

South African Power Cuts Affect Precious Metal Markets Future

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The South African government will give state-owned power utility, Eskom, R80 billion in funding it was announced in the annual budget on 20th February to help it boost electricity generation. Since then it is clear that Eskom will be able to access the needed total funding of well over R300 billion [\$37.5 billion] to expand capacity. Since then Eskom has confirmed that it needs to see South Africans cut power demand by 10% for the next few years. At the moment the main city of South Africa is suffering power outages every second day for between 1 and 3 hours at a time. It has recommended too that expansion plans for the mines, smelters in the country, housing projects and new ventures be curtailed until Eskom can guarantee the needed electricity to operate them. It expects power cuts to continue until at least 2013. So that one on the outside can gain some perspective of the problem and how it will be handled in the future, it would be good to see just how such a SNAFU could have happened.

More than 10 years ago there was excess power capacity in Eskom's hands, but it foresaw that this would be taken up and growth would be accommodated easily, but there would be a requirement for one power station a year thereafter. But the company falls under the Department of Minerals and Energy. It requested funding, so we are told, but was refused it on the basis that Eskom had too much capacity and too many well paid engineers. So the excess power capacity was mothballed expansion was halted. Even maintenance was cut to the minimum. Well, as we know from the man who fell off the 50 story building said as he passed the 12th floor, "Sofar, so good", all was not well!



The one day late in 2007 power was cut and the story came out much to the embarrassment of all in government and all in Eskom [Just as the top echelons were awarding themselves shares and incredible bonuses and salary increases.] The government tried to put a good spin on it, and said the crisis could be contained, by Eskom recently announcing that it would have to change its tune, it was far worse than they thought.

Then one saw the Minister of Finance pleading that Electricity prices had to go up 53% or 100% next year. With the damage scheduled to go on until 2013 and the country being taken off the good investment list, R30 billion worth of government stock has been sold sucking out the [carry trade investments] 'hot money' that has enjoyed a strengthening Rand and very high interest rates of over 13%. The Rand then fell from R6.8 :\$1 to R8.2:\$1 in a matter of weeks.

Given that South Africa continues to have a high trade deficit that is unlikely to slow, the Governor of the Reserve Bank is in a muck sweat. He has warned South Africans to tighten their belts. He had to weigh up the negatives of imposing Exchange Controls on this departing money with the future needs for foreign capital against each other. The money then flooded out.

Just below 10,000 jobs were going to be cut if Eskom didn't play it right, so Eskom decided that household supply was more important than mining supply, until it was realized in the mining industry, in particular the gold sector would definitely have to shed jobs if this was done. The deep gold mines need half their power to light and cool the mines to make work conditions bearable or they would have to close shafts for safety reasons if they only got 90%.



Mining executives have pointed out that cuts in electrical power have a non-linear effect on gold mines. The typical deep level gold mine allocates roughly 50% of its electrical feed to refrigeration, ventilation and pumping. These facilities need to run at 100% before men can be put down the shafts, meaning that a 10% cut in overall electrical feed to a mine would in fact translate into a 20% cut in the balance of the mine's power usage. It was not so bad in the coal mining industry and in Platinum mining where the mines are relatively shallow.

Eventually after some heavy duty negotiations, the government decided to supply shallow mining industries with only 90% of their previous requirements [as they could cut back a fair way] and to supply the deep level mines with 95% of their needs, allowing production close to previous levels to resume again.

Then Gold Fields was able to halve the job cuts it was planning to 3 450 once Eskom increased the proportion of the group's normal energy consumption from 90% to 95%. Gold Fields said the power increase would allow the group to increase output and resume the extension of its Driefontein number nine shaft, which was halted after the power cutback.

The cutbacks will last until at least 2012. Meanwhile wanting to reduce dependence on Eskom, most large power consumers are talking to electricity machinery companies and have even had offers from suppliers who will finance build and install power generation of large sizes. The process is slow and the same problems that caused the problems are still in sway on the applications and contracting of new supplies. The safest concept clearly is that these consumers have in backup a constant 30% of their requirements on tap and even for sale to Eskom. Eskom has put out to tender power generation of up to 3,500 Megawatts.

It is pretty clear that gold production will hold at present levels or drop alongside the ongoing impact of Eskom's problems. But in Platinum there are more economies that can be made so receiving 90% of electricity supply is not a large problem. They should maintain production, but find it more difficult to expand in the short-term. If Eskom fails to show the needed competence, the future of South African growth is bleak. However, South African miners are survivors and have a history of beating local problems, so we would expect them to supply themselves and lower their vulnerability to the state.

The Worst Picture – Already Known & Discounted

- ❑ Gold Fields, which employs 53,000 people, could have to lay off 6,900 employees and contractors in its plans.
- ❑ Gold Fields will spend R200m installing back-up power generation on-site by the end of 2008 to ensure the safety of its workers. We expected to see a far greater development of its own power to enable greater production.
- ❑ Gold Fields has said its South African gold production for the March quarter will be 20 to 25% lower than that for the December quarter, while the June quarter's production will be 15-20% lower.
- ❑ At Driefontein, Gold Fields suspended its R5.4bn, decade-long depth extension plans in favour of its South Deep projects. The extension would have needed 110 megawatts (MW) of power and, importantly, a guarantee from Eskom that this power would be available. March quarter production at Driefontein is forecast to be 1,500 kg lower at 5,900 kg, with total cash costs rising to R116,250/kg from R94,390/kg in the December quarter. The week-long shutdown in January accounts for the bulk of the reduction in output. From the June quarter, steady state production should be 6,800 kg per quarter going forward, with cash costs forecast at R102,150/kg.
- ❑ At Kloof, where Number 3 and 8 Shafts, will be mothballed, March quarter production will fall by 1,700kg to 5,450 kg and cash costs will rise R115,200/kg from R91,029/kg in the December period. Kloof's steady state production from the June quarter will be 5,910 kg per quarter with cash costs of R104,061/kg. Gold Fields has asked Eskom for a special exemption for Kloof mine to draw more power.
- ❑ At South Deep, where conventional mining has stopped because of geological conditions, March quarter production will fall by 700 kg to 1,400 kg and cash costs vault to R237,200/kg from R147,719/kg. From the June quarter, production should fall by 860kg to approximately 1,200kg at cash costs of approximately R250,000/kg. Gold Fields will spend R1bn a year for the next five years at South Deep as it develops the mine, said Goodlace.
- ❑ Beatrix Gold Mine is expected to decline by 1,004kg to approximately 2,644kg and total cash costs may increase from R108,058/kg to R150,908/kg. Steady state sustainable production from the June 2008 quarter and onwards should increase by 35kg to approximately 3,733kg per quarter at cash costs of approximately R108,210/kg.



The Results from South African Mines in 2008-04-07

South African mining share prices have seen precipitous falls lately, but that may well have been overdone. One can see that the “recovery” phase of the mines is going to be more spectacular than foreign precious metals mines, which are not in the same boat. At least this will certainly be true in the first half of 2008. If these share prices based on the continuously increasing Rand prices for the metals alongside the continuing high \$ prices of the metals themselves don't reflect the better

results in dividends then you do have a case of miners keeping digging as long as they can as opposed to those with the Shareholder interests at heart.

In a nutshell, we believe that reports on the first half of 2008 of South African Gold mines are going to be spectacular!

Furthermore, we believe that this next half year will provide the numbers on which to base the South African gold mining companies' future. We expect a highly profitable half due to these measures, which should give confidence in them. Should the companies fail to show excellent figures, we would rate them poorly.

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