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Distressed mines
Brave decisions needed to survive the low price environment

The ongoing low commodity price environment has forced many mining companies into survival mode and is likely to continue to do so for some time. In a low price environment the first reaction is generally to focus on cost and operational optimisation. This is a very effective measure to respond to price pressure and preserve margin and one that should be a continued focus. It also happens to be the option that mining executives feel most comfortable with as it generally fits their own area of expertise and is something they can control. However, every mine has a level below which it simply cannot produce and, at current price levels, the number of mines producing at a loss must be substantial in most commodities.

Producing at a loss is not a good place to be for any mine, but for companies with a strong balance sheet a simple enough strategy is to continue producing at the lowest possible cost and see out the bad times. In fact, some miners are expanding production to lower unit costs through economies of scale to claw back margin. This appears to be a popular response at present, as evidenced by mining production continuing apace despite low prices. The added luxury for those fortunate enough to be in this position is that they may even choose to use the opportunity to add to their portfolio.

Mining companies that find themselves low on cash and high on debt are faced with an altogether different picture. A strategy of hoping for better prices can be fatal as management teams lose control of the situation and creditors and other stakeholders start to drive the agenda. This is already playing itself out with a growing list of mining company liquidations and increasing debt restructurings.

So, once the cost reduction options have run out, what are miners left to do to ensure they preserve value for shareholders? Waking up to the reality of a "lower for longer" scenario, or even a "new normal" is a good start. Thinking long term and being prepared to make brave decisions are the next steps. Management teams have to gain an understanding of key areas that drive decision making in a distressed environment. They need to understand:-

- the real value of the mineral assets. Be realistic and get an independent view;
- what mineral reserves look like at current prices, not the prices we all hope for;
- the skill set within the team. Be honest about the level of expertise and get help from experts where a skills gap exist;
- the implications of putting operations on care and maintenance. Do this while management can still control the process;
- how the situation is impacting staff. Communicate openly with them;
- the creditor profile and their expectations. Get their support early;
- short term cash flow needs. Plan weekly cash flow, daily is even better; and
- how the regulatory environment can provide protection to distressed businesses in the relevant mining jurisdiction.

Once a business finds itself in distress, things can go down-hill fast. Management teams have to adapt quickly and be pro-active in engaging the issues in order to stay in control of the situation. It requires clear vision on what the options are and decisive action to pursue the route that preserves the most value and ensure the best result for all stakeholders.

Mining Indaba 2016

Venmyn Deloitte's Chris de Vries will be arranging meetings at the Waterfront in Cape Town, South Africa, during the Mining Indaba that runs from the 8th to the 11th February 2016. Chris has a corporate finance background and will be available to discuss how to survive the low price environment. If you would like to discuss this topic with him, please email venmyninfo@deloitte.co.za. If you would like to meet with him at a less-formal client event, please contact venmyninfo@deloitte.co.za and we will arrange to invite you to one.

Kind regards,

Chris de Vries