

Speech by Mike Fraser, Chief Operating Officer, South32

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Good morning everyone.

Many of you will be familiar with South32. We are a global mining and metals company with operations in Australia, South America, and here in southern Africa – where we own and operate manganese and coal mines and produce aluminium and manganese alloys.

We also have a zinc, lead and silver development option in the US following our acquisition of the Hermosa project from Arizona Mining in 2018 and a number of greenfield exploration projects globally.

Wherever we operate, we remain committed to our purpose which is to make a difference by developing natural resources, improving people's lives now and for generations to come. We are trusted by our owners and partners to realise the potential of their resources.

We achieve this by operating in a sustainable manner that creates value for our host communities through job creation, business opportunities and through taxes and royalty payments.

Through our disciplined approach to capital management, we balance shareholder returns with prioritising a strong balance sheet and creating internal competition for excess capital.

This session is intended to provide an international perspective on challenges and opportunities in South Africa, so I'll talk about those in the context of the commodities we mine here.

South Africa has significant coal and manganese reserves and resources and is well positioned to supply the key regions of South East Asia and China.

However, in the near term, slowing global growth and ongoing trade and geopolitical tensions will weigh on commodity prices, with trade conflicts and trade policy presenting threats to demand for our commodities in the near to medium term.

The necessary response to climate change will also change demand for our products. Steel demand in China will start to decline. India and South East Asia are expected to support demand growth although at a lower rate.

While coal will continue to play a significant part in South Africa's energy mix given the existing infrastructure and new coal-fired capacity under development, we expect to see the seaborne market decline over time with increased competition from producer countries seeking to place product into the markets we have traditionally pursued.

We have already seen some of these impacts reflected in the export coal price and export volumes out of South Africa.

These trends are likely to heighten global competition, requiring a collaborative approach with government and regulators to ensure the competitiveness of South Africa's mining sector. But we continue to face a number of challenges in terms of community unrest and instability, social pressure, low productivity and power cost and availability that, if not managed, will detract from South Africa's ability to attract investment.

The communities around our operations rightly seek to benefit from having mining activity in the areas in which they reside and we are committed to developing initiatives that can help to uplift our local communities. These include

the creation of jobs for local people, developing small businesses and providing opportunities to supply our mines, and investing in projects, like healthcare, education and housing, that benefit the whole community.

With South Africa's economic malaise and rising unemployment, mining communities are increasingly dependent on local operations and we continue to engage our communities to understand how else we can support them.

In the last 12 months, we have seen an escalation in organised protests which are in the interest of a small number of individuals who ask us to breach standard commercial processes for their own benefit. We've also seen an increase in illegal mining activity.

These activities are disruptive to our operations when they escalate to a point where they risk the safety of our people and the local community.

While this has occurred at many mines across the country, it's been a particular challenge for us in the communities around our Energy Coal business in Mpumalanga.

The draft Integrated Resource Plan forecasts a decline in coal-fired power by 2030. Data released by the Minerals Council shows that the decline translates to an impact on over 2,000 direct jobs and approximately 9,000 jobs affected in downstream industries – so there is potential for unrest to become more frequent.

We know we have a responsibility to contribute to the economic stability and development in the regions around our mines.

But we need a continued and coordinated effort to manage the threat of organised protests and we cannot allow illegal mining.

An increase in the frequency of these specific actions will have a long-term impact on South Africa's competitiveness and ability to attract investment.

We have mechanisms for community engagement and for societal participation, and we remain committed to finding sustainable ways to build resilience to the economic challenges within our host communities.

In Mpumalanga, our South Africa Energy Coal business is working together with other coal producers to address concerns raised by the communities and we have welcomed the support from the Department of Minerals & Energy in this process.

We have also renewed our own commitment to enterprise supplier development.

Our goal is to develop and empower small local businesses to be financially and operationally independent in line with our transformation strategy.

In the 2019 financial year we spent over ZAR 150 million on the development of suppliers through our enterprise supplier development programs.

More than 30 businesses have been supported through our funding programs, which provide funds for assets, equipment, materials, and tools as well as business mentoring and coaching programs.

There is much more to be done to build resilience in our communities and we believe that supplier development is key.

But an over-arching challenge to businesses of all sizes in South Africa is reliable and competitive power supply – which is critical to future industrial growth and creation of jobs.

Our Hillside aluminium smelter in Richards Bay is a major consumer of power and in the 2019 financial year we experienced the highest volume of load shedding since 2015.

Load shedding forms part of our contractual agreement with Eskom and we plan for those events. While we have seen overall improvements in availability across Eskom's generation fleet in recent times, our Hillside and Mozal smelters have continued to see load shedding events.

As a result, load shedding has not occurred in communities in the same period, which demonstrates the role the smelters play in bringing grid stability.

Continued improvements will be dependent on Eskom taking drastic action to address their financial and operational challenges. Unbundling makes sense and can enable generation to be competitive; coal procurement also needs to be improved to reduce costs.

As a major supplier of coal to Eskom, we acknowledge the government's request for suppliers to support cost reduction and will continue to work with them to manage their cost while ensuring our operations are sustainable.

However, we believe the best way to reduce the cost of coal is to transition back to long term contracts that will enable a reduction in the volume of coal delivered by road at higher cost, potentially with additional support provided by a smaller spot market for prompt volumes.

Reinvesting in cost plus operations enables the lowest cost coal procurement with delivery by conveyor – removing the need for short term procurement from high cost producers.

We recently announced that South32 is in exclusive negotiations with Seriti in respect of its offer to acquire our South Africa Energy Coal business.

When we announced our intention to broaden ownership of South Africa Energy Coal in November 2017, our vision was that it should be a sustainable business for the long term and that it should become a South African black-owned and operated business, consistent with South Africa's transformation agenda.

We are also committed to defining a mechanism for communities and employees to share in the value generated by the business – in keeping with the spirit of the Mining Charter – which should positively impact the local economy.

To establish South Africa Energy Coal as a sustainable business, we will have invested ZAR 8.7 Billion of capital expenditure in the 2018, 2019, and 2020 financial years while we progress the divestment process.

This investment includes ZAR 4.3 Billion to advance the Klipspruit Extension Project which will extend the life of the colliery by at least 20 years.

Beyond our ongoing investment in the business, additional investment will be required to sustain production and deliver on the potential of the resource base.

South Africa Energy Coal is a large and complex business and plays a critical role as a major supplier of coal to Eskom. We fully understand the importance of ensuring continuity of supply over the long term.

That's why we have focused on identifying an owner with the necessary mining expertise and experience – as well as the financial backing – to ensure the business remains sustainable and continues to meet its contractual, social and labour plan, and rehabilitation commitments.

Thousands of employees and contractors directly depend on the business, with more indirect jobs and local businesses having a vested interest in its long-term operation.

Our announcement that we have entered into exclusive negotiations with Seriti comes after a fair and competitive process run over the last 12 months.

While we have not yet signed an agreement, it became clear that Seriti has the scale, experience and expertise to sustainably manage the business going forward.

Once a Sale and Purchase Agreement is signed we would commence the process of securing all required approvals, including from the DMRE, Eskom, and the competition authorities.

While we can't pre-empt the outcome of the approval processes, we see strong synergies between South Africa Energy Coal and Seriti that can unlock resource and make the best use of equipment and infrastructure. We anticipate that these would translate into a strong value proposition that would help Eskom to best manage its coal procurement costs.

Looking now to opportunities in the Kalahari, we've seen considerable growth in manganese ore volumes in the last few years, mostly driven by year on year demand increases in China which have boosted export volumes from South Africa.

South Africa has a competitive advantage in manganese given 80 per cent of the world's known resource is in South Africa.

While China is already dependent on imports for 90 per cent of its demand, we anticipate that India's imports will need to increase over time.

South Africa is the marginal supplier of manganese ore with economics of supply determining export volumes. Notwithstanding our resource advantage, our logistics costs place us relatively high on the cost curve.

In our HMM business in the Kalahari, we have benefited from elevated market demand by increasing sales of lower grade products and utilised trucking to deliver to port.

We have also made productivity improvements at our high grade Wessels mine which delivered an increase in premium material.

Longer term, we are studying an option to invest in rapid train load out facility which would debottleneck the rail and reduce road haulage with potential to unlock additional high-grade capacity at Wessels.

We see plenty of opportunities in South Africa to create value in our operations and ensure that this is shared more broadly with our communities and our people – not only through the taxes and royalties we pay. This is evident through the work we're undertaking to strengthen our suppliers, develop skills for our employees and within our communities and invest to provide much-needed local infrastructure and services.

To ensure South Africa can compete globally for mining investment, the challenges that disrupt operations – power supply and cost of power, low productivity, organised protest action and illegal mining – must be addressed.

These issues all have complex underlying causes and are heavily interlinked, for example improving coal procurement can contribute to a more stable power supply at a competitive price – boosting small businesses as well as major industry. Industrial development creates more opportunities for communities and can boost the economy through jobs and procurement.

We need to work together to address the challenges of social cohesion, modernisation and improved environmental stewardship to ensure our attractiveness as an investment destination.

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