Resources Postcard

Ferrier Hodgson

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INVESTMENT RISK - TWO POINTS OF VIEW

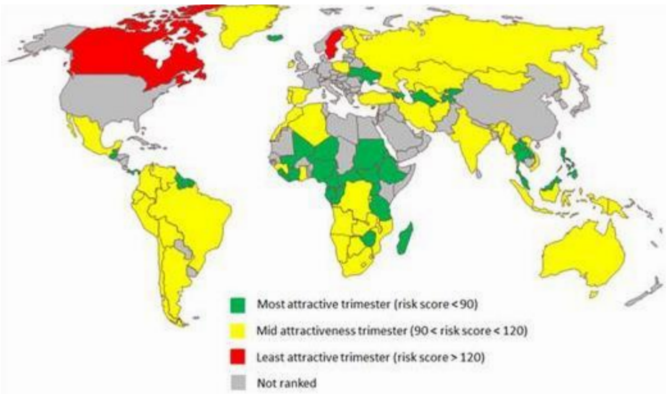
The economic attractiveness of a prospective mining investment is underpinned by the quality of the mineral deposit. Access to deposits and many of the drivers of financial success are heavily influenced by national factors and investor's views on how such factors will impact the project. This is evident through the opposing mining investment destinations preferred by China compared with those of 'Western' investors.

Countries that are most attractive to Chinese investors are the least attractive, highest risk locations for 'western' mining capital. The reverse is equally apparent.

In this postcard, we explore these differing opinions and the preferred 'fishing ponds' for these two key investment groups in the current mining investment environment.

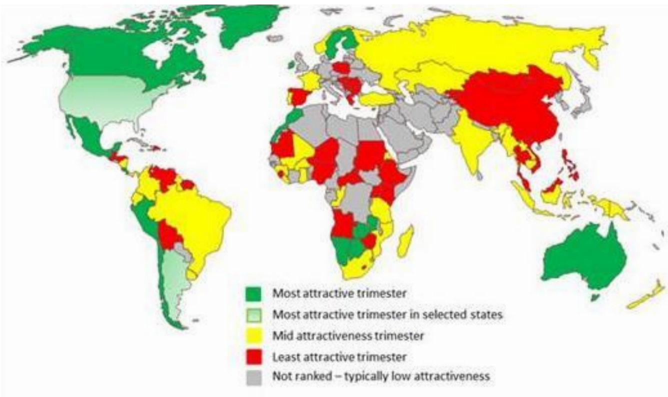
The maps below contrast the opinions of Chinese and listed 'western' investors on mining country risk.

China's investment mining perspective



Note: Click image to enlarge

Listed ‘western’ investors mining perspective



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In summary, from China’s perspective:

- Central and West Africa are highly attractive, due to:

  - Low competition;
  - Easier access to deposits;
  - Flexible regulatory regimes to sovereign investor; and
  - Chinese equipment and labour.
- Key mining provinces in Canada, Sweden and parts of the US are avoided.
- Australia and South America offer mixed attributes to China.

From the perspective of listed ‘western’ investors:

- The attractive mining provinces are in parts of South America, the US, Canada, Australia and Southern Africa, for the:

  - Regulatory and fiscal clarity;
  - Operating and investment familiarity; and
  - Access to skills pool.

  In contrast, the attractive mining provinces have:

  - Higher cost, longer timeframes; and
  - More competition, higher discovery cost
- Central Africa risks are political, reputation and corruption.

The opinions of the two investor groups are largely inverted. Countries that are most attractive to Chinese investors are the least attractive, highest risk locations for ‘western’ mining capital. The reverse is equally apparent.

Chinese investment appears to be driven by supply access and/or economics. Access to available higher quality deposits and capital efficiency seem to lie at the heart of their ranking criteria:

- Countries with weak regulatory regimes, corrupt practices, poor infrastructure and sovereign ownership of mineral tenure will deter competition from the major miners. China’s sovereign role supporting trade, infrastructure and economic development can create proprietary access to quality deposits.
- Construction of infrastructure and mining assets by Chinese companies using their own labour and materials fabricated in China, delivers lower capital costs, increasing China’s exports and employment. The standard of built facilities and operating costs to meet environmental conditions may be less than those that public listed companies would apply. Approval timeframes can be much shorter.
- Chinese investors gain considerable control of most factors that drive investment attractiveness due to their ability to influence host governments through a wider economic relationship with China.

In the mining provinces of most developed economies, the regulations, fiscal regime and operating standards are well known and largely fixed. Competition is greater and no investor has the ability to change the boundaries to their own benefit. The inability to influence many investment drivers appears to increase perceived investment risk and reduce project attractiveness for outbound Chinese capital.

Take away

Most capital invested during the past decade for major expansion of mining production occurred in the globally significant mining provinces of Australia, Canada and South America. Capital was largely sourced from existing listed mining companies through the capital markets and traditional lenders.

Direct external investment in major new mines operated by Chinese companies using Chinese capital has been modest and with mixed outcomes. Citic's Sino Iron project in Western Australia suffered a substantial cost over-run and poor commissioning performance. In contrast, Citic combined with Chinese owned MMG to acquire Las Bambas, a Tier 1 copper mine in Peru, which commissioned successfully.

Given the opposing risk criteria that are apparent from the two mining attractiveness rankings, it would appear the two investor groups are fishing in separate ponds. Also, Chinese companies may have access to better fish and cheaper bait. Nevertheless, well supplied markets suggest the recent mix of capital sourcing could satisfy China's supply risk tolerance.

Footnote: The 'western' risk rankings are published in the Fraser Institute's 2014 Annual Survey of Mining Companies. The China Investment Attractiveness rankings are extracted from material presented at the China Mining October 2015 conference.

Andrew Smith
Partner
+61 8 9214 1423
+61 407 274 840
andrew.smith@fh.com.au

Martin Jones
Partner
+61 8 9214 1405
+61 418 919 403
martin.jones@fh.com.au

Dermott McVeigh
Partner
+61 8 9214 1406
+61 488 986 743
dermott.mcveigh@fh.com.au

Stewart Howe
Mining and Energy Specialist
+61 3 9600 4922
+61 410 479 005
stewart.howe@fh.com.au

Peter McCluskey
Partner
+61 3 9604 5109
+61 419 303 302
peter.mccluskey@fh.com.au

Morgan Kelly
Partner
+61 2 9286 9874
+61 416 007 175
morgan.kelly@fh.com.au

Andrew Rodgers
Mining and Mining Services Specialist
+61 7 3831 4833
+61 412 429 856
andrew.rodgers@fh.com.au

Will Colwell
Partner
+61 7 3834 9205
+61 417 789 205
will.colwell@fh.com.au

Tim Michael
Partner
+61 7 3834 9228
+61 412 090 170
tim.michael@fh.com.au

Martin Lewis
Partner
+61 8 8100 7657
+61 417 869 627
martin.lewis@fh.com.au

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Sydney: Steve Sherman
+61 2 9286 9997
steve.sherman@fh.com.au

Melbourne: Peter McCluskey
+61 3 9604 5109
peter.mccluskey@fh.com.au

Adelaide: Martin Lewis
+61 8 8100 7657
martin.lewis@fh.com.au

Brisbane: Will Colwell
+61 7 3834 9205
will.colwell@fh.com.au

Perth: Martin Jones
+61 8 9214 1405
martin.jones@fh.com.au

Singapore: Tim Reid
+65 6416 1400
tim.reid@fh.com.sg

Malaysia: Andrew Heng
+60 3 2297 1150
aheng@fhmh.com.my