key focus, there is an increasing desire to pursue opportunities from a more robust operating base and stronger balance sheet. We expect to see growth become a greater priority in the next Capital Confidence Barometer (April 2013) with divestments potentially forming a source of capital from which to invest.

Figure 1. Which statement best describes your organization’s focus over the next 12 months?

<table>
<thead>
<tr>
<th>% focused on growth</th>
<th>Oct-10</th>
<th>Apr-11</th>
<th>Oct-11</th>
<th>Apr-12</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>84%</td>
<td>78%</td>
<td>51%</td>
<td>53%</td>
<td>41%</td>
</tr>
<tr>
<td>Mining &amp; metals</td>
<td>46%</td>
<td>51%</td>
<td>49%</td>
<td>52%</td>
<td>38%</td>
</tr>
<tr>
<td>Growth</td>
<td>38%</td>
<td>32%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Cost reduction and operational efficiency</td>
<td>27%</td>
<td>26%</td>
<td>26%</td>
<td>26%</td>
<td>26%</td>
</tr>
<tr>
<td>Maintain stability</td>
<td>38%</td>
<td>32%</td>
<td>3%</td>
<td>3%</td>
<td>3%</td>
</tr>
<tr>
<td>Survival</td>
<td>32%</td>
<td>31%</td>
<td>28%</td>
<td>27%</td>
<td>26%</td>
</tr>
</tbody>
</table>

Mergers & acquisitions

Appetite for M&A rises, although on the smaller side

Confidence in doing deals is increasing, with a 10% uptick in the number of companies expecting to do a deal in the next 12 months. We believe there will be a move away from diversification towards consolidation within same commodity classes by players with strong balance sheets which want to build scale. These players will look to take advantage of the lower valuation opportunities.

We expect the increase in smaller deals will occur as companies take advantage of strategic partnering opportunities such as joint ventures, minority investments and consortium formation. These will be driven by:

1. Resource nationalism
2. A difficult financing environment
3. Lower risk appetite of investors

Unless there is a very clear strategic rationale, transformational deals appear to be off the table as companies bend under increased investor scrutiny to generate return on investment, especially given historic instances of cost overruns and post-merger integration issues. Companies are leaning more towards synergistic deals that create economies of scale and take advantage of low valuations across the sector.

Figure 2. Do you expect your company to pursue acquisitions in the next 12 months?

<table>
<thead>
<tr>
<th>% pursuing acquisitions</th>
<th>Oct-10</th>
<th>Apr-11</th>
<th>Oct-11</th>
<th>Apr-12</th>
<th>Oct-12</th>
</tr>
</thead>
<tbody>
<tr>
<td>Global</td>
<td>65%</td>
<td>41%</td>
<td>39%</td>
<td>31%</td>
<td>28%</td>
</tr>
<tr>
<td>Mining &amp; metals</td>
<td>41%</td>
<td>38%</td>
<td>39%</td>
<td>39%</td>
<td>25%</td>
</tr>
</tbody>
</table>

28% of mining and metals companies expect to pursue an acquisition in the next 12 months, up from 18% six months ago.
Capital structure

Debt to capital ratios remain constant

High levels of liquidity among yield-focused investors have created favorable conditions for corporate debt markets. Companies are exploiting these conditions to reduce financing costs and optimize capital structures by rebalancing debt and equity levels; increasing debt maturities; or shifting short-term bank lines of credit to other forms of debt finance, such as private placements.

The relatively strong balance sheets mean that 60% of respondents have a debt to capital ratio of less than 25% vs. 50% of global companies, marginally down from April and this time last year. 84% of respondents believed debt to capital ratios would remain the same or decrease as companies continued to deleverage. This is due to the threat of margin squeeze which has led to more conservative capital structure. Mining and metals companies can no longer afford to be as bold and are more debt averse, despite their strong balance sheets.

Figure 3. What is your company’s current debt to capital ratio?

Optimism for the global economy weakens

Volatile in commodity prices, lower growth forecasts from China, and the continued Eurozone crisis underpin the decrease in optimism about the global economy over the six months to September. Only 21% of respondents felt the global economy was improving, a huge drop from 65% six months ago. There is good news in that the majority felt that the economy had stabilized.

Figure 4. What is your perspective on the state of the global economy today?

21% of mining and metals executives surveyed said that they felt the global economy was improving.

Spotlight on China

Our Global Capital Confidence Barometer shows a greater focus on stability for Chinese respondents across all sectors on a number of metrics; reinforcing the positive measures put in place by the Chinese Government against the backdrop of a once-in-a-decade leadership change in China:

- 75% of Chinese respondents now view their local economy as stable, compared with 59% in October 2011.
- Confidence in credit markets dropped marginally, although the percentage of respondents who view their credit availability as stable has increased from 47% to 76%.
- While fewer expect to add new jobs, an increased number of Chinese respondents (70%) are aiming to maintain the current size of their workforce, compared with October 2011 (52%).
- China was the most acquisitive country in the mining and metals sector by deal value in 9m 2012, driven by a surge in domestic consolidation and an increase in outbound deals, targeting Africa in particular.¹ We expect China to remain active in outbound mining and metals investments given its strategic need to secure resources.

¹ 9m 2012 Mergers, acquisitions and capital raising in mining and metals, Ernst & Young
Fewer seek to increase their workforce in light of economic challenges

Fewer companies plan on creating new jobs, with only 26% indicating they planned to increase their workforce, a huge drop from 41% seen in April, and meaningfully down from 37% seen a year ago. This would be largely on the back of the global economic challenges which have seen many projects shelved or cancelled. However, plans to maintain the same size workforce (at 66% of respondents) is part of the retention plan of good talent in an industry that views skills shortage as its second largest global business risk.2

Effectively managing and maintaining a stable workforce has never been more critical, especially as there are acute skills shortages in Australia which have spread to projects in Indonesia and Mongolia, and other countries outside of Asia such as Brazil, Chile, Peru and Mozambique. Risks associated with skills shortage include the impact to production, project delays, and increasing labor costs.3

Figure 5. With regards to employment, which of the following does your organization expect to do in the next 12 months?

Optimizing capital drives the boardroom agenda

Priorities have shifted for board members as the global economic environment remains volatile. Efficiency and cost control are a top priority as margins are squeezed, with 77% of companies giving it greater focus. Risk management has also seen heightened scrutiny with the increased regulatory requirements of boards, and more accountability to the shareholders. Capital allocation remains critical as economic conditions continue to impact equity markets and capital remains constrained as a result.

In uncertain times, growth is further down the agenda and expansion into new markets appears to be less of a priority for developed market companies due to concerns over resource nationalism and the general difficulty in assessing returns in unknown territories.

Figure 6. How do you think the Boardroom agenda at your company has changed since the onset of the financial crisis?

<table>
<thead>
<tr>
<th>Category</th>
<th>Greater focus today</th>
<th>Stayed the same</th>
<th>Less focus today</th>
</tr>
</thead>
<tbody>
<tr>
<td>Efficiency &amp; cost control</td>
<td>77%</td>
<td>22%</td>
<td>1%</td>
</tr>
<tr>
<td>Risk management</td>
<td>69%</td>
<td>27%</td>
<td>4%</td>
</tr>
<tr>
<td>Capital allocation</td>
<td>44%</td>
<td>54%</td>
<td>1%</td>
</tr>
<tr>
<td>Growth – innovation R&amp;D</td>
<td>49%</td>
<td>42%</td>
<td>9%</td>
</tr>
<tr>
<td>Regulatory issues</td>
<td>52%</td>
<td>44%</td>
<td>4%</td>
</tr>
<tr>
<td>People (attracting retaining talent)</td>
<td>38%</td>
<td>53%</td>
<td>9%</td>
</tr>
<tr>
<td>Investor relations</td>
<td>41%</td>
<td>52%</td>
<td>7%</td>
</tr>
<tr>
<td>Growth – investing in new markets</td>
<td>32%</td>
<td>49%</td>
<td>19%</td>
</tr>
</tbody>
</table>

2 Business risks facing mining and metals, 2012-2013, Ernst & Young
3 Beyond Asia: Global mining & metals, Ernst & Young, October 2012
Ernst & Young’s Global Mining & Metals Center

With a strong but volatile outlook for the sector, the global mining and metals industry 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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