

Anglo Khula JUNIOR MINING INITIATIVE, South Africa

A recent independent evaluation done by Emerging Markets Group (EMG) Ltd for the Business Links Challenge Fund, supported by DFID, has recorded the successful development of a funding mechanism for junior mining in South Africa that is commercially sustainable, has significant positive impact on the local communities and the area and a strong potential to contribute to Black Economic Empowerment (BEE).

Despite the fact that junior mining companies can and do play an important economic role in operating smaller mines more profitably than large companies, in South Africa many opportunities are left undeveloped, with huge opportunity costs for both local communities and the South African government. The reason is that the perceived and real risks associated with mining, and the isolated locations of marginal mines, mean banks invariably offer loans on very disadvantageous terms to the entrepreneurs the government is trying to support through its Black Economic Empowerment (BEE) policy.

Mining requires significant capital investment upfront; comprehensive and timely technical inputs for licensing, surveying, addressing environmental and safety issues; skilled labour; and equipment, it is too costly for small and medium size enterprises to start up without access to reasonably priced commercial borrowing mechanisms. Therefore, measures and mechanisms to catalyse the entry of small and medium sized black-owned companies into the mining sector provide unprecedented growth and welfare opportunities for remote and impoverished communities and for the economy.

The Anglo Khula Mining Fund is a joint initiative between Anglo American and Khula Enterprise Finance Ltd, a development finance institution established by the South African Department of Trade and Industry. The fund was formed in March 2003 in recognition of the difficulties junior mining companies face when seeking finance for exploration activities. The fund provides loans at prime interest rate to enterprises that have the potential to become commercially sustainable but find the commercial borrowing rates prohibitive or inaccessible due to lack of credit history. The fund management also recognised that providing initial technical support is crucial, and augmented the funds available by approaching the UK's Department for International Development's Business Linkages Challenge Fund (BLCF). The BLCF provided additional funding for technical assistance.

As part of the fund work, Anglo American set about trying to come up with a working and replicable business model to support the South African Government in unleashing the pent up entrepreneurial spirit to operate profitable marginal mines. A pilot project, Vaalkrantz Colliery, managed by the black owned enterprise Leeuw Mining and Exploration, was selected on the basis that, without the financial and technical support, the entrepreneur's operation would have shut down due to the delayed transfer of funds by a creditor bank. This would have been a huge loss for the local community, which is located in an isolated area with higher than the average unemployment rate and no real alternatives for income generation.

Since the loan was made to the mine in 2004, the mine progress has been impressive. In two years (2005-07), the mine has almost doubled its staff and contractors, 85% of whom are

local people. Production has been steadily increasing and moving closer to the target, while revenues have more than doubled between January and December 2006.

Payments to creditor banks and employees have been made on time since operations started and the cash-flow issues have been resolved. The bridging loans granted by Anglo have now been fully repaid. The relationship built in the process has also resulted in Anglo Coal providing a guarantee for a R39m commercial loan, which is required to build a coal processing plant.

In 2005, the mine entered several inland and export sales contracts, some of them long-term, and revenues have more than doubled in 2006. Most of the product is pre-sold in 3 and 5 year contracts. Approximately 60% of the product is exported, while 40% is sold within South Africa. Despite the difficult geological conditions, a shortage of skilled labour and old equipment, production has been steadily increasing and moving closer to the targets. Investors have showed interest in acquiring shares. At current price and production, the mine will re-pay its obligations and become profitable in 4 years.

This is cause for optimism among the 269 permanent employees and 207 contractors. Female employees number 28, including 6 women working underground. All employees have received technical training, safety training and other skills upgrades, including 5 leadership courses. The number of employees receiving specialised training in 2006 was 143. There are also 5 apprenticeships for local people every year. In addition, the mine supports a health clinic on site with two nurses who attend to the needs of staff and their families, including provision of information and testing for TB, malaria and HIV/AIDS.

Of course, challenges remain. Maintaining the highest health, social and environmental (HSE) standards is the company's highest priority following a period of rapid growth.

In terms of broader impact, the mine's commercial turnaround has had a profound effect. The mine has become a source of steady business for local enterprises – including some specifically created to service the mine as Security and Logistics Companies. The mine also contributes to the local school and to municipal projects. The mine is in an area of high unemployment where the only other major sources of income are timber and agriculture. Mining salaries are on average higher than in both the agricultural and timber sectors while benefits are more extensive (transport, health care, housing allowances, etc.). The increased purchasing power of the population and the regularity and predictability of incomes benefits local vendors, traders and leisure business development.

And while we recognise that funding has been key, it is the ensuing partnership between small and big business that has highlighted the importance of technical and marketing assistance in helping a fledgling business navigate risks and grow towards sustainability. The model also shows how, within a short-period of time and with a limited amount of investment, a small business can become profitable and contribute to the growth of an area. Based on this success, the fund is now supporting new applications.