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Speed bumps add to potholes for region's investors

If the Central Asian mining world made up parts of a city street, Kazakhstan would be a green light, Kyrgyzstan an amber light, while Uzbekistan, Pakistan and Afghanistan would be pot holes best avoided. Azerbaijan might be a pedestrian crossing of which motorists take little notice.

Chris Cann | 09 Apr 2015 | 12:00 | Feature

Osh, in southern Kyrgyzstan ... 'supportive legal system and an economy that is heavily dependent on mining industry'

To put this analogy into context, we're not driving down Park Avenue here, but more finding our way through the back streets of Caracas, taking care not to get car-jacked (read: project-jacked).

Only Kazakhstan and Kyrgyzstan rate a mention in the 2014 Fraser Institute Survey of Mining Companies and neither made it into the top half of countries/provinces rated by their 'Investment Attractiveness'.

Kazakhstan was 70th of 122 countries/provinces assessed and Kyrgyzstan was 98th. Among Kyrgyzstan's near neighbours in the survey were Venezuela and Zimbabwe, immediately below. Mongolia, most famous for failing to nail down the country-making Oyu Tolgoi copper-gold deposit, ranked 12 places higher.

Central Asia's collectively poor reputation among investors contrasts starkly with its mineral endowment. In a modern mining world where low-risk jurisdictions are few and far between, rich geology and the potential for policy improvements is a combination that could prove attractive to miners and investors alike.

Investability

All the countries listed above have problems but not all are genuinely looking to improve policies to attract investors. There are, disappointingly, a few non-starters and the two saddest cases from a foreign investment perspective are Pakistan and Uzbekistan.

Pakistan's mineral policy is largely nationalistic. The Mineral Department within the Ministry of Petroleum and Natural Resources is responsible for all aspects of mining ventures controlled by state-owned companies.

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State-owned companies control the production and marketing of chromite, coal, copper, iron ore, and steel, though private sector groups can own and produce some non-fuel minerals – mainly industrial minerals, including cement, according to the US Geological Survey.

There has been some effort to privatise large state groups but government mining continues to account for the bulk of mineral production.

One could almost say Pakistan's most recent effort to engage a large professional miner to develop a major deposit ended in tears, only it is yet to end.

The impoverished yet mineral-rich Balochistan province rejected a mining application in 2011 from Tethyan Copper Company (an Antafagasta-Barrick Gold joint venture) to develop the Reko Diq deposit, which has been slated as a 200,000 tonne copper and 250,000 ounces gold per annum operation. Local bureaucrats reportedly wanted a bigger cut from the project spoils than its 25% interest would deliver. A Pakistani Supreme Court then found the original 1993 contract signed between Balochistan and, at that point, BHP, to be invalid.

The joint venture has given up trying to mine Reko Diq but is attempting to recover costs – some US$260 million has been spent on the project since 2006 – in two separate arbitration cases against the province and the country.

Oracle Coalfields in the Sindh province (south) had its licence revoked in December then handed back two months later. This seems a difficult way to live, but Oracle remains hopeful.

Uzbekistan cuts a similarly unfriendly figure, though is perhaps more readily considered by miners because its most recent case of mismanagement is not as prominent as the Reko Diq debacle.

The country is currently the ninth largest gold producer in the world (2013: 93t) and also produces copper, lead, molybdenum, silver, tungsten, zinc, uranium, recycled steel, and several industrial minerals.

Uzbekistan's first and current president (since 1980), Islam Karimov, has taken a number of steps designed to support foreign investment. This includes the Law On Foreign Investments and the Law on Guarantees and Protection of the Rights of Foreign Investors, which provides the general framework for foreign investment in Uzbekistan.

In reality, it's not so black and white.

According to the Economist Intelligence Unit, the government is "hostile to allowing the development of an independent private sector, over which it would have no control".

Oxus Gold is one company that would attest to this version of the story. The AIM-listed junior is the only publicly listed miner with primary assets in Uzbekistan but is in its fourth year of arbitration following its claimed "misappropriation of exploration assets", Khandiza and Amantaytau Goldfields.

Several years earlier (1995), Newmont Mining Corporation became the first major western investment into Uzbekistan through a joint venture with the government. The company was to develop and mine the 71Moz Muruntau gold deposit until its stake was expropriated in 2006.

Afghanistan is the other pot hole of Central Asia but would rightly object to being lumped in with the two above.

Administrators have done what they can to get a minerals sector estimated to be worth more than a trillion dollars motoring but the military conflict and stuttering progress of a US$3 billion deal signed in 2007 by a Chinese SOE has kept miners away in droves.

The government, wary of its own hard-earned reputation for corruption, has more recently brought in international experts to negotiate contracts on terms favourable to investors and has offered free currency conversions and 100% capital repatriation over the past few years.

From bad headlines to no headlines, emerges Azerbaijan.

Azerbaijan is a stable political democracy, according to one of the only, if not the only, publicly-listed mining company invested there, Anglo Asian Mining. The country has an established democratic government, which is "fully supportive of international investment initiatives".

"Although the mining code is fledgling and runs under the guidance of the Ministry of Ecology and Natural Resources, the country has an established oil industry, with more than 15 major oil and gas companies with PSAs with the Azeri Government including BP, which has been operating in the country since 1994, and Exxon Mobile," Anglo states on its website.

According to the USGS, Azerbaijan experienced high economic growth from 2006 through 2008, fuelled by crude oil exports. This opened up more opportunities for the country and in 2009 Anglo started producing gold from its Gedabek mine, though under an oppressive royalty agreement that equates to roughly US$180 in every ounce sold.

The USGS cited "pervasive corruption" and "structural economic inefficiencies" in its last review of the minerals sector (2012) as issues that could slow down growth and foreign investment.

Despite this, Anglo has managed to hold on to its assets and has had the confidence to invest in its processing capacity. Should this trend continue and the government improve the fiscal regime for miners, others may follow.

The big fish of Central Asia are clearly Kazakhstan and Kyrgyzstan.

Kazakhstan's mining history is dominated by state-run production. The state continues to have a strong influence over mining – most new contracts are signed with a government JV partner – but its official capacity as a miner has diminished significantly through the gradual privatisation then listing of KAZ Minerals (formerly Kazakhmys) in 2005. State-owned uranium and rare metals producer Kazatomprom is still a prominent participant.

Natural resources are the main contributor to the Kazakh economy and mining (and quarrying) accounted for some 18% of GDP in 2011. Kazakhstan is the world's leading uranium producer (2013), the second largest chromite producer (2012), and a significant producer of cadmium, titanium, bauxite, zinc, iron ore, coal and copper, according to the most recent production report from the British Geological Survey.

The country has the transport and energy infrastructure one would expect to find in a major mineral producing nation. More importantly, Kazakhstan plans to become the first ex-Soviet Union State to remodel its mining code on Australian, Canadian, Finish and Chilean principles of exploration and mining rights allocation.

Meanwhile, Kyrgyzstan continues to be seen as a high-risk destination with an under-developed legal and political system, held back by endemic corruption. This perception has been cemented in the market over the past few years by a couple of high profile confrontations with miners.

The more prominent of those is the ongoing spat with Centerra Gold regarding the terms of a deal – originally outlined in late 2013 – that would transfer the government's 32.7% stake in the listed company for 50% in a project level JV. The government threatened to nationalise the 600,000ozpa Kumtor mine (pictured below) in February and the miner has previously threatened to mothball production, putting 12% of Kyrgyzstan GDP at risk.

Stans Energy is also in a tussle with bureaucrats and is after US$118 million in damages and losses following the revocation of its licence for the Kutessay II rare earth mine. The two parties are reportedly pursuing an out-of-court settlement.

Though there is a reasonable number of miners already present in Kyrgyzstan, these incidents combined with falling commodity prices could choke off the foreign investment taps for the sector.

Early last year, the government offered something of an olive branch to mining companies with a clarification of the fiscal regime, but basic provisions such as these are hardly going to turn mining heads toward Kyrgyzstan.

Ones to watch

Kazakhstan remains the stand-out jurisdiction of Central Asia, though Kyrgyzstan has potential and there is room to speculate on Azerbaijan.

"Given the exceptional mineral endowment, and therefore the size of the potential opportunity, combined with the state of the mining industry, the available skill set and support from the government and local banks, plus available infrastructure and relatively cheap and available power and other relevant input factors at reasonable costs, overall, Kazakhstan represents the best opportunity in the near term," Ingo Hofmaier, director of corporate finance firm Hannam & Partners, told *Mining Journal*.

"We see efforts across the board in Kazakhstan to improve the situation for all market participants and the country has a longer and more successful track record of international investment and security of tenure than its peers in the region.

"In addition, the country has plenty of good tenements that are now available again for exploration and a host of projects or operations that are looking for international partners," he said.

Kazakhstan planned to establish a Geological Research Centre to advance its geological accreditations and would look to mining centres in Australia, Canada and Brazil to bring exploration and development expertise into the country. Rio Tinto is on board to identify copper porphyries, while Iluka Resources is assisting with the identification of mineral sands potential, though the Aussie miner currently doesn't report on any Kazakhstan assets.

In December last year, the government also introduced an extensive series of investor friendly amendments to the mining code designed to mimic the Western Australian system – WA has a similar land area but 10 times more exploration activity – for issuing and regulating exploration holdings.

On the surface, this seems a plainly positive development but it is not that straight forward.

"There is a feeling that as long as the government agencies, including GKZ (State Resource Committee), retain very tight control over resource and reserve estimates and production schedules, the state will maintain ultimate control over mineral exploration and production, meaning new projects will be dependent on a subjective decision from the government rather than determined by a credible mining framework," said senior geologist with Behre Dolbear, Tanya Matveeva.

In addition, there is a brand new mining code under development that will reportedly be ready in 2017. The code proposes simpler and faster procedures for obtaining exploration licenses, and aims to attract new players into the region.

The Soviet resource estimation system will be replaced by something akin to the JORC system, which will eliminate double-accounting and is currently in place for many producers. However, the principle of tight governmental control of the resource development apparently will remain in place.

The presence of majors is often used as a measure of a country's resource policy and, using this metric, Kazakhstan fairs reasonably well.

Areva's government-partnered subsidiary KATCO produced some 4000t of uranium in 2013 from two mines, while Glencore's government-partnered subsidiary Kazzinc produces masses of gold and base metals from eight mines. Russian gold major Polymetal International increased its gold reserves by 50% in September last year with the acquisition of the 6.7Moz Kyzyl development in Kazakhstan, providing a companion for its Varvara gold-copper mine.

There are success stories, too, for the little guys.

"Central Asia Metals represents a considerable success story in Kazakhstan," Piran Mining Research managing director Paul Burton told *Mining Journal*.

"It established commercial copper production at its Kounrad tailings re-treatment operation in 2012 and immediately went into profit and started paying dividends. It is currently embarking on a 50% expansion to 15,000tpa of copper, funded from cash flow."

CAM business development director Gavin Ferrar told *Mining Journal* Kazakhstan was rated highly in a regional context and was likely to improve further in the eyes of investors in light of investment incentives set to be implemented early this year.

These incentives include customs duty incentives, state material grants, tax breaks, and investment subsidies for projects deemed as 'priority', which essentially means an investment of at least US$20 million.

GoldBridges Global Resources, otherwise known as the reinvigorated assets of Hambledon Mining, is another to watch. To be fair to Hambledon, it would probably have been one to watch before a tailings leak in 2011 and the resulting fines forced a rescue of sorts by a major shareholder, which now owns 65% of the company.

The miner has been working on its open pit Sekisovskoye gold mine for six years and since the takeover has brought down operating costs, increased reserves, acquired a pipeline project, and successfully tested the feasibility of expanding into the high grade underground operation that would lift production from about 30,000ozpa last year to more than 100,000ozpa by 2017.

Kyrgyzstan rates as a potential winner over the near-to-mid-term for two reasons: there are plenty of companies in there already to prove that it's manageable; but the current problems mean it has plenty of room for improvement.

Numis Securities described Kyrgyzstan as a "seemingly safe and friendly country, with strong resource potential and a willingness to change and improve" following a site visit to see Chaarat Gold's proposed namesake development.

"In our view, the main challenges for western companies in their dealings with the authorities are less related to structural issues – Kyrgyzstan is generally a good place to do business, with a supportive legal system and an economy that is heavily dependent on the mining industry – than with the after-effects from the country's turbulent recent history," the investment bank said in a note last year.

"The country is under-explored using western techniques, and we believe that once current issues surrounding Centerra's Kumtor mine are resolved, investor confidence is likely to grow."

Growing in confidence already is Chaarat, as it moves through the feasibility process on its likely 120,000ozpa operation. The mine would start as a low cost open pit with heap leachable ore before graduating into a higher grade underground mine in later years.

Meanwhile, Manas Resources has completed a bankable feasibility study on its Shambesai project for a compact four-and-a-half initial life that would deliver 241,000oz of gold at all-in-sustaining-costs of US$720/oz for free cash of almost US$140 million and an IRR of 106%.

It's a modern day plan with low pre-production capex (US$41 million) and quick returns for the bankers but the clear potential to add to the base case with 900,000oz of resources outside the mine plan plus a highly prospective 500km2 exploration portfolio to be funded by cash.

The opportunity to the west in Azerbaijan relies on the government realising it is faced with an opportunity, according to SP Angel analyst Sergey Raevskiy. He told *Mining Journal* that the need to diversify away from oil and the positive example being set by Anglo Asian, had presented bureaucrats with the perfect backdrop to relax the fiscal clamps on its mining sector and usher in a new generation of exploration and development juniors, if not the odd major.