Indonesia seeks mining boost

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Mining remains a mainstay of Indonesia's economy and looks set for further growth, despite a degree of unease among some investors over changes to laws affecting the sector.

The mining industry attracted US$1.1 billion of foreign direct investment (FDI) totalling US$5.9 billion in the third quarter 2012, and the sector drew in US$3.2 billion in the first nine months of the year – making it the largest destination for FDI in that period.

Such figures reflect a strong appetite for investment in the country's metal mining and coal sectors in recent years, buoyed by high world commodities prices. The mining sector's strength also provides a springboard to realise the aim of President Susilo Bambang Yudhoyono's government to turn Indonesia into one of the world's biggest economies over the next two decades.

"The government is very supportive of mining and understands its contribution to the country," says Marcus Engelbrecht, chief executive of Archipelago Resources, which operates the Toka Tindung gold mine on the island of Sulawesi.

The country is a major player on the world stage, producing significant amounts of copper, tin, nickel and bauxite, as well as gold. Indonesia also ranks among the world's largest exporters of thermal coal – a sector driven by rapidly expanding demand from its fast-expanding Asian neighbours. Mining now accounts for around 12 per cent of the country's gross domestic product.

While much production is going overseas, an expanding domestic economy can be expected to provide extra demand for the country's natural resources as well over coming years. Massive investments in Indonesian industrial infrastructure, such as that promised by South Korean steelmaker POSCO, should kick-start that process. POSCO said in October 2012 that it intended to boost its investment in Indonesia to US$11 billion from US$6 billion at present, much of it going into new steel-making and smelting projects.

Similarly, the coal demand both at home and abroad is expected to expand rapidly, despite difficult global trading conditions at present. The Indonesian Coal Mining Association forecast in October that the country's coal production would rise from 340 million tonnnes in 2012 to 485 million tonnes in 2015 and 680 million tonnes in 2020.

Going for gold

Gold miners have had a particularly good run over recent years, supported by a gold price that has more than doubled over the last five years to reach around US$1,700 an ounce in late October 2012.

Indonesia has the world's fifth largest gold reserves, estimated at around 3,000 tonnes. Grasberg, the world's largest copper and gold mine in terms of recoverable reserves is located on the Indonesian island of Papua. The mine's owner, US group Freeport-McMoRan, estimates reserves there to total 33.7 million ounces of gold and 32.7 billion pounds of copper.

Freeport reported in October that the mine produced 202,000 ounces of gold and 922 million pounds of copper in the third quarter 2012. While copper production nearly matched that of the same period of 2011, gold production fell by more than half. However, that was mainly due to a deterioration in the quality of the ore being mined – something that happens from time-to-time in big mining projects, analysts say. Freeport expects ore quality from the mine to improve again shortly.

A similar problem has hit mining operations at another major mine, Newmont Mining Corp's Batu Hijau mine on Sumbwa island, which has cut is forecast for gold production in 2012 to 71,000 ounces of gold from an previous estimate of 114,000 ounces, and that for copper to 170.6 million pounds from 192 million. It expects output to be similar in 2013 as it exports low-grade ore from stocks. The company expects output of both gold and copper to rise sharply in 2013, when it returns to mining higher quality ores.

Newmont, which does not expect a pick up in production in 2013, has embarked on cost-cutting measures, including a redundancies programme, in an effort to balance the books.

New regulations

Plenty of enthusiasm over the potential of the mining sector is evident, but firms seeking international funding are having to work hard at the moment to reassure potential investors in the face of uncertainties over the impact of new mining regulations, disputes over mine ownership and the concerns of people living around mines over their social benefits and environmental impact.

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As an April report by PwC on legal and tax issues in Indonesia's mining sector put it: "Global mining companies consistently rank Indonesia highly in terms of coal and mineral prospects, however assessments of its mining policies and investment climate have not been so positive. As such, in recent years there have been limited levels of investment, particularly in greenfields projects, other than in the coal sector."

In particular rules aimed at bolstering the development of value-added industries, such as metals processing, domestically have had a dramatic impact on some parts of the mining sector. Eager to prevent ores heading overseas for processing, the government has implemented regulations, in effect from May 2012, that restrict raw exports and require ore to be processed in Indonesia by 2014. Foreign mining firms have also been told they must divest more than half their assets after they have been in production 10 years. The implementation of these new rules led to a spike in exports in the run up to the deadline, followed by a slump in its aftermath.

Some companies have also run into problems establishing their legal rights to mining concessions, when they have run into disputes with their local partners or fallen foul of local regulations.

Earlier this year, Australia's Intrepid Mines was ousted from its Tujuh Bukit copper and gold project, in which it had an 80 per cent interest, by its local joint venture partner Indo Multi Niaga and is currently in the process of trying to resolve the situation.

Meanwhile, another Australian firm, Churchill Mining is taking legal action against Indonesia's authorities after it was lost control of a large coal project in 2010. And in October 2012, Nat Rothschild, co-founder of Bumi, whose business is based on Indonesian coal reserves, resigned. He cited disagreements with his local partners and directors over plans to change the ownership structure of the company.

Such news inevitably risks producing poor perceptions among foreign investors, but those working in the country say it is easy to overstate the negatives.

"Indonesia is no different to any developing country. You have to commit time and resources to develop relations with local and regional governments, and also at the federal level," says Archipelago's Engelbrecht.

His company has avoided a dispute similar to those at Intrepid and Churchill and is also exempt from the new mining sector regulations on exports and ownership at present. Archipelago, like Freeport and Newmont, operates under older "contract of work" agreements with the Indonesian government. The companies say these could only be modified mutual agreement between a firm and the government.

Archipelago's exploration programme at Toka Tindung continues to yield what the firm describes as "significant" results, which have persuaded the company to spend around US$12 million on further exploration around the existing mine.

Even executives at firms more severely affected by recent events remain keen to develop their Indonesian projects and seem positive that short-term difficulties can be overcome.

"Once the current dispute with joint venture partner PT Indo Multi Niaga is resolved and permitting achieved, Intrepid looks forward to the day when the mine development can proceed to the benefit of shareholders, central and provincial governments and a local workforce of over 400 permanent employees," Brad Gordon, Intrepid's Chief Executive, said in September.

Strong community relations

Successful handling of social and environmental issues is crucial to mining projects anywhere, and Indonesia is no exception. Mining firms know good relations with the population living around their sites are key, not least because many will be employed in the mines.

A stoppage in late 2011 at Freeport's Grasberg mine due to a pay strike shutdown operations for three months. However, new pay deals for the more than 20,000 people that work there has seen a return to smoother operations this year and left Freeport optimistic, as it seeks to negotiate its contract at the mine beyond its expiry date of 2021.

Richard Adkerson, Freeport's Chief Executive, said in October the company had "made a lot of progress" in negotiations with the government recently. "We feel very encouraged by the progress we've made this quarter and we are looking forward to completing this process," he said in a results conference call. Freeport is also considering floating its Indonesian operation on the Jakarta stock exchange.

Archipelago's Toka Tindung mine is a much smaller operation, employing around 800 people directly and another 600 or so employed with local contractors, but good labour relations are just as important. Engelbrecht says the company has sometimes chosen to carry out some environmental measures around the mine in a more labour-intensive way, rather than using machinery, to provide more work for local people.

Archipelago has also sought to avert environmental issues that can hold up mining projects have not caused significant hold ups at Toka Tindung. The mine receives over 2 metres of rainfall a year, and while there are no toxic chemicals in use there, it is still crucial to ensure that excessive sediment from the operations does not run off into local rivers. That has involved digging a network of drainage ditches and settling ponds to make sure that water leaving the site is clean. F