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| Press release |
| Contact person: | Gleb Kostarev | 25 August 2015 |
| Company: | EY |
| Tel.: | + 7 (495) 755 97 00 |
| Email: | Gleb.Kostarev@ru.ey.com |

**Future growth becomes the top business risk for mining and metals companies**

* **Need to cement productivity gains still top three issue**
* **Leverage concerns for mid-tiers and juniors puts access to capital as key risk**
* **Cybersecurity and innovation risks increase**

*SYDNEY, MOSCOW, 25 AUGUST 2015*. Pro-cyclical behavior and short-term focused shareholders have pushed “switch to growth” to the top of EY’s annual ranking of business risks in mining and metals companies globally.

EY’s *Business risks in mining and metals* *2015-2016* report, released today, finds that the lack of investment by miners is shrinking supply pipelines and reducing sustainability of production volumes, which also limits future growth options.

The top 10 business risks for mining and metals companies today, compared to the top 10 in EY’s 2008 report at the peak of the super-cycle, provides a stark contrast to the issues faced now and then, and underlines the cyclical nature of the sector. Just three of the top 10 risks from 2008 rank in the top 10 this year.

EY Global Mining & Metals Leader Mike Elliott says:

“Growth today is undoubtedly fraught with risk and tension, but standing still is not an option. Growth is essential in an industry that diminishes with every tonne or ounce it produces, where value is ultimately destroyed if the pipeline is not replenished.”

The inevitable upturn in the cycle for most commodities is expected in the next few years because of emerging constraints in new supply from lack of exploration and development in recent years, the removal of high-cost supply and the expected continued growth in demand.

However, Elliott says: “Many mining companies risk missing future growth prospects because they are hostage to highly risk-averse investors and, as a result, are focused on short-term cost-cutting and maximizing current returns to shareholders.”

Adding to the threat, new competition is emerging from private capital investors and commodity traders, who may be in stronger strategic and financial positions to make long-term countercyclical investments without the resistance of risk-averse public shareholders.

“Unless mining companies reinvest, they are essentially liquidating their asset base,” says Elliott. “The switch to growth is looming, and assets are now still relatively cheap. Given the long lead time to develop new supply, decisions to invest for future growth have to be made now or long-term returns will be lowered.”

Productivity and access to capital both maintained a top three ranking on the risk list, at number two and three, respectively, each down one spot from last year. New entrants to the top 10 risk list include cybersecurity and innovation.

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| **Top 10 risks** |
| **2015** | **2008 (peak of the super-cycle)** |
| 01 | Switch to growth | 01 | Skills shortage |
| 02 | Productivity improvement | 02 | Industry consolidation |
| 03 | Access to capital | 03 | Infrastructure access |
| 04 | Resource nationalism | 04 | Social license to operate |
| 05 | Social license to operate | 05 | Climate change |
| 06 | Price and currency volatility | 06 | Rising costs |
| 07 | Capital projects | 07 | Pipeline shrinkage |
| 08 | Access to energy | 08 | Resource nationalism  |
| 09 | Cybersecurity | 09 | Access to energy |
| 10 | Innovation | 10 | Increased regulation |

**Productivity remains a focus for CEOs**

During the mining super-cycle, productivity in the sector fell to its lowest rate in 30 years. While most miners moved from outright cost-cutting to productivity improvement measures in 2014, the need for sustainable, enduring productivity improvements is a two-to-three-year transformation.

“Boards and CEOs recognize that regaining lost productivity is critical for long-term return on capital employed – there is still a long way to go in cementing productivity measures in most mining operations,” says Elliott.

While number two in our ranking, productivity will remain the top operational focus of CEOs throughout 2015/2016.

**Access to capital**

Capital raised by the mining industry fell 15% year-on-year in 2014, in part a reflection of the lower appetite for spending by producers, but also a reflection of the challenging market conditions. Most of the debt raised in 2014 went into refinancing, with very little new debt or equity going into the sector.

“Producers are focused on restoring stretched balance sheets and improving profitability through asset sales and capex reductions; distressed mid-tiers are restructuring debt; and juniors are struggling to access the equity needed to sustain their activities,” says Elliott.

Equity raised by junior minors has fallen year-on-year since 2012, with more than half of the issues by junior companies in 2014 raising less than US$1m and about a third of those companies returning to the market more than once to raise additional funds, some as many as 6-8 times.

Elliott says: “Leverage remains a key concern for juniors, particularly in the iron ore and coal sectors, with little prospect of near-term turnaround for smaller, higher-cost producers, and a cumulative US$14b of debt maturing in the next three years in the relatively small US high-yield sector alone.”

“Conditions are arguably ripe in certain sectors of the industry for distressed debt hedge funds looking to take advantage of ‘buy to own’ opportunities.”

“While companies with funding issues often faced limited choices, they need to carefully consider the ramifications on future earnings, true cost, control and future financing to properly understand the true funding costs.”

**Cybersecurity, innovation move into top 10 risk rankings**

The business risks to mining companies from cyber hacking and lack of innovation have both increased to push both issues into the top 10 for the first time.

Cyber hacking in the mining sector has become more widespread and sophisticated – in the EY *Global Information Security Survey 2014,* 65% of mining and metals companies said they had experienced an increase in cyber threats over the past 12 months.

Integration of IT and operations technology (OT) has made miners more vulnerable to cyber hacking, with mining companies more reliant on integrated IT systems as a result of the drive to improve productivity and reduce costs.

Being a victim of any form of cyber attack can cost a mining company millions of dollars in lost production or cause massive reputational damage, by leaking of confidential or sensitive stakeholder information, or by threats to worker safety.

“Cyber attacks are an issue across the mining sector regardless of the size or scale of the business. Mining businesses need to increase their efforts to deal with cybersecurity and it needs to be a board- and CEO-level priority,” says Elliott.

**Innovation key to further productivity gains**

The focus on regaining lost productivity has also brought to the fore the almost complete lack of innovation in the sector, pushing it onto the risk rankings this year.

It is widely accepted that compared to most other industries, there has been minimal transformational innovation in the mining sector. The first automated truck was seen 20 years ago and yet there is still not a complete fleet in existence at a mine anywhere.

Relative to revenue, the mining and metals sector spends 90% less on technology and innovation than the petroleum sector. The oil and gas sector recognizes innovation as the single most important driver of productivity improvement, highlighted by recent innovations in shale and coal seam gas, and floating LNG platforms, all of which have enabled reserves of oil and gas to last much longer than predicted.

“Innovation will be vital to protecting and sustaining margins in the long term, and will be key to maximizing revenues in the future,” concludes Elliott.

**About the report**

EY’s *Business risks in mining and metals 2015-2016* report is based on EY discussions with leading global mining and metals companies, and analysis of the operating environment for companies in the sector. It is EY’s eighth annual report analyzing and ranking the top strategic business risks for companies in the sector. Underlying business risks for mining and metals companies do not vary significantly from year to year, but the acuteness of the issues and its priority can change. While the report does not provide an exhaustive list of the risks facing companies in the sector, it does provide a snapshot of the most significant challenges today. Mining and metals companies that best understand the risk scenarios and potential impacts on their business are better positioned to manage these risks and seize strategic opportunities.

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