

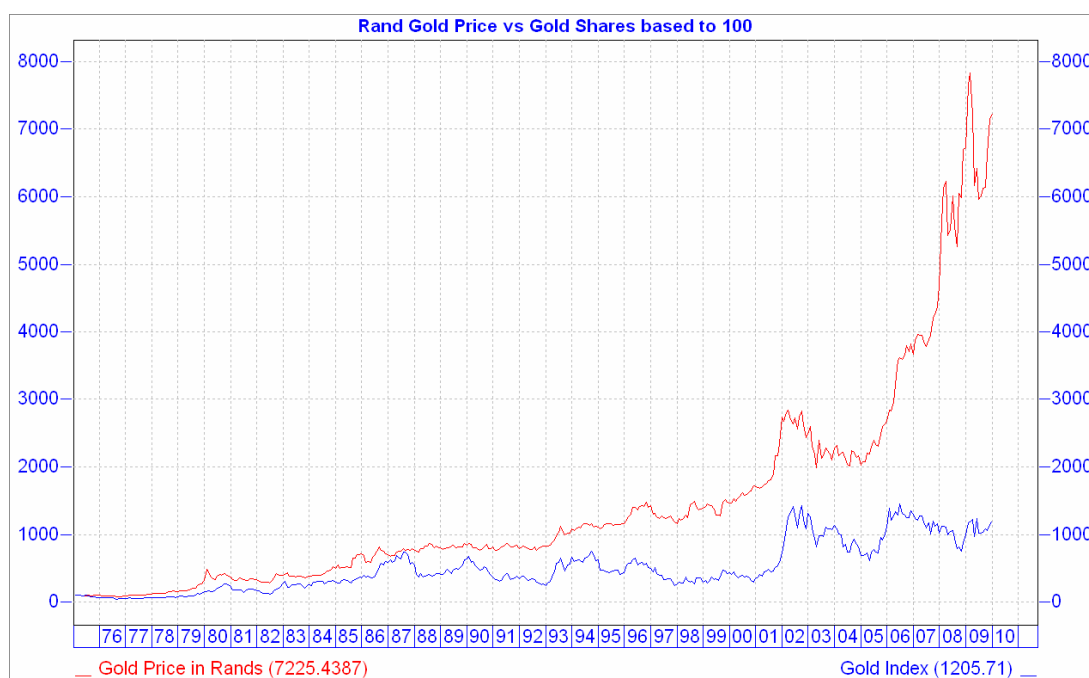
Bullish on gold? ...You don't have to own South African gold mining shares - Kagiso Asset Management Head of Research Abdul Davids

A positive view on the gold price does not necessarily translate into a positive view on South African gold mining companies. In fact, there are a number of compelling reasons why South African gold stocks are not great investments and why alternative ways to invest in gold are well worth considering.

The gold price has run about 30% in the year to date in dollar terms, surging to record highs, and the yellow metal outperformed every major equity index in the world in 2008. Looking ahead, a rosy outlook on the gold price is supported by key drivers of the price of the metal, which in real terms are very much intact and will in all likelihood increase: US dollar devaluation and US inflation. The resurgence in the gold price is mainly due to developed market debt woes and the impact on currencies like the US Dollar. As investors seek protection from rapidly depreciating dollar denominated assets, they are increasingly turning to gold as a value protection measure. In addition, gold counters are sought after for their 'optionality value,' meaning that shareholders can benefit from higher gold prices by investing in gold companies whose profitability and hence share prices are positively correlated to a rising gold price.

Despite this upbeat view on the direction of the gold price, some of the reasons why South African gold mining companies are not an attractive investment include:

- Gold shares have historically underperformed the yellow metal significantly by a ratio of six to one. (See graph below 'Rand Gold Price vs Gold Shares')



Source: Inet

As per the chart above, a theoretical R100 investment in gold in 1975 would be worth R7225 today, whereas a similar investment in gold shares as represented by the Gold Index would only be worth R1205 today.

- Current share prices are too high and are already discounting a very positive outcome for the gold price including forecasts by Singapore based Rogers Holdings that the price of the metal could top \$2000/oz in the next ten years. For many of the big South African gold producers, such as AngloGold, the gold price would have to hit \$1300/oz and remain at that level for an extended period to justify their current valuations - a scenario that is highly unlikely.
- Profits made by South African gold producers over the last 34 years have been far from spectacular: Producers currently face falling gold reserves and a strong rand, which cuts into their rand revenues.
- The cost of gold mining in South Africa has increased significantly over the last few years: With falling grades, measured in grams per ton, the amount of investment that has to go into gold mines to pull out gold is very high. Current mining depths in South Africa are very deep and therefore very expensive and dangerous. Gold companies are spending vast amounts of money on infrastructure such as sinking new shafts and refrigeration units to extract gold with typical grades of only 6 grams per ton.
- The South African majors continue to invest in exploration - trying to find new gold to replace declining reserves - with very little success. As a result, South African gold companies have generated very poor returns to shareholders over the last five years, as the table below highlights:

South African Gold Miners' Return on Capital

Rand Millions Year	Harmony			GoldFields			AngloGold Ashanti		
	Free Cashflow	Market Capitalisation	FCF Return	Free Cashflow	Market Capitalisation	FCF Return	Free Cashflow	Market Capitalisation	FCF Return
2004	-628	20927	-3%	436	32100	1%	1320	52631	3%
2005	-1532	22906	-7%	280	37513	1%	1019	83191	1%
2006	-336	45290	-1%	1974	80162	2%	4285	91155	5%
2007	892	40069	2%	-657	71320	-1%	2362	81295	3%
2008	423	38309	1%	4586	64989	7%	4818	89078	5%

Source : Kagiso Asset Management; Annual Reports

On balance, owning South African gold stocks is not an attractive investment. Alternatives to take advantage of the running gold price, such as exchange traded funds and physical gold (Krugerrands and gold coins) may well be the way to go.

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