SA Bullion to make gold ownership easier

David McKay | Thu, 15 Nov 2007 11:24

[miningmx.com] -- THERE have been more lamentations in the sector following another round of poor quarterly results from South Africa's gold companies. Wayne McCurrie, deputy MD of fund management company Momentum, says: "Profits have seriously declined in four years, even though the gold price has been going up. You've got to think this is an industry in decline."

In 2003, the rand price of gold was around R3,300/oz or R105,600/kg. It's currently at R5,500/oz. By comparison, profits from South Africa's gold producers are down an estimated 70%.

"Were gold companies to take capital expenditure as a production cost – and not amortise them – nobody would make money," says McCurrie. The only scenario where the gold industry could improve would be for a 10% to 15%/ year increase in the rand value of gold over the next three years. "Then I suppose gold shares would be seriously cheap," says McCurrie.

Against that background, how do investors make hay while the gold price shines?

Currently at $814/oz – and headed for $850/oz next year, so the experts predict – it's never been better than to find gold exposure. But given that gold companies offer such poor returns and are relatively expensive how is that achieved?

Hilton Davies, SA Bullion

Share Price

ANGLOGOLD ASHANTI LIMITED (ANG)

Last Trade :	**R 327.50**
Change(%) :	-0.46
Cumulative Volume :	101719
Market Cap :	R124.93bn

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NewGold, South Africa's gold-backed exchange traded fund, is one route. But investors are still exposed to a security, says Hilton Davies, a former Allan Gray fund manager and now MD of SA Bullion Fund Management (SA Bullion). There's also a spread of about 6% in terms of managing the cost of a share.

The alternative is to buy a Krugerrand, which suits investors who view gold as currency or cash and not as paper wealth. But again, the cost of buying and selling is potentially daunting. Says Davies: "You can pay 10% over the price of gold to buy a Krugerrand and another 10% beneath the price to sell it."

By way of alternative, SA Bullion has launched a scheme whereby investors can buy physical gold without heavy transaction costs. Its fee is 4.5%/year and includes the cost of vaulting the metal, insurance and other important checks and balances, such as an audit of SA Bullion's business by Deloitte and Ernst & Young and a report to the SA Reserve Bank.

Sounds great. But there are drawbacks, which Davies readily acknowledges. "I really wouldn't want to knock the gold ETF off its pedestal, because this really is a case of swings and roundabouts," Davies says.

One problem is that investors can't "visit" their gold – which is vaulted at Rand Refinery in Johannesburg – due to security measures at the refinery, which daily ships gold for South African and international clients in considerable volumes.

However, investors can leave with their physical gold in it if they decide to exit the scheme.

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SA Bullion isn't for the faint-hearted. Its minimum investment is set at around 30 ounces, which at the current gold price is around R158,000. Davies says though smaller amounts won't make a business case for SA Bullion, it might almost certainly limit the amount of private clients who could invest in its product.

It also appears that South Africa's authorities also have an iron grip over SA Bullion.

Since gold is viewed as cash, the SA Reserve Bank places a limit on the amount of turnover SA Bullion is allowed – currently R650m – and no more than R20m/month.

That changes annually in increments, such that in three years' time SA Bullion will be able to turn over as much as R3.5bn. However, Davies concedes to frustrations with the current regulatory environment.

South Africans still aren't allowed to hold "unwrought gold" – metal that hasn't been fashioned into a jewellery item or a Krugerrand, mainly for fear that relaxing the law will encourage the gold bandit phenomena underground at South Africa's mines.

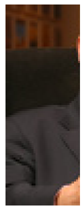
However, the proposed Precious Metals Bill suggests that private individuals will be able to hold so-called "minted gold´– a gold bar that bears the Rand Refinery stamp. But once the bars are minted, investors suddenly find they'd have to pay VAT at 14%.

It's not all bad. Investors who can afford the minimum investment threshold wanted by SA Bullion would recognise a considerable rand hedge. "I'm not saying the rand is to weaken as it did to $1/R13 in 2000 but recognise the opportunity," says Davies.

And what of the embattled South African gold industry? Chris Hart, a South African economist, says a high enough gold price will encourage massive investment on a par with the platinum industry. "We could see a resurrection of the gold industry, where every man and his dog wants the metal."

Hart says South Africa's gold industry was operationally compromised during the Nineties owing to the low gold price – a development that gives rise to its current poor performance. "Not enough stope face has been developed," Hart says.

What may happen with a high enough gold price is fresh investment in marginal mines, old workings and even new projects, such as the deepening projects of Gold Fields and AngloGold, although McCurrie disagrees. "The only other scenario for the gold industry," he says, "is to look elsewhere for gold, such as overseas. Our miners are ultra-efficient. The fact of the matter is that it's now just too expensive to do digging 3km underground."



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