

GOLD IN 2010: KEY CHALLENGES AND OPPORTUNITIES

Outline of an address by Bobby Godsell, CEO, AngloGold Ashanti Limited
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In contemplating what the gold industry may look like in at the end of the first decade of this new millennium I want to think about the challenges and opportunities facing gold miners in three key areas: **markets**, **operational issues**, and our **social license to operate**.

MARKETS

The macro circumstances of gold markets are more encouraging than they have been anytime in the last fifteen years.

I am convinced that future economic historians will see the last decade of the nineteenth century as highly unusual, and indeed aberrant. It was a decade of the imperial US dollar. Every person, institution and country that had funds to invest unquestionably placed these in US dollar denominated instruments. In a post cold war era the United States acquired the status of imperial Rome. To its unquestionable status as the world's only super power was added an economy which appeared to defy the laws of economic gravity. The information age was claimed to have introduced a new productivity revolution. US equity markets soared and PE ratios climbed to unprecedented heights. Then came the dotcom revolution. Any internet idea, or even a dot.com address, could raise hundreds of millions of dollars in an IPO without even the most rudimentary of business plans.

In capital markets dominated by a triumphant dollar the allure of all of the dollar's investment destinations paled. In particular hard assets were banished to the very fringes of investment consciousness. Then when the gold inventories of central banks and international institutions became the focus of selling concern, the obituaries for the gold industry came fast and furious. If there were to be a competition for the most clichéd newspaper headline of the period surely this must be "*gold has lost its glitter*".

The first decade of the new millennium looks very different.

We now live in an era of the weak US dollar. Whilst market commentators are indeed divided as to where the dollar is likely to trade over the next few years I see no one predicting a return to parity with the Euro, let alone those heady days of **82 US cents** to the Euro, even though the Euro itself is by no means a self-evidently "strong currency". Indeed now it is the dollar that is the subject of rumour and concern about central bank reserve allocation. Who would have thought that an announcement by the central bank of South Korea of their intention to diversify foreign exchange

reserves away from their concentrated holdings of US dollars would have been able to weaken the US dollar by 1.5% against the euro in one day? Perhaps the headline we need now is has the greenback lost its crispness?

Concerns about US trade and fiscal deficits are centre stage. Stock prices increasingly reflect future expected earnings. These earnings in turn reflect no assumption of divinely determined (and provided) growth at high double digit rates. It is a very different world.

And it is a very different world for gold. Throughout history mankind has seen gold as a store of value. This side of heaven, all judgements of value are comparative. Will property retain its value better than bonds or cash or equities? The implicit assumption of the 1990's was that gold was losing its value compared to other categories of wealth.

The United States is unquestionably the world's only super power. However if it is a latter day Roman Empire it resembles that empire during one of its more troubled periods of history. Pax Americana is proving both difficult and costly to sustain and enforce.

And if America's new expansionist foreign policy is being tested, then the centre of world economic gravity has also changed. What the dot.com was to the nineteen nineties, **China** has become to the first decade of the new millennium. And indeed the Asian economic challenge to both America and Europe has now moved beyond the mere export of manufactured goods. The economic boom in China is currently both driving commodity prices and consumable shortages, as is the merging boom in **India**.

And this in turn has extended the Asian challenge into the services sector. The dramatic growth in **business process outsourcing** is seeing a new international division of labour.

In this context the comparison between the US dollar itself, dollar denominated bond and equity instruments, and non US dollar investment categories has changed profoundly.

This is certainly good news for gold.

In investment terms the gold market occupies a very small space. It requires only very modest changes in market participation and market perception for investment sentiment to move gold prices. In the mid 1990's we saw the impact of negative sentiment. Today we see a growing desire of existing holders to add to their gold exposure; and individuals, institutions, hedge funds and the like who previously had no exposure to gold are entering this market.

One measure of this increased interest in gold is evident in the very positive response of the market to the new gold security or ETF. This new investment instrument launched in separate products here in Australia, in the US, the UK and in South Africa has seen some **230 tonnes** of gold find new owners.

Equally indicative is the move to a consistently (and significantly) net long position on gold exchanges, particularly the New York COMEX. COMEX has been net long gold almost continuously now for four years, and the net long position during 2004 exceeded a level of **600 tonnes** of gold positions for over two months of that year.

The perception that gold will trade as least as well as the dollar itself and dollar denominated bonds and equities is crucial. This perception causes holders to retain or extend their holding rather than diminish or exit the metal. This has profound significance not only for central bank and international institutions holdings, but indeed for all gold holders.

Relatively healthy **physical demand**

If investment demand has so often set the ceiling for gold, physical demand in general and jewellery demand in particular continues to provide a floor. And there are encouraging indications in regard to this demand.

Gold jewellery is most clearly a discretionary purchase. Particularly in the world east of Athens jewellery demand has been very price sensitive. This makes sense for jewellery sold by gold content, and sold together with a repurchase guarantee. Therefore it was to be expected that as gold prices rose so Asian jewellery demand declined. Though it is early days yet there are indications that reasonably healthy levels of Asia demand are returning at current prices. And as Asian economies grow their level of discretionary spending will also grow. This is not to say that physical demand is without its threats.

Over thirty years and more during which Peter Drucker has been writing about business, one belief has remained unaltered. This is the belief that businesses exist in the first instance to meet customer demands. Without customers there can be no business. For gold producers the dominant, if not exclusive, customer during the 150 years of gold as a monetary standard was the worlds' central banks. Today Central Banks are sellers not buyers. Gold is moving from public to private hands.

Human beings have displayed an affinity for gold that has been constant throughout 5,000 years of recorded history. Gold jewellery is nevertheless a product that must compete in the market place against all the other modern forms of discretionary spending. Both East and West of Athens this means that gold jewellery will need a competitive renewal in design, manufacture and retail offering. AngloGold Ashanti has been engaged in exploratory activities in downstream jewellery. From what we have learnt we are convinced that this sector can be reinvigorated. With the right partners we're determined to do what we can to help bring this about.'

Supply side limits

There is a third fundamental parameter of gold markets which suggests good times for gold. The **de-regulation** of gold markets and the gold price which occurred during

the 1970's lead both to the re-opening of old mines, and a surge in gold prospecting. The application of **heap leach** recovery technologies also made previously uneconomic ore bodies viable. Together these factors saw the production of newly mined gold rise from some 25 million ounces a year to some 75 million ounces over the fifteen year period 1985 to 2000. Whilst new discoveries of gold are inherently unpredictable nobody is suggesting that growth in new mine production can continue at this level. Indeed a prudent view of future production trends would suggest mine production **either flat or modestly declining** in the medium term, and certainly declining in the longer term as the world's major gold provinces reach maturity. This is good news for the gold price. It also poses a fundamental challenge for gold producers, and for AngloGold Ashanti it provides the challenge to grow our market share within the context of a diminishing market. This is a challenge I'll return to when I discuss the exploration challenge and the social licence to mine.

OPERATIONAL CHALLENGES

In this very rosy picture for gold markets there are some very acute challenges for gold producers.

The first challenge is that of operating margins and financial returns. Notwithstanding the stronger gold market over the past year, the frustration for gold investors has been the constant or shrinking margins amongst gold producers. Thus while gold equities always retain optionality to the gold price, the fact remains that managers also have to run a real business, in which profits are generated, rather than simply the promise of leverage to future price strength or potential volume growth. Shareholders need to be rewarded both today and tomorrow. This simple truth is one which Australian gold investors have always demanded of Australian gold companies.

There seems every reason to believe that the dollar gold price will trade in a range of \$400 to \$500 for the foreseeable future and maybe even move higher. This gold price view is a strong encouragement to gold producers to hedge less and achieve greater exposure to spot prices. Over the last three years AngloGold Ashanti has taken some **12 million ounces** out of its hedge book. In a recent restructure we have ensured that the large majority of production this year and next will be exposed to spot. We will continue to deliver into forward sales contracts and look for opportunities to expand our exposure to spot.

However higher gold prices do not automatically translate into better margins for at least two other important reasons.

Firstly many of the very forces driving gold prices up are also driving mining costs up. Pre-eminent amongst these of course is the **oil price**. Open pit mining in particular is oil price intensive.

And the drivers of world economic growth, especially in China, also have cost consequences for mining. Across the globe **contract miners** are pressing for contract increases in the realms 20%, 30% and even 40%. Physical constraints are also

emerging, in particularly open pit mining, and plant expansion projects. We are seeing quantum increases in the price of other fundamentals such as **steel**. The construction boom is also putting pressure on both the availability and cost of **construction people**.

All of this is seeing real cost pressures on gold producers worldwide. Outside of dollar denominated gold production the weakness of the US dollar is seeing exchange related margin pressures for producers in Australia, South Africa, Brazil, Argentina and the like.

Unless producers can manage costs down the price good times will not translate into margins and earnings. At AngloGold Ashanti we have taken **US \$50 million** out of our costs last year. This year we plan at least another \$50 million. We have just launched a renewed and extended cost review in the light of what now seem certain to be continued margin pressure, given the range factors I've outlined.

In the short term costs can be cut and deferred. In the long haul unless activity can be made more effective and efficient the benefits of cost reduction exercises will be short lived. In AngloGold Ashanti in this regard our drive is for a culture of continuous improvement to maintain margins. Critically we seek better technologies and the smart use of people.

On the technology front our long experience in deep underground mining has produced challenges which had led in turn to new technology benefits.

The **seismic monitoring** systems developed from our constant involvement in seismicity and now marketed through **Integrated Seismic Systems Pacific** (here in Australia) and ISSI elsewhere is an example. The lessons we have learnt about mining in seismically active geology has lead to a significant reduction in accidents and injuries from this source. As other mines go deeper this technology will have wider application. ISSI and ISSP are also looking at seismic systems as early warning devices for high wall failures in open pits.

Equally our experience with **ventilation and cooling** at depth will also have wider application. We expect both productivity and safety improvements at Ghana's Obuasi mine at existing depths of mining, let alone in the prospect of mining yet deeper in this substantial ore body.

All mining stands to benefit from both the more extensive and creative application of information technologies. The old/new economy divide is a deep conceptual error. The ability to collect, manipulate and apply vast amounts of information in real time and on a highly dispersed basis has significant productivity implications for mining both open pit and underground. We have projects to get smart about **underground transport systems**. The applications for cost and inventory management systems are huge.

Here in Australia, at our **Sunrise Dam** operation, we have pioneered the use of

handheld **IPAQ's** for the purposes of real-time geological mapping, so that data can be updated in the field to continuously improve and refine the mining process and maximize the benefit of geological information. In addition to this direct interface between a handheld device and our Vulcan mine planning software, handheld pc's are used by ore spotters in the pit to record ore truck destination and loading data, with this information being downloaded into the Mine Production Reporting System. With the integration of GPS technology and the MPRS database, geologists, pit technicians and supervisors are now able to carry with them the latest electronic plan or ore blocks to be mined and any associated grade control data. This is a powerful example of the interface between cutting edge technology and best practices in open pit mining, one which has been developed and innovated on the ground by our local management team, and now can be applied across our global business.

Thus a critical challenge in regard to achieving operational excellence is our ability to attract the brightest and the best into an industry which one of my Australian colleagues pithily pointed out has more laptops than shovels. I am delighted to tell you that both this year and last saw South Africa's two mining engineering departments receive their highest first year intake ever. At the University of the Witwatersrand some 150 first years registered this year. Mining schools elsewhere are under threat, particularly in the U.S and Europe. We need to restore mining worldwide to being a career of challenge, opportunity and community pride. Without the best people we will not meet the challenges posed by rising costs and ageing and diminishing ore bodies.

This brings me to my last operational challenge.

This is the challenge to find tomorrow's production ounces. Greenfields exploration results over the last decade or so have been modest to say the least, although within this context, the achievements of Australian explorationists globally have been significant. The challenge of greenfields exploration is premised on the reality that gold is a **precious** metal because it is **scarce**. Its supply has been both erratic and inadequate, throughout history. This, at least in my view, is why it has never been extensively used as money in the form of everyday coinage, though it has always been a store of value, with monetary application. There are just three things I'd like to note on the challenge of finding tomorrow's gold ounces.

Firstly and most logically most new gold is likely to be found in the least explored but still prospective parts of the world. By their very nature these are also often countries and regions in the middle of political transition at best, political uncertainty and trouble at worst. The capacity of mining companies both to explore and to produce gold in politically, economically and socially **high risk countries** will be a key competitive advantage in the early decades of our new millennium.

Second, likely in the future as in the past, new ore bodies will be discovered often by **local, junior or mid tier companies**. Gold majors will benefit from such discoveries by providing the source of both capital and technology needed to turn gold resources

into reserves and reserves into profitable production ounces. It is not easy to frame a mutually beneficial relationship between gold companies of a very different character, size and nature. This ability to find the right fit will be a key competitive advantage.

Third, those companies that seek to marry both exploration activity with intellectual excellence and cutting edge technology, and of course the brightest and best people, are likely to be most successful in finding ore bodies and or forging relationships with others who have found the ounces.

TOWARDS A SOCIAL LICENSE TO OPERATE

In thinking about the gold industry in 2010 my third area of both challenge and opportunity is generic to capitalist enterprise as a whole, and certainly does not derive from the particular character of the gold mining industry, although this again is an area in which we should aspire to lead rather than to follow. As someone remarked some years after the fall of the Berlin wall, *“if we’ve won, why doesn’t it feel better”*.

Certainly the 1980s saw a definitive end to the socialist experiment of some generations. Nobody makes the case today for command economics. Yet the 1990s have not seen the ushering in of a triumphant and confident new era of capitalism. We have not yet experienced the end of history. Quite the reverse. We live under the shadow of **Enron, WorldCom, Parlatam**. The vivid images are of CEOs in handcuffs and of names such as Hank Greenberg moving from the business hall of fame to its wall of shame. Indeed in my thirty years in business I cannot recall a time when the moral character of business was so under attack.

Clearly gold mining is in no way exempt from this attack. The attack is multi-faceted. One core element of this is whether businesses can be run honestly. The line between honest entrepreneur and tainted crook is now dangerously thin. A second, perhaps equally important area of attack examines the impact of business on both society and environment. Gold mining will need to meet these challenges effectively if it is to be a credible avenue for wealth creation in 2010.

In AngloGold we recently spent some time, most especially with our managers and employees, examining the kind of company we wanted to be. We agreed a handful of simple values, which characterise the way we go about our business and we hope will position us well if the 21st century is indeed to be the age of ethical investment.

Our very first value, and necessarily so, says that our job is to earn **competitive rates of return** for our investors. It seems to me important to assert this. Wealth creation is our fundamental purpose. We are here to generate **profits**. We are here to take 100 units of investment money and over time turn this into 110 or 115 units. This is the truth of the parable of the talents. It is the miracle of market economics. Without this pattern of wealth creation a good society and a stable but vibrant polity are not possible. Without this market place reality in particular the Millennium Development Goals adopted by the United Nations at the dawn of this new age will not be achieved. It is vigorous, market driven economic growth alone which will enable

developed societies to meet and overcome the very significant structural challenges that demography pose them. It is just this growth that alone can lift developing economies out of crippling degrees of poverty.

We need to do this. Do it well. And be proud of doing it.

A second value is that we conduct our business with **honesty and integrity**. These are pretty simple words. They are the words that make wealth creation sustainable over time. The tragedy of Enron was not just that senior management people lied. They built a huge company on a house of cards. They were doomed to fail and this resulted in innocent employees losing both their jobs and life savings. More so than the growing regulation that businesses now face in the post-Enron world, and understandably so, it is the honesty and integrity of people in business that will determine the success and sustainability of the wealth creation machine.

A third value is that we offer our employees **team work, freedom and accountability**, the opportunity to **grow their skills and competency**. We want employees who are literally the gear box that converts capital and technology into wealth creation.

We commit to a **safe and healthy workplace** and impose a duty to this end on every manager and every employee.

We commit to work in an **environmentally responsible** way. Some think this is a particularly difficult challenge for mining companies to accept. I beg to differ. Mining activity is a foreseeable, indeed planned process, from the earliest aspect of exploration to the last steps of rehabilitation. It is both possible and indeed generally required that each step should be planned and the environmental impact of each anticipated and managed. Urbanization and tourism in contrast offer generally less opportunity to plan, foresee and manage environmental consequences.

Finally we make the bold claim that **communities should be better off for our having been there**. The claim is bold because each ore body and therefore each mine is by definition finite. The time will come when mining ends. That said most mines operate over a period of years, and some over decades. We have two mines which have been in continuous operation for over 100 years. I would think that the average life of a gold mine well exceeds the track record of dot.coms or indeed venture capital businesses more generally.

The commitment though does involve a willingness to be part of the community in which we operate during the mining period, and to aspire to leave a legacy that does leave the community better off. Companies cannot (and indeed should not) assume the role of either provider or decider for a community. They are but one (corporate) citizen amongst many others. Companies require a certain social context if they are to operate successfully and profitably. They require the support of communities in particular ways. For example they need safety and security, the rule of law, effective infrastructure, political stability, an educated workforce. In return they can contribute

to the economic and social development of that community in many ways. I certainly believe that in AngloGoldAshanti we are acting in a way to support our claim in the 21 communities in which our mines operate.

IN CONCLUSION

Thus as we look at the gold industry in 2010, the opportunities outweigh the challenges. Our collective responsibilities are clear and our ability to shape the future, to be at the cutting edge of all aspects of the wealth creation machine, is well within our grasp. This is what for me makes this an enviable business to be in.

Thank you.