MINING & EXTRACTIVES

ESG AS A PREDICTOR OF PERFORMANCE, RISK

Executive Summary

Produced by Cornerstone Capital Group Global Thematic Research

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Introduction

The extractive sector is important to the global economy and will be critical to a sustainable future. With a market cap of over US$6 trillion, the extractive sector encompasses over 5,000 companies. Mining is particularly important for emerging markets, as these companies generate a significant proportion of economic activity in less-developed economies. The sector provides raw materials for everything from energy creation to high-tech manufacturing to electronics. Even as the world starts to transition from greenhouse gas emitting commodities like oil and coal, natural resource extraction will remain essential. Smartphones and electric vehicles, for instance, require metals sourced from extractive operations around the world. Yet natural resource extraction is, by its very nature, environmentally destructive and socially disruptive — and managing the risks inherent in mining is of prime concern to extractive companies and the host countries in which they operate. Extractive companies’ success will be in part determined by their ability to position themselves for this future.

Risk Assessment in Context

The environmental and social (E&S) issues we address in this report highlight strategic concerns for any mining or extractive company. Tailings risk (tailings are the effluents generated in a mine processing plant, and require long-term, secure storage), community-company conflict, contract workers and labor disputes, and management of global reputational risk (using biodiversity impact as its proxy) create event risks such as mine failures, shutdowns or license denials. They also impact longer-term operational planning because they require proactive engagement with local, global and contextual stakeholders to assure passage. We assess selected companies’ corporate governance as it relates to actively managing E&S issues, identifying leaders and laggards based on relative “attentiveness” to material E&S concerns.

Detailed analysis of E&S issues provides predictive insight. We offer a proprietary framework to assess extractive companies’ underlying values, leadership, and culture based on a bottom-up analysis of material, yet underappreciated environmental and social (E&S) issues. We then explain how the issues impact specific items within a company’s financial statements.

Key observations. At a high level, we came away with these conclusions:

- **Community influence increasingly impacting social license to operate.** Concerns over erosion, loss of biodiversity, contamination of soil and groundwater, waste material management, and worker safety continue to threaten project timelines and economics. Local communities are increasingly protesting new mine expansion by companies that have failed to meet community expectations for previous mine closures, especially as community conflict becomes more transparent with social media. The cost of project delay from community conflict runs to $20m per week, though the largest cost is the inability to expand or sell a project.

- **High CEO turnover impacts performance.** A change in leadership is often followed by fresh initiatives and new strategies, especially in regards to health and safety. Among the companies we
analyzed, outsider CEOs were more likely to be associated with best-in-class initiatives on transparency. The majority of these companies’ CEOs are engineers in training, which is well suited to the industry but also may counterintuitively increase the risk of community conflict.

**Employment.** All else equal, an owner-operated mine is better-equipped to manage its relationship with the community than one that relies heavily on contract labor. Though contract mining is inherently more flexible, owner-operated mines invest in local communities and, when execute successfully, better maintain their social license to operate.

**Best / Worst performers.** Cornerstone identified several markers of a company’s culture, values and leadership quality, which in turn speak to its willingness and ability to address emerging risks as it executes its strategy.

- **Leaders:** Antofagasta, Newcrest, Randgold, Tullow Oil
- **Laggards:** Buenaventura, Harmony, Philex, South32

**Methodology**

We evaluated a set of representative companies according to seven metrics that together provide a clearer picture of their potential for long-term success in executing their strategies. These metrics are:

- CEO leadership and turnover;
- Management of tailings risk;
- Community relations
- Labor relations
- Approach to biodiversity issues
- Corporate reporting structure (i.e., reporting lines for environmental and safety executives)
- E&S incentives in management compensation.

We performed our assessment on the companies listed below. We “score” the companies on each of the seven metrics, then roll those up into an overall “attentiveness” indicator.

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