Session 2

Issues Facing Producers

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Good morning, ladies and gentlemen.

A quick look at the agenda…

1. AngloGold Ashanti background
2. Looking back at the financial crisis
3. Refinancing a gold major amid the storm
4. Lessons learned
5. Gold outlook

Allow me first to give a very brief description of AngloGold Ashanti to those of you who may not be familiar with us. AngloGold Ashanti is the world's third-largest gold producer. We have 21 mines across 10 countries and active exploration across the globe. Our market capitalisation is $16 billion, the lion's share of our stock is traded in New York and Johannesburg, and we're the world's top-performing major gold stock over the past year.

What a year to navigate. To call it an eventful 12 months since last year's LBMA conference in Kyoto would be an understatement. There's scarcely a sector of the world's economy that hasn't been profoundly impacted by the financial crisis that took most of the global financial sector to the edge of the abyss in late 2009 and early this year. While gold was clearly a beneficiary of the ructions that continue to reverberate across the banking sector and the global economy, gold producers have had a difficult landscape to navigate.

Since pulling back from the brink, the overall markets have recovered a lot of lost ground. The panic that was so widespread in the fourth quarter of last year and gained momentum through the New Year has abated and lending has loosened. Before we get too jaded, it may be worth a look back at the general market and how close we got to the edge of the abyss.

By this time last year, we'd lost Bear Sterns, Lehman Brothers, Merrill Lynch, Wachovia and Washington Mutual. Hedge funds were failing at an alarming rate, hit by the market in freefall and the seizure in short and long-term credit markets. Since the onset of the crisis last year, more than 330,000 financial services jobs have been lost and institutions have racked up more than $1.6 trillion in losses.

This first slide shows the complete paralysis in lending during the worst of the financial meltdown, even among the world's strongest banks. Here, we see a chart of the LIBOR-OIS spread, a measure of banks' reluctance to lend to each other, and we see the massive spike as we head into the end of the year. For anyone looking for loans, the landscape could hardly be worse.

The credit market was at the epicentre of the storm. This chart shows the composite spreads between five-year corporate debt and five-year US government treasuries. For those companies lucky enough to get any debt at all, the cost of lending more than tripled. For scores of other companies, the vault was firmly locked. Worse still, while anyone lucky enough to have capital for investment was not distributing anything at all, given the complete opacity of credit market in the medium and long term.

With seaborne export markets all but dead and letters of credit impossible to get, we saw commodity markets collapse. Iron ore stockpiles were growing in ports and we saw copper stocks rocketing and prices collapsing. That was the same for just about any other commodity you care to mention, except gold.

Gold held up very well amid the chaos. While everything else was in freefall, gold did a good job holding steady. And while the Reuters CRB Commodities Index registered a 36% drop and the Dow was down 34%, we saw gold up 5% last year and almost 20% this year. Not bad going for the barbarous relic.

That doesn't mean it was easy being a gold producer, and especially not a gold producer looking to the debt markets. This chart shows the cost to insure debt for Barrick and Newmont, the only producers with liquid credit default swaps in the US. We saw those swaps – the instruments used to insure debt – go through the roof at the end of last year. It shows that, regardless of what you were producing, all bets were off as far as the banks were concerned.

We were staring down the barrel of a refinancing in the second half of last year. We had a $1.0 billion, five-year convertible note coming due in February and it was looking like a daunting process to get that refinanced.

Concerns over whether we'd be able to raise the cash we needed to settle the bond was one of the main factors overhanging the stock. We were acutely aware of the threat in that market environment and the impact it was having on our stock, and we set out with the target of getting the debt issue sorted out by the end of last year. It meant that we really had to test the mettle of our banking partners.

We canvassed support from some of our relationship banks at the time, and had some very interesting discussions and learnings, but it was clear to us that while they may have been keen assist, most were inwardly focused and in no shape to actually do so. Those with exposure to subprime were closed for business, which limited our options to a large extent. Bulge bracket banks and the Europeans with US exposure were happy to talk, but could not cross the line in the end.

Our relationship with Standard Chartered finally did the trick. Throughout our executive and the board, we have people with strong links to people in StanChart – people like Ray Smedy and Doug Strong. Not only did StanChart know our management well, but it also had good knowledge of our asset base.

Never was there a time when that kind of relationship was more necessary. It was also a good time to realise the benefit of maintaining a diversity in banking relationships and not putting all your eggs in one basket, but having links with an array of banks, each with different qualities.

Stanchart is a conservative outfit, by virtue of a long history working in emerging markets. It also had no exposure to subprime, which meant its balance sheet was strong enough to handle what would end up being the largest single deal it took on last year.

We did the deal with Stanchart in mid November, taking only three weeks between getting sight of the term sheet for the first time and signing on the dotted line. At first, StanChart proposed doing half of the $1.0 billion we needed, but it very quickly came back to us and offered to do the whole lot – a clear and simple solution for us. It was not cheap, as measured by our previous loan metrics. We did pay a margin of 4.25%, but importantly, it came with our standard RCF agreement structure and covenants, indicative that the issue for StanChart, and indeed all the lending institutions, was not AngloGold Ashanti's credit, but rather the scarcity of funding in the market.

Its willingness to do this was in part because of its very positive view on what we'd done to de-risk the company financially before the collapse in the market. We'd completed a rights issue in June to take out the rump of the hedge book, bringing it down to around five million ounces, from about 12 million. That, along with our growing operating credentials, made us a good bet for StanChart.

Internally, StanChart also had a very bullish view on the gold price. It had been calling for $1,000 an ounce by the end of 2008 for some time, a view underpinned not only by the big rise in investment demand in the ETFs, but also by a good long-term outlook for physical demand out of China and India.

We'd set the end of the year as the target to get the refinancing in the bag to deal with the obvious drag the issue was creating on the share price. No sooner did we announce the deal on 21st November, than our share price rerated and has outperformed its peers since. While it was a trying time for us, we grasped the nettle and showed that we have the right in-house expertise and external relationships to achieve a good outcome at a difficult time. By working hard on our balance sheet, we created a strong platform for our equity to deliver value to shareholders.

It would be easy to get complacent now that some equilibrium has returned to the market. By May, the markets had recovered to the point where we managed to get very attractive terms on a $738 million convertible bond, at an interest rate of 3.5% and a strike price of 37.5% over the VWAP on the day. We also have a lot more of the banks that were closed to us at this time last year, now banging on the door to get a piece of our business.

- The fact is, given our own experience over the past 12 months, we're more focused than ever before on the integrity of our balance sheet. We believe balance sheet risk has become the single biggest factor for prospective investors.

- The proactive management and evaluation of our banking relationships is critical. We're looking carefully at the spread of banks we do business with and how each of them can be best used to do discreet bits of business, whether it be the way in which we parcel out work on our debt offerings or who handles M&A activity for us. We want to make sure that – in the event we're faced with distressed credit markets in the future – we have the right spread of lenders at hand, with a diversity of risk profiles amongst themselves. It has reinforced the banking relationship model we have practised since the formation of AngloGold some 11 years ago.

- The massive dislocation in credit markets also forced us to take a more critical and detailed look at all our agreements with lenders and counterparties than we'd ever done before. While it was also fortuitous for us that none of our counterparties did hit the wall, the overall market climate forced us to run a series of scenarios that looked at what would happen if one of them had gone under. Would it have accelerated liabilities or forced early settlement? As it turns out, there were almost as many answers as there were scenarios and jurisdictions, but it forced us to raise our risk game and prepare for legal risks and eventualities that we previously were less concerned by.

- It's clear that the financial crisis has scared several previously eager banks and other financial institutions out of the hedging and derivative business – probably for good. The remaining banks that do still want to be involved have cranked up their asking price to make it worth their while, which will have an impact on the cost of doing business for some time.

- This aversion to risk has not only narrowed the field of players, but it has also limited the flexibility to manage hedge books. While for years it has always been relatively simple to roll or restructure an existing contract, we are now experiencing a range of responses from the bank counterparts – from settle when due to no problem but at a cost.

- An overarching change that will come to the gold market are the new regulations being penned in the US and elsewhere for OTC derivatives. While intended to avert very large speculation and reduce systemic risk in a market, which for many years has operated very effectively with undue regulation, it now runs the risk of limiting if not totally stopping normal and good hedging management practices by corporate business.

But while some credit markets remain more difficult to navigate than they were years ago, and while the mechanisms for trading gold may change in the months and years to come, there is little doubt that the overall picture for gold is healthy.

Production remains constrained and that's not going to change. The world's major producing nations are facing secular declines in grade, and existing ore bodies are getting older and more difficult to operate. South African production is falling sharply amid a flurry of safety-related stoppages and closure of production that's not profitable at current depths, grades or exchange rates. The US and Australia are also facing serious challenges in maintaining their output profiles.

At the Denver gold show, Barrick suggested a global drop in output of the order of 5% to 7% over the next two years and, to us, that does not seem unreasonable. That's all the more so if you look at the considerably longer timeframes needed to develop projects, provided they can be permitted at all.

The demand side is a lot rosier. The proliferations of Gold ETFs have been a stunning success in taking gold off the market. We're seeing hedge funds and general investors not just paying lip service to gold's role in the prudent portfolio, but actually putting their money where their mouths are and buying it.

At the same time, the trend of central banks selling their gold reserves appears to be coming to an end. In fact, it's possible that – with China's activity in the gold market over the past year and its need to diversify dollar reserves through a limited number of outlets – that we could see central banks being net purchasers for the first time in a decade.

These trends are likely to continue and to spread among more institutions as the quantitative easing, bailouts and stimulus packages we've seen over the past year undermine the foundation of paper currencies. In addition, we now have numerous countries actively looking to manage their own currencies down to weaker levels.

What remains for us to do is to prove that gold producers are a viable business, that we can generate cash and real returns, that we provide a real vehicle for investors to achieve leverage from a higher gold price, and that once prices decline, we can generate those returns through the entire cycle.

After all, we now face stiff competition from a far less risky alternative in an array of increasingly liquid ETFs ■