Is this the end of Australia's Mining Boom (2013)?
(What can we learn from China?)

Presented by Ron Manners
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My talk has been made easy with the release, this week, of a 53-page report from the Grattan Institute titled *The Mining Boom: Impacts and Prospects*.

The link to the full paper is;
http://grattan.edu.au/static/files/assets/705d0122/194-mining-boom-impacts-and-prospects.pdf

The Grattan Institute report can be summarized as follows:-

1. This has been the biggest mining boom in Australia's history.

   The 1850s' Gold Rush comes close.

   We have seen a $400 billion investment in the past ten years, but that has dropped off, as have our mineral exports, our national income and government revenue.

2. Overall, this boom has been good for all Australians.

3. The major concern is that the benefits of the boom have not been saved and that concern is justified.

   For those interested in more details, I recommend reading the full version of the report.

So, that takes care of all the details. Now we can apply a very broad-brush approach in today's talk and adopt a theme of 'survival through flexibility'.

So, now let me continue with a few personal experiences and anecdotes from my own involvement over the years with Australia's boom and bust culture.

I've been through some 'interesting' booms and busts, a phenomenon which Australia seems to repeat regularly. My first was in 1962 and it is interesting to compare the similarities and the subtle differences between each vigorous cycle.

Each 'down turn' (or bust) teaches us the same easily forgotten lessons.

Our boom and bust cycles are exaggerated in Australia because we have never developed the art of having a broad front of industries which all perform well at the same time.

If one is a 'star', as has been the case with our resource industry over the past ten years, everyone tries to climb on board and, predictably, sinks the ship.

The political catch-cry for the past ten years has been 'sharing the benefits of the mining boom', rather than, 'earning a share of the mining boom'.

I've been fascinated by Australia's habitual boom and bust culture and, in fact, wrote a book called *Heroic Misadventures*, but subtitled, *Australia Four Decades – Full Circle – www.heroicmisadventures.com* .

When I started the book, it was intended to be about my own turbulent business experiences. But halfway through writing it I realized it was more about Australia's experiences than my own.
http://www.mannkal.org/downloads/S-C224-MANN13081617140.pdf

The book covers the period from the early 1970s when Australia had just emerged from what was called the 'nickel boom', where in the game, almost everyone was a millionaire. Once the nickel boom fell over, it was like the tide having gone out leaving all the boats stranded on the beach.

This is just being repeated before our eyes now having come through this remarkable 150-year event in Australia, as detailed in the Grattan Institute Report, and the tide is proceeding to go out.

As Warren Buffet says, "It's only when the tide goes out you can see who is swimming naked."

However, 'booms and busts' are also great opportunities and there are some remarkable bargains around for those with cash and who are patient enough to sit out a five-year cycle.

These opportunities are on offer and, although I am not an investment advisor, I'm always happy to direct people in the right direction—toward companies and people who have a trustworthy track record.

There are many reasons why Australia's resource companies have been belted mercilessly in the market. In fact, they've been belted so hard that Australian stockbrokers are far more inclined to recommend the purchase of blue chips such as Telstra and the Commonwealth Bank than they are resources stocks.

The phenomenon of 'swimming naked when the tide goes out' is not new to me. I was confronted with this experience in 1972 when the nickel boom came to a sudden end.

That nickel boom was essentially created by a supply shortage of nickel metal when the Canadian nickel miners went on strike and the whole world was short of nickel.

During this international nickel shortage, a remarkable discovery in Australia became a history-making event which led 380 exploration companies from all over the world to come to the Western Australian nickel fields (mind you, only two of them ever mined nickel at a profit).

The end of the nickel boom became quite a social event in that:

1. Almost everyone in the game had become a millionaire, and then suddenly they weren't.
2. There was an outbreak of divorces as many people who had become accustomed to being a millionaire, were not so comfortable when the money disappeared.

At the peak of the nickel boom, our family company had 48 people working together in an enterprise which combined prospecting, exploration and the supply of mining equipment.

Then it suddenly came to an end (mainly because the nickel price collapsed as the industrial disruption in Canada ended and supplies returned to normal).

One day I suddenly realized that not a single one of our 48-member team was actually operating at a profit and financial alarm bells started ringing loudly.

I realized then, in 1972, that something had to be done urgently. I looked in the mirror and said, “Ron, what are you going to do about this?”

To do nothing would have meant going broke and certainly going out of business.

I realized that despite the capital expenditure that had been made to bring these new mines into production, they could not produce profitably with the out-dated techniques and equipment they were using. The rest of the world’s mining industry had not enjoyed the same ideal conditions as the nickel industry had so they were operating in many parts of the world much more efficiently.

I further realized that the only way of saving our family company was by doing something beyond our comfort zone—so I jumped on many a plane. In a quest for better ways to mine effectively and efficiently I just went to see how they were doing it in other parts of the world.

I visited every mine in Sweden from north to south, plus mines in Canada and the US and came back with lots and lots of ideas and equipment agencies.

It was Thomas Edison who said “To have a great idea ... have lots of them.”

So, I came back with lots of stuff and we completely changed the direction of our company and we came through those seventeen difficult years in a really healthy position. (So I learnt early the benefits of being flexible and of embracing change.)

One of the lessons you learn after being in business as long as I have is the importance of ‘cash flow’, particularly in periods when ‘cash is king’. Like right now.

Nearly 30 years ago I floated an Australian mining company. We raised our capital and bravely went on to explore.

After nine months of drilling many exploration holes we didn’t find anything of sufficiently high grade to turn into a mining operation and when we saw that we were running out of capital we realized that our future as an explorer was coming to an end. We had to become a producer and create a cash flow quickly.

We did an extremely courageous thing (it’s all detailed in my book *Heroic Misadventures*) and bought an ‘almost ready to produce’ gold mine from Rio Tinto (CRA) because it was obvious that that particular mine was too small for a huge company like Rio Tinto—but it was just right for us.

That enabled us to go on and produce over 1.25 million ounces of gold and pay eleven dividends to our shareholders over a period of 20 years.

However, those 20 years were not all easy going.

One morning, about ten 10 years into the company’s life, the Mine Manager drove in from the mine to my office with the news:

“Because the price of gold has halved and the cost of cyanide [an important component in the production of gold] has quadrupled, from this morning we have stopped being profitable.”

On hearing that news I immediately recalled that wonderful quotation of Samuel Gompers, that remarkable American Union leader from the 1920s. His quotation rang loud and clear in my mind:

“The worst crime against working people is a company which fails to operate at a profit.”

I immediately drove out with our Mine Manager and we closed the mine. We then drove over to the milling treatment plant which was about 17 km away and promptly closed that too and sent the entire workers home simply with the promise that we would start up again as soon as we located some gold deposits which were of sufficient grade to withstand the new circumstances.

This we did and nine months later we contacted all our team offering them their old jobs back and, much to my surprise, they all returned.

I asked them:

“How is it that you are still available and haven’t obtained jobs elsewhere?”

The gist of their comments was:

1. They had enough confidence in us to know that we would find something reasonably quickly.

2. They all welcomed a break from the long hours they had been working and used the break effectively for a range of things, such as building another room on their home or taking an overseas holiday or just attending to so many things that we all put on hold in our own personal lives.

It was a great feeling to bring the same team back and my proud privilege to continue working with that team on many successes for an additional ten years.

The secret of our team was the mutual trust that each had in the other together with their acceptance of flexibility. The company performed well while that culture existed.

More recently I saw a wonderful example in the US of flexibility which leads me to believe that the US will come out of its economic turmoil in far better shape than Australia and perhaps Europe.

Just as the Global Financial Crisis was coming to a peak, I was in Washington DC and one evening had the enjoyable experience of taking a fine young think-tank executive out to dinner.

We went to a reasonable Washington restaurant, started drinking at 6.00 pm, concluded our meal and finished at around about 11.00 pm. I got the bill which was US$72 total.

I suspected that they had made a mistake, so I called the waiter across and asked if I had only got the bill for the meal or just perhaps only for the drinks?

He smiled and told me this story:

> “My friend, I know what you are saying, but let me explain how our restaurant is currently still operating successfully.

A few months ago all our staff realized that because of those Wall Street spivs (elsewhere called the Global Financial Crisis) our business was suffering and some of us were about to lose our jobs."

We all went to the manager and said:

"We are prepared to take a 50% salary cut, because that means we can all keep our jobs and we'll all be here together when things get better again."

The manager then said to us:

"Wonderful, and if you do that, then I will extend our 'happy hour' and make it into a 'three-hour' happy period."

You, my friend, did most of your drinking and eating during that three-hour period."

I was astonished at that story as I could not see that happening anywhere else in the world, but I was later told that it was quite common-place in the US during that period. Again, the power of flexibility aids the survival process.

Now there are some sobering messages for this downturn for Australia and I'll just touch on a couple of points on the various impediments to progress in Australia.

In what way is this 'end of a boom' cycle different to those that came before? (I'll stick to mining.)

Previously there has been a single major cause for a boom's demise, but this time it seems that there is a whole orchestra of enemies working against Australia's mining industry, which although it has not quite killed the industry altogether, it has changed the shape and the direction of investment in the industry.

Regulation and what can we learn from China?

If you remember one thing from my comments here, let it be this.

Australia and China are both currently confronted with a downturn, but the attitudes of each country's government stand in stark contrast one to the other. You might think that we lived on different planets.

On getting into this 'tight spot', the two countries have travelled different roads. China's government usually has an eye to prioritizing expenditure on projects that stand a chance of generating benefits which exceed the real cost of debt, whereas Australia's government rarely thinks beyond 'buying votes' at the next election.

Let me give you two stark examples of both governments' attitudes to new private productive projects:

1. Kim Williams (CEO of News Limited, used this example in his address to the Leaders Forum in Perth in June 2013).

> I am currently chair of the Business Council of Australia's deregulation taskforce. . Some of the examples of compliance costs on mining companies almost drain you of the will to live.
>
> I was shocked to learn that a mining company in Queensland submitted a document that was **46,000** pages long to meet its Commonwealth and State regulatory obligations.
>
> Forty-six thousand pages long! It's preposterous. I guarantee you that no one has read the whole thing other than perhaps the company's lawyers and compliance people. Frankly, all of us, as people and companies, only have so much energy.
>
> I am not saying for a moment that there is no place for regulation, but it needs to be judiciously applied and be applied with a clear eye to its costs."

Please read his comments again and weep for Australia's prospects of ever achieving her true potential.

2. Now, contrast this with China's attitude in getting new projects up and running (and I'll use coal projects, so that we are comparing like with like).

Chinese media, *Xinhua*, reported on 26 June 2013 as follows:

> "China to amend laws to cut government red tape
>
> The revision to the laws is to implement a plan of institutional restructuring and functional transformation of the State Council, adopted at the NPC annual session in March, said Song Dahan, director of the legislative affairs office of the State Council, or China's cabinet, when elaborating on the bill to lawmakers.
>
> The amendments are aimed at stimulating creativity in the market and in society and giving full play of local governments' initiatives, Song said.
>
> According to the bill, private owners of cultural heritage sites will not need government approval for selling and mortgaging properties or changing the use of them, but should inform authorities so that they can supervise the proceedings.
>
> A coal mining company will not need to apply for a production certificate before it starts operation, once they have obtained a safe practice certificate from the work safety administration, which simplifies the procedure of running a coal mine, according to the draft amendment to the law on the coal industry.
>
> The bill also removes the administrative approval for opening a company in the coal business.
>
> The proposed revision to the law on administration of taxation shortens the processing time for tax authorities to review an application of tax registration from a company and issue a certificate, from the maximum 30 days to one day.
>
> The bill is believed to be a follow-up move after the State Council published a list of items last month that no longer require central government approval or now only require consent from lower-level authorities.

> A total of 71 items that were previously subject to central government administrative approval would require legal revisions and it will appeal to the NPC Standing Committee for amending the related laws."

This same deregulatory legislation was similarly reported in China's NBD as follows:

> "Cabinet to Reduce Red Tape
>
> The State Council, China's cabinet, on May 16, issued a document to abolish central government administrative approvals on 117 items. The document made 104 of the items public, while the other 13 remained undisclosed on the grounds of national security. The listed items cover projects such as investment in civil airports and urban transportation projects. The cabinet said such projects will no longer need government approval or will only require review from lower-level authorities. The move is part of the government's reform plan to reduce government bureaucracy and regulatory overhand. But some experts expressed concern that easing government controls could lead to an investment boom." — *Original article by NBD – August 2013*.

These pro-development headlines are a daily occurrence in China, and are put clearly and unambiguously.

Another example comes from the *South China Morning Post (1 August 2013)*

> "The central government has put fresh investment initiatives at the core of plans to ensure stable economic growth, promising the private sector a reasonable return as top policymakers sketched out measures to counter an economic slowdown.
>
> The State Council yesterday unveiled a raft of such measures at a meeting chaired by Premier Li Keqiang, which followed a Politburo meeting on Tuesday that vowed steady economic growth in the second half.
>
> "Investment should be encouraged to improve city infrastructure, including subways, underground pipelines and waste treatment," said a circular after yesterday's meeting.
>
> The same day the Beijing municipal government announced a 338 billion Yuan (HK$424.2 billion) investment outlay to construct 126 projects including subways, roads, heating facilities and water and waste treatment centres. Of that, 130 billion Yuan is expected to be private capital, the Beijing municipal development and reform commission said.
>
> The introduction of private capital is a 'breakthrough in deepening reform', Yang Xuhui, an official with the commission, was quoted by Xinhua as saying. The government will grant private investors "a reasonable return" through service purchases, financial subsidies and other measures, he said.
>
> Xu Shaoshi, head of the National Development and Reform Commission (NDRC), told Xinhua that a slew of projects would be launched as part of the policy to boost private investment."

Environmental Extremists

My example here concerns Whitehaven Coal who, after lengthy delays, have obtained all approvals to proceed with their $800 million Maules Creek Mine (these delays and conditions have already saddled the company with additional costs of $4 per tonne).

Having got this far, they are now obstructed with claims from an extreme environmental group who have used the *Environmental Protection Biodiversity Conservation Act*, 1999 to challenge the Federal Environment Minister's decision to approve the mine.

Whitehaven has said that it will push ahead with the development, saying that the 'mere commencement' of litigation did not prevent the company from relying on federal government approval to proceed with construction of the mine.

This sort of nonsense makes you wonder if there is anything such thing as property rights in Australia.

If you think my comments are a little pessimistic for our nation's future, let me refer you to an article by well respected mining leader, Julian Malnic which appeared in the *Australian Financial Review* on 6 August 2013 under the heading 'Corruption has trashed NSW for miners' http://www.afr.com/p/opinion/corruption_has_trashed_nsw_for_miners_VnHPgJ6w7w5KkQGh28QUGN [subscription required]

Australian Productivity

Now there are some sobering messages for this downturn for Australia and this topic is covered in detail here http://mannkal.org/downloads/submissions/sub20130708c.pdf
This summarises a three part Productivity and Competitiveness study.

In Australia today it's impossible to blame one single cause or problem when you have the whole orchestra playing against you, including:

- Government.
- Weak management.
- Labour Unions.
- Environmental extremists.

Concluding Comments

To return to the title of my talk tonight, is the Australian mining boom over? Almost certainly, the peak of the Capital Expenditure (CAPEX) boom is over but the boom for the restructuring and productivity experts is about to begin.

Are the prospects for recovery as bad as I have been making them out? Yes, for the reasons we have just examined in terms of flexibility, excessive regulation, environmental activism and loss of productivity. Things are perhaps marginally less gloomy in Western Australia. Even without deregulation and flexibility, we will muddle on, living off the benefits of the oil and gas projects of more than $120 billion and mining projects of $55 billion—all either under construction or committed in Western Australia.

As the construction teams move out, they will be replaced by the thousands of operators and contractors whose challenge will be to bring profitability to the over-budget projects in an effort to pacify angry shareholders who are starting to demand dividends.

If Western Australia were a separate country, it would rank among the world's top 40 economies measured by GDP, roughly equivalent to Egypt, Portugal or Israel. However, my frustration, as a participant and writer of our mining history, is that we will never attain our true potential unless we overcome the four 'diseases' infecting the resource sector, namely:

- Overbearing governments
- Weak management
- Rampant labour unions
- Environmental extremists

Nevertheless, opportunities will continue to be thrown up during the current turmoil but only for those of us who are prepared to adapt and learn to enjoy constant change.

As I have already suggested, the secret to success for the immediate future will be to become adaptable and flexible!