Contractor vs Owner Mining

Defining Contract and Owner Mining

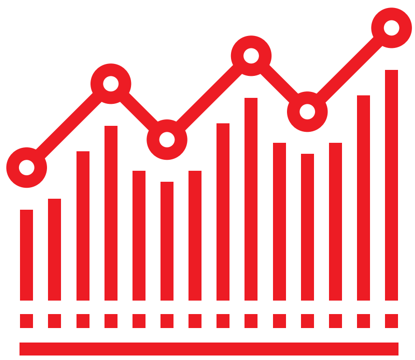
Mining involves a multitude of operations, including the use of equipment and personnel. Often mine management is faced with the question of how their operation should be run; either undertaking all the mining operations using their own equipment and personnel, contracting specialist mining contractors, or running a hybrid model with a combination of contractor- and owner mining.

When deciding between an owner-, contractor-, or hybrid mining operation the following strategies may apply in a typical open pit mine:

- Mining activities (drilling, blasting, loading, hauling)
- Mining area (pit location, pushback, material type)
- Management, supervisory and support functions

How does the mining cycle influence the decision?

Just like all economic cycles repeat themselves every three to five years, mining and commodities are also cyclical. Commodities react to economic phases, which leads to prices reaching high points every three to five years before slumping again.



When commodity prices are high, miners experience a cash injection, and most then explore the possibilities of transitioning from a contracted mining operation to an owner mining-operated operation.

In most cases, the trade-off between owner vs contractor mining is based on a financial decision, but we at VBKOM believe this should be a function of project and owner requirements and not based on commodity "spikes". When considering a transition from one mining operation to another, the decision is far more complex and there are more factors to consider.

When considering either an owner- or contractor-operated mining operation, there is no right or wrong answer, and there are no "one-size-fits-all" solutions.

Busting the myths

Does the owner have less risk and legal responsibility when appointing a contractor?

No, it is widely percieved that when considering contractors, that there is a shared risk and that the mine owners mitigate or share the risk.

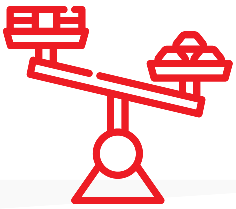
Although contractor's rates make provision for some perceived risks, it is important to note that the contractor's risks are limited to performance and availability, but that the owner always carries all the risks (i.e. legal, employment act, safety, operational, corporate).

VBKOM's risk specialists understand the risk areas and can assist you in weighing the risks against each other before making a final decision.

The owner mining capital is spent upfront whereas the contractor capital is deferred over a period of time. But is this always true?

One of the major reasons junior miners opt in for a contractor-operated operation is due to the belief that with an owner operation you need to have the capital available upfront to purchase equipment. In reality the contractor also requires upfront capital and includes this as an ownership portion in their rates.

VBKOM's expertise in financial models can help you to understand the financing and owner leasing options that may be available.



Which one is cheaper?

When you trade-off based on cost, an owner operation will always come out less expensive. But in practice the owner often measures themselves to higher standards than they would a contractor, making the owner operation more costly and less efficient.

In theory, an owner operation should always be cheaper and more efficient, if the right management practices are maintained.

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Top risks that mines face regardless of owner- or contractor-operated mining operations

There are a lot of considerations to take into account when deciding on an owner- or contractor-operated mining operation, below are some of the top risks:

When making the strategic decision to run an owner- or contractor-operated operation, the major difference between junior mining companies and large corporate mining houses is the availability of skills, expertise and capital.

Most junior miners, in both open pit and underground operations, cannot start an operation without opting in for a contractor-operated operation due to the assumption of upfront capital layout required for an owner mining operation. Deferring capital over time should also be a key consideration for an owner mining operation.

Another factor within the South African landscape is that the number of Tier 1 contractors has declined in recent years, and the Tier 1 contractors available now come with a hefty premium to both junior and large corporate miners. With the decline in these specialised skills, the contractors' bargaining power and margins increase.

A major risk that a contractor-operated mining operation face is that the contractor can give notice to the owner, which forces the owner to either contract with a new contractor, or to transition to an owner mining operation.

Both contractor- and owner mining operations face risks regarding workforce and equipment availability, occupational health and safety, environmental and community considerations.

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