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Danakali fights Eritrean history

Danakali remains disappointingly short of the funding needed for its Colluli potash deposit in Eritrea.

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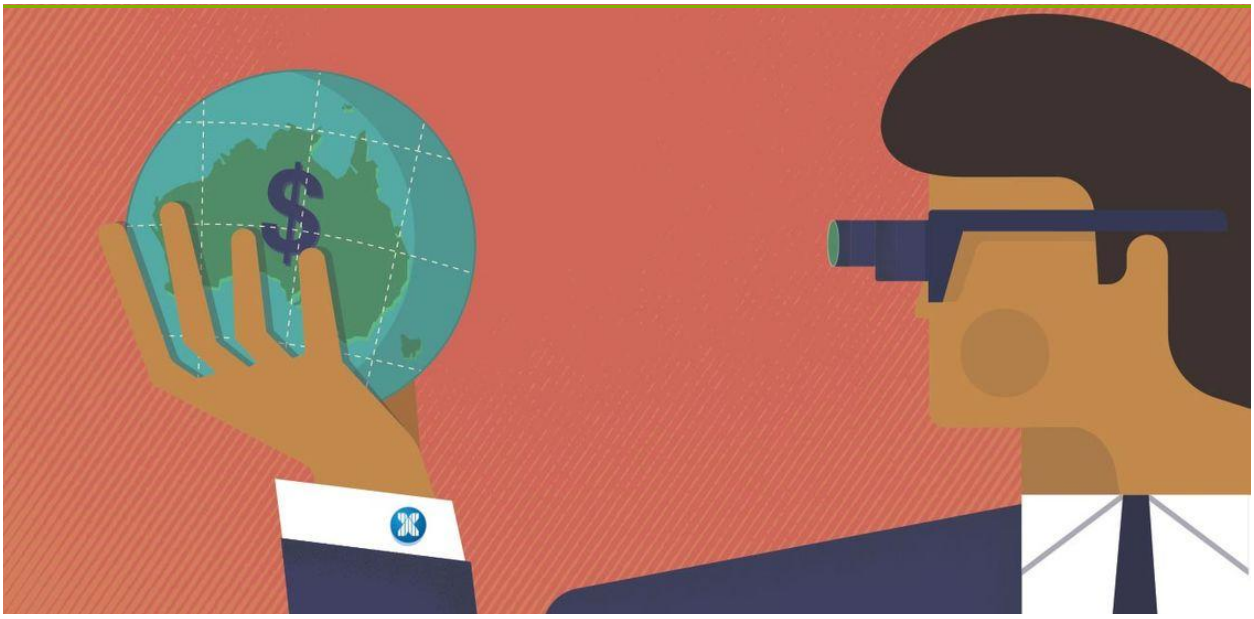

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The Colluli sulphate of potash (SOP) mine has been a long time in coming. As South Boulder Mines, Danakali took up an exploration licence as early as 2009. By 2012, the company was advertising a production start "in 2016 or sooner". Now, production is set to begin in 2022.

Development work has commenced and commitments for the majority of the necessary finance have been received, according to chief executive Niels Wage in a September 3 webinar report to investors.

To drive home the quality of the project, Wage enlisted the help of Osam Iyahen, the head of natural resource investing at the Africa Finance Corporation (AFC), as well as recently retired JP Morgan Asset Management investment heavyweight and newly appointed Danakali director, Neil Gregson.

The investment proposition behind the Colluli project looks stunningly attractive.

Thematically, the project's attractiveness revolves around the pressures on productive land to meet steadily growing global food demand.

From a mining standpoint, the deposit is large, flat and shallow. The economic studies have assumed a 60 year life but, so extensive is the mineralisation, as much as 200 years may prove feasible.

Despite Eritrea's generally underdone infrastructure base, Colluli is within trucking distance of a suitable port accessible via an existing road link.

Sitting in northeastern Africa, the deposit is conveniently positioned near the coast to tap African, European and Asian markets.

Prospective cash flows are underpinned by a ten year offtake agreement covering 100% of the first production module, set to produce at a 472,000 tonne annual pace. The second module, due to click in after six years, will take average annual production to 944,000 tonnes.

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The company has assumed a US$569/tonne SOP price, based on an assessment of long term marginal production costs, compared with average total cash costs of US$242/tonne over the assumed project life.

A US$302 million pre-production capital spend plus a US$20 million dollar working capital requirement will produce average annual free cash flows of US$173 million, according to the latest economic study.

Colluli is a potentially long life, large-scale mining operation with strong cash flow potential at a low price by any industry standard.

Wage confirmed that the project had attracted US$200 million in senior debt and US$50 million in equity funding commitments. But that still leaves him short of what is needed. The best he could muster to reassure investors was that he was "hoping to be able to close the gap", in all likelihood through more equity.

In reality, Eritrea's unsavoury historical legacy hangs over what would otherwise be an outstanding investment opportunity.

Asked about Eritrea's standing among investors, Iyahen conceded some lingering concern about the country's history but observed that more investors were becoming interested.

Iyahen spoke about the strong commitment of the AFC to the project. As well as its attractive investment return potential, a Colluli development delivers spin-off benefits through jobs, exports and growth.

Iyahen admitted some delay in finalising the funding package due to COVID-19 restrictions but described the AFC as committed and determined to see the investment through.

Gregson characterised Colluli as an unusually long term investment, offering the prospect of two centuries of dividend flows. He, too, downplayed the historical impediments to attracting capital asserting that "good projects do get funded". Colluli, he said, "will get funded".

Abandonment of UN sanctions following a peace deal with Ethiopia in 2018 helps the country's investment rehabilitation. Even so, more wide-ranging reputational impediments to socially aware investment remain unaddressed.

Perceptions of corruption remain a bugbear. Only 20 out of 180 countries have had a worse reputation for official corruption over the past three years than Eritrea, according to Transparency International.

Danakali executives, on the other hand, have consistently denied that corruption is a problem. A June 2020 corporate presentation refers to Eritrea as "safe, stable and development focused". An accompanying graphic depicting a bribe is boldly headed "no evidence of corruption".

One man's stable jurisdiction can easily be another's one party dictatorship. Corruption, too, can take many forms. Danakali shareholders are being forced to fund state-owned entities, acting outside the nation's defunct constitution. In New South Wales, such behaviour would be called corruption.

Investors with a social conscience will have cause for other worries. The Minderoo Foundation Global Slavery Index places Eritrea very near the top of its list of countries with a high prevalence of modern slavery. Only the North Korean regime is more likely to use enslaved labour, according to the foundation.

Numerous reports, including by the US State Department, the United Nations, Human Rights Watch and Transparency International, have referred to open-ended periods of compulsory military conscription for Eritreans resulting in effective slave labour.

Eritreans make up a disproportionate number of people claiming asylum in Europe. According to Eurostat data for the first quarter of 2020, 79% of Eritrean claims were accepted, giving official weight to allegations of widespread suppression of human rights in the country.

Earlier this year, Canada's Supreme Court allowed the country's courts to hear claims for compensation from three Eritreans allegedly forced to work at the Bisha copper-gold mine while run by Nevsun Resources.

The Canadian decision is a fresh warning for investors. Companies can no longer rely on home legal systems letting whatever happens in Eritrea stay in Eritrea.

No-one has suggested that Danakali directors will knowingly employ slave labour. That said, and given the nature of the Eritrean regime, the company may be hard pressed to prevent a local contractor, with military backing, from doing so. Nor can it be sure that the roadway to the port or future public infrastructure, so critical to its commercial success, will not be built or maintained by enslaved workers.

Investors also face risks associated with the certainty of an eventual regime change. Planning for political evolution is highly problematic in a jurisdiction without any precedent for peaceful leadership transitions and with a proven Marxist cynicism toward constitutional government.

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