A lesson from history
25 May 2010

The world claims that nobody predicted the Global Financial Crisis and the commodity price squeeze which accompanied it. But this is untrue. You might think the GFC is over but with 18 first world countries (including the US and Japan) facing debt defaults, ie bankruptcy, it would be a brave person (or a fool) who believed that boom times were here to stay. Just look at copper as an example. Jul10 Copper fell as much as 19% in May. This is feeding off stockmarkets which are off their (manipulated) high points by 10-15%.

Back in 2007/08 there was almost universal support amongst Economics academics that the situation in the US was unsustainable. There was even one of the regulators, Brooksley Born, who spoke out and was quickly excised. Funny how the media is only bringing this to light now.

Quite apart from this, in August 2007 I gave a presentation where I said that the current resources boom could not go beyond 2009. I must confess I didn't see the end being so rapid but it had to end; history said it would. In February 2008, Leigh Clifford was in the press saying we were at the start of a 50 year super cycle. At this point I knew the end was near. Investment is reducing and the Mining Profits Super Tax will ensure that this continues.

We all know that the mining and resources industry works on a boom-bust mentality. It is possible to track this back to 1846 when copper was officially discovered in South Australia. Australia's first (and greatest) resources boom lasted to 1852/3 after the hoopla of the official discovery of gold in Australia in 1851 died down. We see subsequent resources booms starting in the 1870's, 1890's, 1920's, 1950's, 1970's and 2000's. These are not necessarily stock market booms but rather investment booms and not always mineral resources; in the 1950's we had a wool boom. The average time between booms starting is 25 years and varies between 22 and 28 years. Of significant interest is the fact that they have never run more than 8 years (nor less than 6 years). Consequently, the most recent boom, which did seem to be a particularly strong boom

Head Office
Brisbane Technology Park
Unit 2 / 53 Brandl St
Eight Mile Plains Q 4113
Australia
Ph: +61 7 3147 8300
Fax: +61 7 3147 8305
Email: gbi@gbimining.com
www.gbimining.com

South African Office
8 Corridor Crescent
Building B Ground Floor
Route N4 Business Park
Ben Fleur X11 Witbank 1035
South Africa
Ph: +27 13 6564114
Fax: +27 13 6564114
www.gbimining.com

after a really difficult time in the industry during the 1990's, and which started around 2001/02, couldn't go past 2009/10. In addition, the 2000's boom closely mirrored the 1920's boom which ended in the 1929-1933 stock market crash. In both cases a financial bubble was formed using creative financial products. Don't kid yourselves here. In the 2000's high commodity prices were driven by leverage from the banks; leverage for speculators to push and manipulate prices up and down, and leverage for US households to keep spending and push consumption through the roof. In the 1920's high stock prices and resources speculation were driven by leverage provided by brokers with the support of bankers.

What is my point? Don't believe for one second that investment is going back to boom times. History says it can't before 2023. Add to that the fundamentals which see the US basically bankrupt, a financial system which must keep deleveraging and there is no reason for demand to drive commodity prices up. I believe the masses were being sucked into a financial con by the big (mostly US) banks who are using government borrowings and printed money to create an illusion of recovery to drag Mums and Dads back into the market (many through superannuation) so they could further deleverage the derivative products.

We are therefore left in a "bust" until at least 2023 and possibly until 2029. I have said before, the last bust (1986 – 2001) addressed labour numbers in the mines. Workforces were slashed by 50% and more which increased an illusion of efficiency in terms of output per manyear. This bust will have to address equipment efficiency. Where is there any blood left in the stone? You can't just squeeze more people. For many mines it will be a simple equation; operate more efficiently or die. The new coal and iron ore barons will die and/or be swallowed up by the big players or by Chinese companies. My estimate, again based on history is that at least 70% of current mine owners / companies will be gone by the start of the next boom. You have little choice but to improve efficiency. You might as well start the process now; the pain will be less later. When your company is losing money on every tonne of a commodity going out the gate what owner will allow their equipment assets to be 20%, 30%, 50% below their capability?

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They won't. In the same way, Charles Copeman and Peko Wallsend addressed labour issues at Robe River in 1986 (followed by a raft of less advertised examples across most of the mining industry), this industry will, over the next 10-15 years, address equipment underperformance issues. For some mines which can't or won't that will mean closing.

But surely our mines aren't this bad. Surely, this was also addressed in the previous busts? Well, no it wasn't. In the 1980's we didn't know how badly most of us operated our equipment. We had a feeling that it could be done better but it is only with the advent of complex monitoring systems and the data-warehousing of worldwide data that we now know how inefficient most of the industry is.

If you as an individual and company haven't developed the most important strategic skill – value-adding change, chances are you won't survive in this industry to see the next boom.

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