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Far Eastern Goldfields:

Zijin, Shandong and the Chinese arrival

- Diggers & Dealers preview
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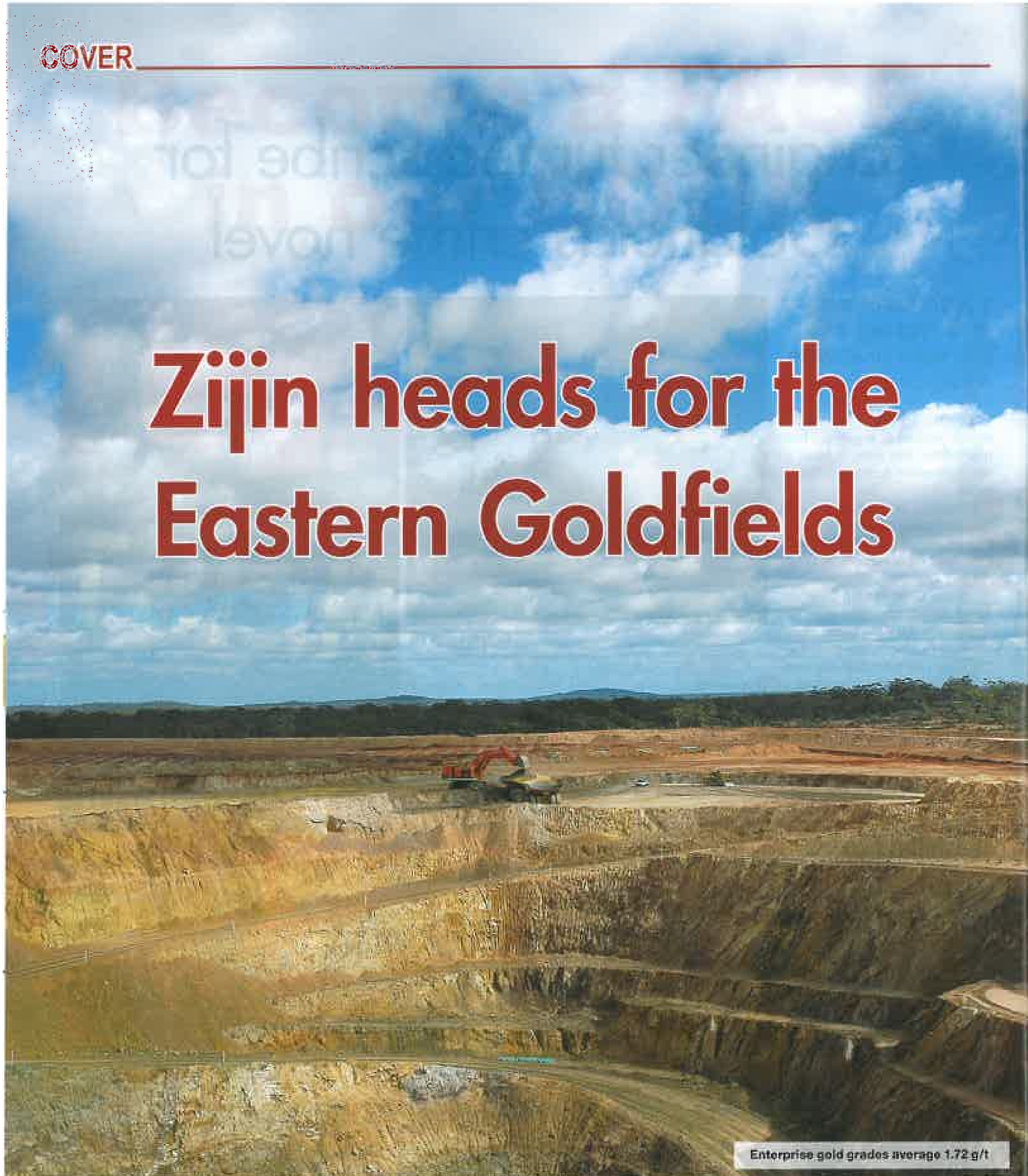
Zijin heads for the Eastern Goldfields



Enterprise gold grades average 1.72 g/t

In Australia's early gold rushes of the 19th Century, Chinese miners arrived in their thousands to work the goldfields of first New South Wales and then Victoria.

During this time they were often targeted by their xenophobic Anglo-Saxon contemporaries, largely because of their willingness to rework gold claims that had been abandoned by European miners because of difficult conditions, low grades and uneconomic profiles.

More than 150 years on, there are the first rumblings of a new wave of Chinese gold miners arriving in Australia to rework its exhausted mines, but this time they are arriving in the form of major state-owned enterprises (SOEs) laden with advanced exploration and engineering skills and balance sheets capable of making an impact on an Australian gold sector shorn of most competition.

As the international majors who moved into Western Australia's Eastern Goldfields in the 1990s grow increasingly tired of mature mines, high labour costs and minimal new discoveries, there is a widespread acceptance that opportunity exists for a new generation of mid-tier players to emerge in the Australian gold sector.

Twelve months ago this seemed likely to come from one of the domestic juniors participating in a round of consolidation. The likes of Silver Lake Resources Ltd, Evolution Mining Ltd, St Barbara Ltd and Regis Resources Ltd have set their sights on hitting the 400-500,000 ozpa group production profile that will elevate them above the madding crowd of junior gold producers and into clear second place behind Australian gold behemoth Newcrest Mining Ltd.

However, there have also been new entrants from the north. In August 2011, China's largest gold producer, Zijin Mining, acquired a controlling stake in Kalgoorlie gold miner Norton Gold Fields Ltd. Then, in September 2012, China's second-largest gold miner, Shandong Gold, acquired a controlling stake in Coolgardie-based producer Focus Minerals Ltd.

The two deals shared many similarities as Norton and Shandong took controlling stakes in established Goldfields miners that had struggled to keep costs down and maintain margins. Both Norton and Focus were in dire need of a capital injection if they were to maintain production profile and increase reserves and with the local market growing increasingly wary of junior gold companies after a string of failures, the offers of investment from China became attractive.

PCF Capital director Trevor Benson worked as Shandong's adviser on the Focus transaction (which has handed it 51% of the Coolgardie miner). He told **Gold Mining Journal** Shandong had spent years designing a strategy for its entry into Australia.

"Shandong wanted to become an international gold miner and was looking solely at Australia and Canada because of the sovereign risk profile," Benson said. "The deal was put together over six months and Shandong visited site at least four times as they looked to build the relationship with the Focus team.

"The rationale is that they're long-term investors with interest in supply. In the short-term the gold price is not a major concern to them. The move for Focus was more about getting a foothold in the region and then growing the business through acquisition.

"In the case of Focus they saw an opportunity to get 51% control. Focus had always been hamstrung by capital markets and the ability to raise money. They were living hand-to-mouth and never really had an opportunity to take a regional approach and look over the horizon and that meant shareholders kept getting diluted."

The Shandong offer saw the Chinese miner take 4.55 billion shares, raising $227.5 million for Focus. It was, Benson said, the cash injection the company needed to fully test the exploration and growth potential of its suite of assets across Coolgardie and Laverton.

However, what the deal also brought Shandong was a portfolio of operations struggling with high operating costs.

"Focus had never been able to get a handle on cash costs but though Shandong saw the large problems they were taking on, they believe their experience in terms of operating gold mines could, over time, realise reductions in cash costs."

Shandong's action has been swift. In its March quarterly report, released on April 30, Focus announced it was stopping mining at its Laverton gold operations. Laverton had been the prize asset in Focus' takeover of Crescent Gold Ltd but with the gold price sliding and the cost of toll treating ore at the nearby Granny Smith mill (owned by Barrick Gold Corp) continuing to weigh on costs, Focus executive chairman Don Taig said the company was left with little choice.

"The long-term outlook for the gold price, campaign nature of processing, and the escalating processing costs we have been faced with over the past six months at the Granny Smith mill made this a necessary decision for us in protecting the value of the Laverton assets for all shareholders," Taig said.

A new era of Chinese gold miners are starting to arrive in Australia

Group cash costs had risen from $1,125/oz in the March 2012 quarter to $1,421/oz in the December quarter and $1,893/oz in the March 2013 quarter.

"The high cost base in the Australian mining industry and rising mining inflation of the past few years has seen all of the reductions and operational improvements we have been delivering continue to be consumed."

Eagle Research managing director and **Gold Mining Journal** columnist Keith Goode believes Shandong was surprised by the cost of production at Laverton.

"I think Shandong have been a bit shocked by their losses at Focus," Goode said. "I think Focus/Shandong's move to close Laverton was because they were sick and tired of the Granny Smith toll and will probably try and renegotiate some of those other royalties there."

In Kalgoorlie, Zijin inherited a similar scenario with Norton and its Paddington gold operation. Paddington C1 cash costs came in at $884/oz in the March 2012 quarter but by the September quarter they were up to $1,377/oz.

However, for March 2013, costs were down to $1,033/oz and Norton managing director Dianmin Chen told **Gold Mining Journal** the company was confident it could drive all-in costs (inclusive of royalties) down from the current $1,400/oz in coming years.

"Since the third quarter of 2012, we have put a lot of effort into implementing our plans," Chen said. "I think we will achieve $1,200/oz all-in costs in two or three years potentially."

The opening of the higher-grade, lower-cost Enterprise mine in May will play a major role in that drive but Chen believes Zijin's own mining experience will weigh just as significantly.

"I think there is expertise that China can bring to Australia. When Zijin looked at Paddington it realised it had good potential but for it to realise that potential production performance would have to improve. Already we are seeing new technology and research and development applied and the integration of Zijin and Norton will continue. In the next few years you will see the technical strengths of Zijin benefit production at Paddington."

Such talk may seem overly confident to Australian gold miners who have witnessed a succession of overseas companies impose their production and management beliefs on the local scene in the past, only to come unstuck and turn back to Australians with experience, but Benson agrees that the Chinese gold miners may have the right kind of expertise to rejuvenate

Tony Crook

Dianmin Chen

Enterprise will be important in containing cash costs at Paddington

tired-looking Eastern Goldfields assets.

"The Chinese are very experienced gold miners and in Zijin and Shandong you have two internationally competitive miners, both producing more than 1 mozpa. And their technical capabilities are very strong.

"I visited Shandong's mine at Yentai in north-east Shandong province and it was remarkable. It is an underground mine producing 300,000 ozpa and at one stage I was 200m under the ocean. The coal industry could be different but in my experience these gold mines are Rolls Royce; it looks more like a hotel than a mine, all the infrastructure was concreted and at one point we were standing on a reclaimed tailings dam that had offices, a car park and a driving range on it. Certainly, they see opportunity in driving down the costs on Australian operations."

Norton Gold Fields managing director Dianmin Chen, Xuelin Cai (non-executive), Anne Bi (non-executive), Federal Member for O'Connor Tony Crook MP, Jinghe Chen (non-executive chairman), Noel White (non-executive) and Paddington general manager Cullum Winn

Chen said Zijin's rise to prominence in the Chinese industry had come on the back of strong technical fundamentals.

"Different companies have different focuses to achieve their financial and economic goals. Zijin are very solid gold miners, not market players. You can see from the backgrounds of the directors that they have high levels of technical capabilities and the technical strength to bring costs down and increase production."

Speaking at the opening of Enterprise – 39km from Norton's Paddington mill – Norton and Zijin chairman Jinghe Chen, who has an academic and corporate background in geology and engineering, said controlling cash costs would always be a focus for Norton at Paddington.

"We expect Norton to be a competitive, low-cost miner. Zijin has a very good cost profile and at current prices we are not worried but for Norton it is slightly more difficult. However, even at $US1,200/oz Norton will be able to continue production and management focused on its own projects and operations. Australia is a high-operating-cost environment, largely because of labour and materials, but in terms of innovation, there are opportunities to bring costs down."

Zijin believes its mining expertise and technical strengths will benefit production at Paddington

Dianmin Chen agrees with his chairman that technology will be a key area of Norton and Zijin's partnership.

"The Chinese companies here are focused primarily on reducing cash costs and lifting productivity but that will be done through technology and research and innovation. Norton has 6 moz in resources but most of our issues are associated with lower grades, therefore we are working with Zijin's research and technology team to understand how we can better utilise that lower-grade material."

The initial moves have involved bringing the 1.72 g/t Enterprise mine on-stream and moving largely to owner-operator on its mines.

"We have also got rid of a lot of equipment rentals and that has helped reduce operating costs further and there are other cost initiatives in place. We try to adopt a culture of reducing costs and that is very important as it has helped us build a different culture and already we have seen a 25% reduction in six months. It has been a good team effort all the way from the corporate office to the frontline team.

"In China's gold industry, much like its iron ore mining industry, they are more careful to utilise the entire resource by using lower cut-offs and so forth. We are looking at new technology to improve the recoveries in heap leach. We are also talking to Australian research and development companies and institutions to develop technology to increase extraction from low-grade orebodies, which will further increase gold production."

> "When Zijin acquired Norton it was its first move overseas and it inevitably takes some time to understand the Australian gold mining culture. This was why I was recruited, to fast-track that understanding. I've been in Australia for 20 years but am still learning the culture and if you think you know it all, you are kidding yourself.

Dianmin Chen has been in Australia for more than 20 years, working for the likes of Rio Tinto Ltd, Barrick Gold Corp and Citic Pacific. As such, he is acutely aware of the differences in Chinese and Australian gold mining cultures.

"When Zijin acquired Norton it was its first move overseas and it inevitably takes some time to understand the Australian gold mining culture. This was why I was recruited, to fast-track that understanding. I've been in Australia for 20 years but am still learning the culture and if you think you know it all, you are kidding yourself.

"You have to balance the team between Australian and Chinese cultures and you can then step over most of the pitfalls that have befallen other companies.

"The culture of the Chinese gold industry is all about how you make money and so it is used to pushing for higher productivity. Zijin is doing quite well on production and cash costs because it is focused on how much money its operations are making, rather than competing to see who can produce the most gold.

In 2-3 years all-in costs at Paddington are forecast to be $1,200/oz gold

"When I first came to Australia, the focus was often on ounces not profits, and quantity over quality, but I think we are seeing that change of emphasis across the global gold industry now."

If Norton and Shandong have set their sights on international expansion, surely their ambitions extend beyond marginal, 100,000 ozpa producers?

Dianmin Chen said Norton had committed itself to exploration in the Eastern Goldfields, a region he believes has been neglected in recent years.

"Our exploration budget is $30 million after we spent more than $20 million last year. We are fully committed to further exploration on these leases. Exploration in the region has been underdone and our focus will be on areas that will give us high-grade resources and reserves and generate good targets prospective for high-grade orebodies."

Benson is in agreement, believing the Chinese firms view the Eastern Goldfields as far from exhausted.

"Exploration-wise they are very skilled and they do see opportunities but it is going to have to make sense regionally. They have a long-term view of the gold industry and will execute that in their exploration strategies."

Jinghe Chen was forthright in his assessment of Zijin's strategy for its Australian interests.

"Norton is an important platform for Zijin's international gold expansion," Jinghe Chen said. "The reason we launched the takeover was because of the quality of the staff and management, the resource and the location in Kalgoorlie, which is an important part of the strategy of becoming a large international gold miner. We will use Paddington as the starting point for Zijin in Australia."

The company has previously been linked with some of Barrick's WA gold assets but Dianmin Chen wouldn't be drawn on the company's exact intentions.

"Norton's strategy has always been in three parts: increase production to 300,000 ozpa in the next three to five years, while at the same time reduce all-in operating costs to $1,200-1,300/oz; increase exploration to increase the resource base; and thirdly intensify M&A activity. Paddington has always been a high-cost operation and we need to improve grade and production performance and M&A will help that."

He said the current weakness in the spot gold price and junior equities meant Norton was in a position of strength when it came to M&A.

"The gold price and share prices are down and that offers opportunity for a company like ours with good financial backing to increase gold production and improve its position.

"We want to fulfil those production and reserve base goals so any M&A needs to strike a balance between early stage assets and later-stage ones that we can bring into production or are already producing. It is important for Norton to acquire good assets.

"We haven't defined any particular areas; we would look anywhere in Australia and are open to any opportunity that is on offer."

Benson believes Shandong is in a similar position and neither company, nor any other Chinese

> **"The culture of the Chinese gold industry is all about how you make money and so it is used to pushing for higher productivity. Zijin is doing quite well on production and cash costs because it is focused on how much money its operations are making, rather than competing to see who can produce the most gold.**

Norton's aim is to increase production to 300,000 ozpa in the next 3-5 years

firm keen to take a stake in the Australian gold sector, will struggle to find prospective partners in the current market.

"There are stacks of companies like Focus with good assets but short on cash, but it is a very different world to six months ago. The gold price has plummeted – although the Aussie dollar has helped – and companies are now running out of cash and the projects are too small to survive on their own. Therefore companies will have to merge, find new ways to raise money or face extinction.

"The likes of Shandong are looking closely at high-quality assets that have good operations – high grade, low cost – and some of these projects will become oversold and therefore cheap."

Benson does not believe, however, that the Chinese gold companies will fall into the trap their compatriots in the iron ore space did a decade ago of paying over the odds for questionable Australian projects.

"They are looking for value. We have Perth companies coming to us every day but people have to be realistic about asset prices."

The problem of unrealistic expectations extends beyond the small-caps.

"The North Americans and the Africans still want too much for their WA assets. They are dreaming and unless they get realistic and acknowledge that the market has changed no one is going to pay 2012 prices for those projects. Look at Newcrest Mining Ltd's recent writedowns."

Cullum Winn, Jinghe Chen and Dianmin Chen at the Enterprise mine opening

Interest from outside the SOEs in China is also burgeoning.

"Because of the Shandong deal we've had many Chinese companies coming to us looking for advice on investment in Australia and they're primarily after gold and copper but also iron ore, nickel and uranium," Benson said. "There are also so many private companies over there and they will possibly take the place of the SOEs as they pull back foreign investment."

Dianmin Chen agrees that Chinese investment in the gold space will continue.

"From an Australian junior perspective, having a good investor from China is only going to help. I think you will see more and more Chinese companies coming in but how fast they learn the game will be key. They need to adopt a strategy suitable to their own company culture.

"The Chinese culture reveres gold and there will always be high demand for it," he said.

– Dominic Piper