

Companies & Investments

Platinum: At rock bottom

South African platinum shares have underperformed a recovery in the dollar price of the metal by about a fifth so far this year. The lag suggests that a recovery in the equities is possible especially if assistance can be provided by the mines themselves in the form of consistent production and cost control improvements.

The market has already shown a promising uptick. In dollars, the platinum price is 18% higher year to date. And despite the strengthening in the rand against the dollar over that period, the price received for platinum in rand is 12% higher.

Still, there's huge pessimism. Says Simon Kendal in a recent report for Morgan Stanley: "The platinum group metals sector is currently a difficult sector. Economic uncertainty is likely to continue to result in weak demand fundamentals.

This weakness, coupled with industry-wide operating challenges, means we stay nega-

tive on the sector."

Unfortunately, production growth and cost controls are not features easily associated with the likes of Impala Platinum (Implats) and Anglo American Platinum (Amplats) lately. One analyst estimates SA's platinum counters won't contain costs lower than 4% or 5% above CPI this year.

The outcome of this assessment is that while the worst may be over for platinum stocks, they will bump along the bottom for most of this year. Yet in these particularly dark days for platinum shares, it's perhaps worth asking whether there's a means of playing the sector.

Broadly speaking, there are short-term platinum opportunities, such as Implats, which has defensive characteristics, and medium- to longer-term prospects – those shares with production growth potential such as Amplats and Northam Platinum. Production growth lowers unit costs. The risk is the track-record, however: real production growth has been very hard to achieve for platinum miners.

Production at our platinum miners, however, has been hammered by the well-documented section 54 safety stoppages, as well as industrial action.

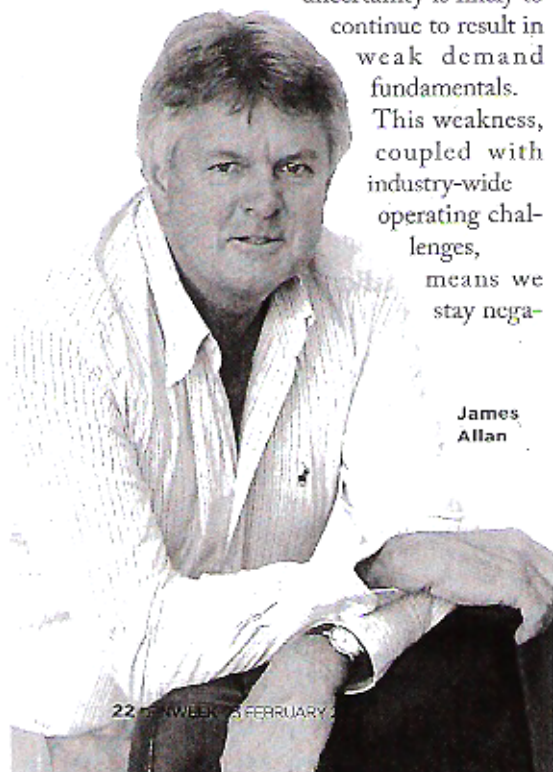
According to one analyst, it would be unrealistic to expect Government's mineral resources department (DMR) to soften its stance on stoppages, especially those related to fatalities, although a task team comprising Government and industry representatives may look at more judicious ways of enforcing stoppages. For instance, one compromise is to stop non-localised shutdowns of mining areas – those not directly connected with the accident –

which Amplats chairperson, Cynthia Carroll, estimated cost her company 100 000 oz in the last financial year.

Production has also been struck by strikes, the most recent at Implats's lease area in Rustenberg. Analysts estimate the company will lose about three weeks of production from the mine – about 80 000 oz of output or, astonishingly, R1.7bn to R1.8bn. Some of the lost production will be offset by use of metal held in inventory. Implats was due to report its interim results at the time of writing, but it's expected to guide second half production down to 850 000 oz to 915 000 oz at the lease area which, incidentally, accounts for about half of total group production.

It isn't alone. Lonmin and Royal Bafokeng Platinum (RB Plats) have both struggled with industrial relations, the latter losing nearly 4 000 4E (four elements of PGMs) ounces of production and earning a downgrade from Morgan Stanley.

Amplats struggled to meet its production target of 2.6m oz for its 2011 financial year courtesy of metal in inventories. Aquarius Platinum is also unlikely to see production growth from its Everest expansion as quickly as forecast. "Aquarius is cautious



James Allan

Platinum



SOURCE: McGraw-Hill IFA

about the short- and long-term production outlook in both South African and Zimbabwean operations due to widespread section 54 stoppages and increased regulatory oversights," stated BMO in a recent report.

Against this background, here's a best effort guess at what to think of SA's most prominent platinum stocks.

IMPLATS:

By the time you read this, Implats will have adjusted its guidance on second half platinum production, possibly down by 60 000 oz from its lease area. Full-year earnings could be hit by as much as a fifth. But since it reacts the least to spot prices, it's the most defensive of our platinum stocks. Its exposure to Zimbabwean platinum reserves is not really in the stock, so the downside of negative news relating to indigenisation is not likely to knock the share. Current CEO David Brown is leaving the company in June. Although an extremely sound manager, he's being replaced by Metorex's Terence Goodlace, who's highly regarded for his meticulous operational nous.

NORTHAM PLATINUM:

It's all about the company's project team. Without its two growth projects, Zondereinde and the R3.9bn Booyendal UG2 project, Northam is ex growth. If the team can deliver on project schedules and stay within capex – it's fully funded – then Northam will have achieved a first in the SA platinum sector of near painless growth. There's difficult geology at Zondereinde. A crucial year. One last observation, Kazakh company ENRC has a board seat and a minority shareholding which could presage a takeover at some future point.

AMPLATS:

The gnawing problem at Amplats – once called "The Big A" by Aquarius Platinum CEO, Stuart Murray – is that roughly half of its production is mined from the western limb of the Bushveld near Rustenburg, where the local Mines Inspectorate's newly established office has been handing out work stoppages like fliers at a

set of traffic lights. So it's most exposed to regulatory risk of all of SA's platinum miners. Much turns on ramping up production at Mokgalakwena on the eastern limb of the Bushveld and Unki in Zimbabwe. Ominously, Amplats CEO, Neville Nicolau, seems to be battering down the hatchets. He recently announced a R1bn cut in capital spending to R8bn and lower sales of 2.5m oz to 2.6m oz compared to initial estimates of 2.7m ounces. Worth avoiding.

ANOORAG RESOURCES:

The company that can't fail? Anglo Platinum helped create Anoorag by selling its assets back in 2009 that ultimately had to be repriced several times. In its latest financial engineering exercise, Anglo Platinum's empowerment gambit now sports a new structure, a new balance sheet and an accelerated project pipeline.

In Dawid Stander, Anoorag's Bokoni Platinum Mines in the northern part of the Bushveld has a mine manager of some repute. The share hasn't responded to the restructuring as one would have thought. Watch and wait.

It has been noted that platinum shares are starting to behave like their gold counterparts where returns are slim and yield is poor to non-existent. Any residual capital is poured into the next hole in the ground in an inexorable race for market share. If that's the case, then platinum shares become the trading instruments of professionals only, not the kind of investment to be putting in the bottom drawer.

But it's a question of perspective. If

platinum shares have hit the bottom, it might be worth stepping in cautiously. Consider the optimism of James Allan, founder of AllanHochreiter, which is standing behind the upcoming listing of Sable Platinum. "We're listing at what we think is the bottom of the market, therefore the timing is brilliant for our shareholders," says Allan. "It makes good sense to get in now and ride the share upwards," he adds.

Sable is also raising exploration finance of some R40m, with Allan hopeful it can be achieved.

That means at least some investors think platinum has long-term potential. It's worth noting that Sable is being formed through a reversal into Newcorp Capital, a cash shell consisting of some R45m that will complement the pre-IPO capital raising.

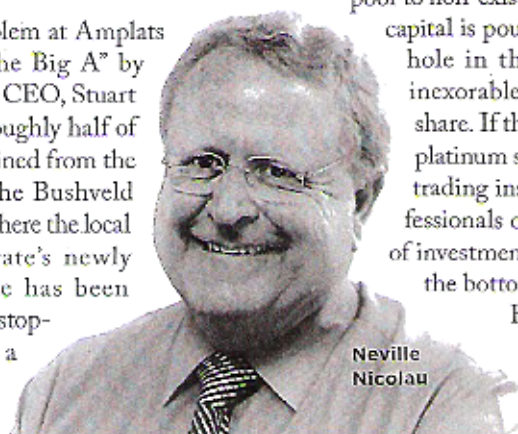
Taking Allan's approach, the only way is up for the platinum shares. But if

you've been in the shares from when the platinum price was trading at \$2 200 in 2007, you can be forgiven a sense of déjà vu. By the end of 2008, the price of platinum was down to \$800/oz. It recovered to around \$1 800 by mid-2011 but has generally been on the slide again amid eurozone debt crises and a sluggish US recovery.

Of course, there's always the view of veteran analyst David Davis, an analyst at Standard Group Securities. Although no longer a platinum analyst, he's an indefatigable student of supply and demand dynamics in precious metals markets. He recommends buying platinum metal in the short term, possibly through an exchange-traded fund. Why, after all, make the stresses of management part of your portfolio when all you want is exposure to renewed industrial demand?

David McKay

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Neville Nicolau