

CIS is back on investors' agenda

A one-day symposium in London explores the investment outlook in Russia and the CIS

THE Commonwealth of Independent States has hardly been the favourite destination for international mining investors during the past ten years. There are indications, however, that the mood might be changing.

Some 200 delegates at the recent Russian & CIS Mining Symposium in London heard 24 experts discuss the investment outlook in Russia, and recent developments in the region. Many of the speakers talked of the opportunities for foreign investors, and that the situation was better than portrayed overseas.

In the opening session, which was sponsored by mining consultant SRK Consulting (UK) Ltd, Kirill Kirilenko, a senior analyst at the engineering consultancy NBL International Ltd, reviewed the gold-mining investment climate in Russia. He said that production grew 9% in 2009, lifting the country's global ranking to fifth. This still represents an underperformance compared with Russia's share of global gold-ore reserves.

Mr Kirilenko commended the Russian gold-mining sector to investors, saying that the investment climate had improved during the past few years and that the country had a relatively stable financial system. Indeed, he criticised those that found the region 'scary'. What is needed, according to Mr Kirilenko, is someone to consolidate the gold-mining sector in the CIS.

RESERVE REPORTING

Mr Kirilenko was one of several speakers to note the difficulties caused by a mineral resource and ore-reserve classification system which was different to that used in the developed countries. However, he argued that, although they did not conform, the CIS classification system was at least understandable.

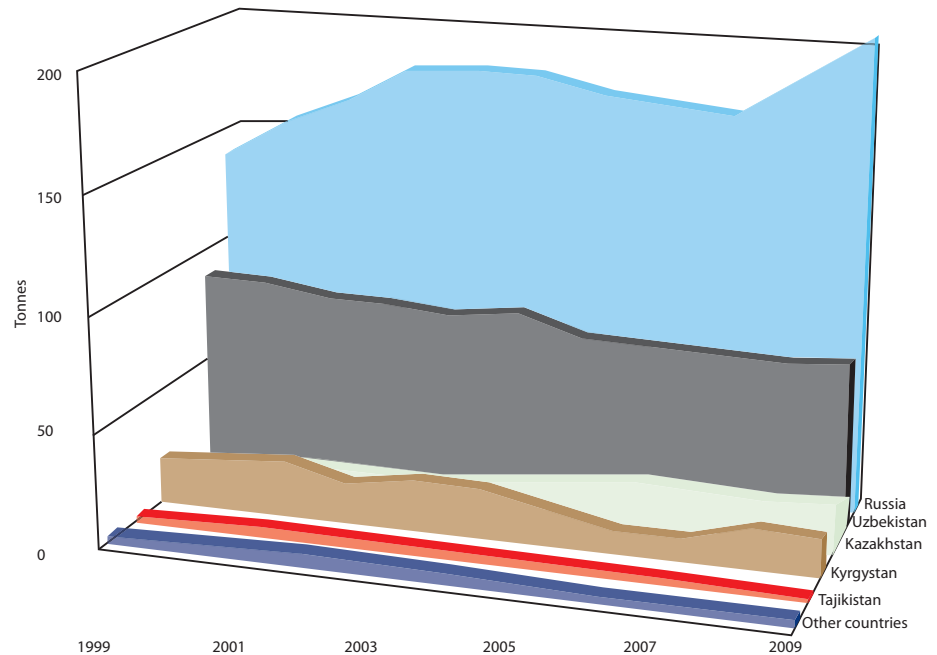
The resource-reporting system in the CIS was explained by Mike Armitage, the chairman and principal geologist of SRK Consulting (UK). Three categories in the GKZ system (P1, P2 and P3) are 'prognostic' resources, while the other four (C2, C1, B and A) involve reserves. Dr Armitage said that the A and B categories are usually only for detailed areas within the C1 reserve.

These classifications are based, according to Dr Armitage, on "regimented data collection and evaluation", with little judgement required. International codes, on the other hand, are heavily reliant on the judgement of experts (including 'competent person' reports).

Russian resource-reserve reporting is based on insitu figures, and takes no account of the losses and dilution involved in mining. Some categories do not have an equivalent in JORC.

An initiative was launched in 2006 to explain the differences, and reach compromises in the reporting of figures. Dr Armitage said that the working group hoped to deliver a final document at the MINEX Forum in October, and Russia will then develop a code that is acceptable to international (CRIRSCO) guidelines.

The whole issue of project evaluation was aired by Alexander Lopatnikov, the managing director of American Appraisal. He said: "Price is what you pay, value is what you get." Mr Lopatnikov told delegates that to establish this value accurately, it is crucial that investors fully understand the property. For this they need full disclosure.



Gold mining in the CIS

Source: NBL International

DELIVERING VALUE

As an example of delivering value, it would be hard to do better than Petropavlovsk plc (previously Peter Hambro Mining). The company's co-founder and chairman, Peter Hambro, talked of the company's switch to JORC-reporting so that Petropavlovsk could convince investors of its mineral wealth.

Mr Hambro said, however, that JORC was also "imperfect". He stressed that "the only truth is when you mine", noting that on several occasions the company has achieved grades above those predicted in the JORC statements.

Mr Hambro also cast doubt on the previous speaker's assertion that full value can be achieved by full disclosure. He noted that Petropavlovsk's iron-ore assets were close to China, and enjoyed "remarkable competitive advantage, but were "not appreciated" by investors in the predominantly gold-producing company. For that reason, he is looking (again) at spinning out these assets.

Another gold-mining company active in Russia is Highland Gold Mining Ltd. The company's chief operating officer, Brent Horochuk, talked of the improving operating conditions but described a lack of qualified personnel as "a challenge".

Highland Gold was incorporated in May 2002 and underwent fundamental changes in its management structure in 2008-9 (Barrick Gold Corp emerged with a 20.3% stake and Millhouse LLC, through Primorod International, 32.0%).

The company now operates two mines (MNV and Novo) and has two development projects (Belaya Gora and Taseevskoye) and four exploration properties. Gold production this year is expected to exceed 200,000oz from corporate resources put at 5.5Moz.

The chief executive officer of Ovoca Gold plc, Tim McCutcheon, made an impressive presentation of the Dublin-based company's strategy. He described Ovoca as the only independent junior still operating in Russia (management owns 45% of the company), and with

US\$43 million in liquid funds was fully funded for the next three years.

Ovoca's market capitalisation, however, remains under US\$30 million. Much of this is because of a deferred performance-based consideration of US\$18 million that is owed to the vendors of the three gold properties acquired in the Magadan region in January this year (Rassoshinskaya, Nevsko-Pestrinskoye and Stakhanovsky).

Nevertheless, Mr McCutcheon characterised the share price as being severely undervalued, and in May the company announced plans to buy back up to 10% of its issued share capital before end-September 2011.

Like other speakers, Mr McCutcheon said the risk of operating in Russia was not as bad as many countries in Africa. He claimed, for example, that there was "confusion" over the country's mining laws, which he accepted were "bureaucratic", but argued that they did work.

Moreover, although there had been widespread condemnation of the government's protection of 'strategic' assets, these rules applied to everyone, and were not designed to confiscate valuable assets from foreign investors. In the meantime, he told delegates, Ovoca would remain "focused" and not waste funds on unnecessary exploration.

STRATEGIC PLANNING

The heads of strategic planning for three Russian companies made presentations at the symposium, and explained how they were creating world-class coal and non-ferrous metals producers.

Raspadskaya Coal Co suffered a catastrophic explosion at its eponymous mine on May 8, killing 67 people, with 23 miners still missing. The company has recently had to make a series of presentations to the government related to the accident, and is also working on plans to restore corporate production levels. As a result, the director of strategic planning, Alexander Andreev, had to make his presentation to the

symposium via a video link from Mezhdurechensk.

Production ahead of the accident from the company's three operations (Raspadskaya, MUK-96 and the Raspadskaya open pit) was about 950,000t/month (run-of-mine coal). With Raspadskaya closed, production is currently only 350,000t/month but there are plans to lift output 15% this month.

Mr Andreev conceded that the company would need more funding to get back to its pre-accident production levels. He expected to be holding meetings with rating agencies in the near future.

Oleg Pertsovskiy, the head of strategy and corporate development at Siberian Coal Energy Co (SUEK), also made a 'remote' presentation. He claimed that the company was the largest coal producer (88Mt in 2009), exporter (31Mt of thermal coal) and holder of reserves (5,800Mt) in Russia. Indeed, in terms of coal reserves worldwide, only Peabody and Shenhua are larger.

SUEK has 17 open-pit and 13 underground mines in seven regions of Russia. Mr Pertsovskiy said that the company also has 18 integrated power plants in five regions. He also pointed out the huge opportunities for growth because of the burgeoning demand for power in Asia.

The deputy director of strategic development at MBC Corp (part of the Metropol Group), Sergey Garichev, talked of recent developments at the Ozeroye zinc-lead-gold processing plant. The company, he said, was on track to become one of the world's ten largest metals producers.

Located in the Republic of Buryatia, Ozeroye is owned by Techprominvest (also part of Metropol) and managed by MBC. The JORC-compliant resource totals 157Mt of ore grading an average of 5.2% Zn and 1% Pb. A 25-year mine is being constructed to produce 0.74Mt/y of zinc concentrate, 110,000t/y of lead concentrate and 2,500kg/y of dore gold from 6.0Mt/y of ore. Commissioning is scheduled for 2012, with full production being reached in 2013 after a total capital expenditure of US\$954 million.

POTENTIAL OF CENTRAL ASIA

In a session sponsored by Wardell Armstrong International, the exploration potential of Central Asia was outlined by the deputy head of the Centre for Russian and Central Eurasian Mineral Studies at the UK's Natural History Museum, Alla Dolgoplova.

Dr Dolgoplova illustrated the over 5,000 identified mineral deposits in the eight countries of Central Eurasia (China, Kazakhstan, Kyrgyzstan, Mongolia, Russia, Tajikistan, Turkmenistan and Uzbekistan). She explained how targets could be identified through metallogenic studies.

Dr Dolgoplova demonstrated the research work undertaken, with case study examples of uranium deposits in Kazakhstan and Uzbekistan, and the importance of the Paleozoic arc system in the region. Central Eurasia, she concluded, was a "potential commodity basket of the future".

Phil Newall, a director of Wardell Armstrong, agreed, and told delegates that Kazakhstan, in particular, is "open for business". Dr Newall described the country as a "good place to work" as it was politically stable, had a transparent fiscal and mining code, and had enjoyed a long history of mining.

Because of its geologic, political and economic advantages, Kazakhstan has enjoyed the lion's share of inward investment in Central Asia since its independence. The government is attempting to build on this success by focusing on modernisation, training and ecology.

The country is fast becoming an important mineral producer, and the government has made 67 major exploration and mining projects available for investment.

However, Dr Newall identified two main areas of concern. First, the country's resources and reserves are calculated under GKZ protocols, and international investors are demanding JORC-equivalent figures. Second, Kazakhstan's environmental regulations do not comply with those espoused by the World Bank.

Gordon Reid, the vice president of operations for Centerra Gold Inc, said that the company had been in the Kyrgyz Republic since 1994 (Centerra also operates in Mongolia). Mr Reid said that the civil unrest in April (which had ousted the president) had had "very little effect" on business activity, and he did not anticipate any change.

Last year was a mixed one for the company. Cameco had sold its equity stake but ore reserves at the Kumtor project had risen 36% and there had been a good operating performance. Gold production this year is expected to be similar to last year's 675,592oz.

Mr Reid said that the company's ore reserves had grown by 2.9Moz to 7.3Moz over the past six years, despite having mined 6.6Moz. He said that Centerra planned to continue to maximise its existing assets (exploration expenditure this year is expected to be US\$30 million), and then to expand into new projects and seek joint venture partners.

"Ukraine has one of the best qualified labour forces in the CIS"

MINING IN THE UKRAINE

The head of structured finance at Exim-Consulting, Igor Stelmakh, conceded that the Ukraine was not as rich as Russia but added that its coal and iron-ore assets were world class.

The country also boasts 10% of the world's reserves of titanium, and 26 deposits (mainly ilmenite) have been identified. Mr Stelmakh said that the major titanium deposits in the Ukraine are in three groups: Irshansk, Birzulivske-Nosachivske and Volnogorsk.

Sergey Voloboev, a director of emerging markets research for Credit Suisse, told delegates that the country had been hit hard by the recession (the economy contracted 15% in 2009). Much of this, he said, was because cyclicality had been exacerbated by the government (mainly through high levels of external borrowing). Facing insolvency, the Ukraine received emergency funding from the International Finance Corp (IFC) in October 2008.

There have also been unnecessary problems, such as the dispute with Russia in January 2009 over gas transportation. Nevertheless, Mr Voloboev said the economy is "coming back".

Looking ahead, Mr Voloboev is optimistic. Pensions, he said, "were minuscule and are now almost decent", the new government approved a tight budget in April and is in talks with the IMF for funding (see *Comment, page 2*). The economy is now growing quickly (albeit from a low base), with output up 12% year-on-year.

Mining can be expected to benefit. It is already by far the largest sector in the economy, and the recently-elected president is a mining engineer. Also, Ukraine has one of the best qualified labour forces in the CIS.

Mr Voloboev commended the creation of a sovereign wealth fund to act as a financial "buffer". However, the most important priority is to improve the country's endemic level of corruption. He told delegates that most officials do not understand the concept of

'conflicts of interest', and there is no separation of private and business issues. He warned that Ukraine "needs to act fast" to avoid the fate of its poor and divided neighbour.

FUNDING ISSUES

In a discussion on funding, Mr Hambro said that his maxim (passed down from his father) was "never borrow money from those to whom you wouldn't lend it". This, he said, was one of the problems with issuing bonds, as you could never be sure who would emerge as holders.

Several speakers (in a session sponsored by PricewaterhouseCoopers) addressed the financing of mining companies in the CIS. For example, John Meyer, the head of resources at Fairfax IS plc, described the world economy as a "car crash", with "life flashing before your eyes". He said that "banks were not being very helpful" but argued that "good projects can still get funding".

Sacha Backes, the business development officer of the IFC, agreed that there had been a "flight to quality", and that financiers were very risk averse. In looking at the financing of mining in 'frontier countries', Dr Backes noted that there had been a decline in the number of syndicates offering debt finance to mining companies during the past two years, and that the amount offered had slumped dramatically.

De-leveraging is still going on, according to the IFC, and Dr Backes expected the availability of debt to get even worse in the short term.

With regard to the CIS, Dr Backes agreed with Mr Voloboev that corruption in the region is an issue for investors. Nevertheless, he agreed with most of the other speakers, saying that "if you can work there, and with the government, there are significant benefits to be reaped".

PricewaterhouseCoopers' UK mining leader, Jason Burkitt, criticised companies for the inadequate thought given to their initial public offerings when coming to the market. They should focus, for example, on their preferred tax structure, which people were going to be involved and which projects were to be included in the vehicle.

The actual flotation (setting up and delivering) was relatively mechanical, Mr Burkitt said. However, a "huge number of things" need to be done after the flotation, including ensuring an adequate flow on information to the market, and properly staffed legal and public relations departments.

The role of stock exchanges was also explored by Ayuna Nechaeva (London Stock Exchange) and Aaron Goldstein (NYSE Euronext).

Ms Nechaeva said that there were over 100 CIS companies, in total, on the main board of the LSE, with nine in the mining sector. She spoke of the advantage of reaching an international investor audience through the LSE.

Mr Goldstein countered with the advantages of NYSE Euronext, claiming that it had the better liquidity, valuation and exposure. The New York Stock Exchange's European platform was formed from an amalgamation of the stock exchanges in Paris, Amsterdam, Madrid, Lisbon and Brussels.

The combined NYSE Euronext has exchanges located in the US and five countries in Europe, with over 4,000 issuers representing a combined US\$14,700 billion in market capitalisation (including a constituent market capitalisation in Europe of some €2,100 billion).

The exchange accounts for one-third of the world's total equity trade. Like Ms Nechaeva, Mr Goldstein argued that the exchange made companies visible to a large pool of investors.