Africa rush

From political risk to corruption, obstacles to mining in Africa are many, but for those who persevere, the rewards can be huge

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An excavator at a First Quantum mine in Congo. There are many obstacles to mining in Africa, but those who stick it out can reap huge rewards.

Before an audience of thousands at the 2008 Mining Indaba conference, Cynthia Carroll, chief executive of Anglo American PLC, ended her keynote speech with a message that everyone knew was coming: "Africa's time has come!"

The mining folks in the audience nodded. They have heard all this before. In fact, they realized it a long time ago, even if their investors in Toronto, London and New York are just starting to figure it out.

They were all drawn to the continent years ago with the hopes of capitalizing on democratic reform and access to unimaginable resource wealth that came with it. The fact that nearly 5,000 people, a record number, trekked to Cape Town for this convention shows that those dreams have been largely realized, or will be.

The numbers tell the story. More than $45-billion in new mining investment is expected over the next five years. Canadian companies alone now have mining assets worth more than $12-billion in Africa, a number that is projected to nearly double in the next three years. Five years ago, Canadians had less than $1-billion invested on the continent.

Despite a turbulent political environment, Africa is quickly earning a reputation as the place where mining gets done right. Unlike Canada, this is where mines can get permitted and built with breathtaking speed by entrepreneurs who rarely disappoint the market. A group of small, nimble companies like Equinox Minerals Ltd. and CIC Energy Corp. are developing remarkable projects in Africa in a fraction of the time it would take in Canada. Many of them trade in Toronto.

"In Africa you don't get the long permitting delays to get your environmental assessment through. There doesn't seems to be any issue getting drill rigs, unlike in Canada. There are good assay labs and good engineering support out of Johannesburg. It's all there," says Canadian Stephen Dattels, the entrepreneur who built African miner UraMin Inc. almost overnight and sold it for US$2.5-billion. "There's a reason mining companies are looking beyond North America."

It is no surprise that Africa is receiving unprecedented levels of mining investment amid today's sky-high metal prices; the continent holds about 40% of the world's known gold reserves, 60% of the cobalt, 65% of the diamonds, 88% of the platinum, and so on.

The investment numbers point to a very healthy industry, but you wouldn't know it by reading the headlines. The news that flows from Africa -- mining or otherwise -- is invariably bad. When it comes to mining, the talk usually focuses on a handful of predictable topics: violent upheavals threatening projects, corrupt governments scrapping contracts, and collapsing infrastructure and power failures. Then there is the overbearing spectre of China, which wants the vast resources for itself.

There is no question that Africa is a difficult place to do business. But as anyone at Indaba will point out, the "bad news" misses the point: companies mining Africa are overcoming the challenges and succeeding.

WEALTH OF RESOURCES

In North America, investors have reached a stage where they assume that mines will not be delivered on time and on budget. That is largely due to a glacial permitting process that can hold up projects for years as politicians and other interest groups grandstand.

In Africa, meanwhile, a company like First Quantum Minerals Ltd. can get its Lonshi mine up and running less than a year after a discovery is made. "We wouldn't want to be in the U.S., for example, because the permitting requirements are so severe," says Clive Newall, First Quantum's president. "It takes 10 to 20 years to take a mine into production. We just don't operate like that."

There is another simple truth: It is much easier to find resources in Africa. In Canada, the easy stuff has been found and companies are now developing low-grade projects with marginal economics. The most notorious is Teck Cominco Ltd.'s Galore Creek, the British Columbia debacle that was halted late last year after costs spiralled out of control.

In Africa, there are highly prospective regions like the Central African copperbelt that have had no serious exploration for decades, or ever. "You're looking at virgin ground that's almost untouched. It's finally being explored properly," says Jean Luc Roy, CEO of the copperbelt exploration play El Nino Ventures Inc.

For investors, it comes down to "picking your poison," as one hedge fund manager puts it. Do you want the growing geological risk of Canada or the political risk of Africa?

More and more investors are choosing the latter, and that doesn't surprise Mr. Newall. His mining company was the first to enter the Zambian copperbelt when it opened up for foreign investment in the mid-1990s, but it still had little trouble raising money. "The quality of the projects we were presenting to the banks was so high that they were not likely to turn them down," he says. "They were surprisingly easy to finance, given that we were first mover in an environment no one had been in for decades, in a time of collapsing copper prices."

But there is more to the booming African mining industry than good geology and easy permitting. The continent is drawing people with that extra entrepreneurial spirit who aren't afraid to take big risks to get projects built.

There is CIC Energy in Botswana, a creation of Canadian and South African entrepreneurs that is building a staggering $9.5-billion integrated coal project and power station. The power will go to South Africa, which is suffering a huge shortage. In Egypt, a company called Centamin Egypt Ltd. followed the lead of the ancient pharoahs and found millions of ounces of gold. In countries like Eritrea and Central African Republic, a few juniors have dared to enter totally uncharted territory and been rewarded.

These miners are kept on a shorter leash than the ones operating here at home. Shareholders are already worried about the volatile politics in Africa, and if these firms can't manage political risk and deliver on their promises, the money will vanish overnight.

POLITICAL RISKS

The downside is obviously the political risk. In Africa the political environment changes, for better or worse, very quickly. It happened recently with the ethnic violence in Kenya. And a lot of miners are worried about South Africa, where controversial politician Jacob Zuma is gaining more power and rattling the nerves of foreign business owners.

But the big hot zone right now is the Democratic Republic of the Congo (DRC), a fledgling democracy that is still trying to find its feet after a bloody civil war. That is where the investment dollars are flowing these days and it's not hard to see why: "If you look at the head grade of all the open pit copper producers in the world, it's approximately 1.2%, 1.3%," says Robert Lavalliere, vice-president of investor relations at Anvil Mining Ltd., which has three major DRC projects. "If you look what we have in the DRC, it's three, four, five times that."

Operating in the DRC is always an adventure, and the companies never quite know what's coming next. Most famous is the "contract review" process that is now forcing each company to renegotiate its mining terms. Investors are livid, but that kind of thing happens in this corner of the world.

To overcome these challenges, DRC companies like Anvil and Lundin MiningCorp., expend huge amounts of effort into government relations and community development, teaming up with NGOs and reinvesting millions of dollars in social spending and infrastructure development. They also give Gecamines, the state-owned company, stakes in many of the ultra-high-grade projects.

The DRC is an extreme example, but even stable countries can turn on a dime. In January, the Zambian government introduced an unheralded profits tax on mining companies, boosting the effective rate from 31.7% to 47%. The companies heard about it when their investors did.

There was a predictable uproar afterward. But as one source pointed out, Ontario slapped a royalty on diamond mining last year and nobody blinked.

THE CHINA FACTOR

In the long term, the biggest threat to Western mining interests in Africa may not be the politics or the lack of infrastructure but China, which craves the resources to feed its surging economy and is using its considerable heft to get them.

At Indaba, the Chinese are the proverbial elephant in the room. Ms. Car-roll's remark that the Chinese "have not been guilty of under-appreciating Africa's economic potential" is about as public as the comments get. But the Chinese come up frequently in casual conversation.

"In every jurisdiction we were in, the Chinese were there trying to steal our projects," offers one individual, who claims he was harassed and threatene as he tried to secure projects and build his company.

The Chinese are often accused of not playing fair in Africa. But to their credit, they have had a significant positive impact on the continent. They will offer countries hundreds of millions (or billions) of dollars in aid and infrastructure build-out in exchange for energy and base metals.

Critics call this "colonialism" and the tactics have angered mining companies, who find it difficult to compete. "They play by different rules," says Paul Conibear, senior vice-president of projects with Lundin Mining. "For example, when anything meaningful happens to us, we have to press release it with all the fundamental details. So, automatically the Chinese get all this benchmarking. We'd love to know the details of the last four or five Chinese deals in Africa, but you have no way of finding out."

Bruce Shapiro, president of business development firm MineAfrica, says most African nations would still prefer to deal with Western mining companies. But the more volatile the country, the more likely the Chinese will be looking around. "They know these countries are more desperate for investment and are not as concerned with the niceties of the situation," he says.

Naturally, the DRC has become the big battleground between East and West. Last fall, a Chinese consortium struck an eye-opening $9-billion joint venture deal with Gecamines, in which it pledged to build an array of infrastructure projects.

The agreement was criticized by the World Bank and others, but sources close to the DRC say the deal made total sense. When the World Bank lends money, it takes forever to arrive and comes in small amounts with a mountain of conditions attached. But with the Chinese, the results are immediate.

"The way I look at it, it's up to the Africans," a Johannesburg-based hedge fund manager and African nationalist says. "If the African leaders and African subjects want an honest regime, the Chinese are not going to deflect them from that. If they want a dishonest regime, the Chinese permit them to do that.

"But it's quite clear from the history of Africa that many Western companies and governments have been very comfortable supporting bad government."

THE RUSH GOES ON

The one thing everyone in Africa agrees on is that the foreign mining dollars will continue to pour into the continent for years in the future. As long as commodity prices stay at high levels there is no reason to assume otherwise.

The question is, who will be making the investments. In stable countries like South Africa, Western mining interests are established and are not going away. But in countries like the DRC, Zambia and Eritrea, the investments by companies like Lundin and Anvil are still a new phenomenon. They have been remarkably successful so far, and if this continues they will have a lot of company.

"If these investments are all successful, then everyone will come --all the transparent Canadian, North American and European companies," Mr. Conibear says. "And if they're not successful for whatever reason, mining will still occur but by much less reputable [companies]."

Mr. Newall at First Quantum looks at it another way. His company has tried to expand out of Africa on a number of occasions. Each time it goes after a big acquisition off the continent, it gets trumped by a company with more financial horsepower, such as Xstrata PLC. It gets a bit frustrating.

But he has to admit that staying in Africa isn't such a bad thing. "You get drawn back here because when you're looking at competing investment opportunities, the potential of the opportunities here, notwithstanding political risk, is too tempting. Too attractive. "So you keep being drawn back."