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Companies blinded to DRC risks

What happens when some of the world's best geology is in one of the world's most risky mining jurisdictions?

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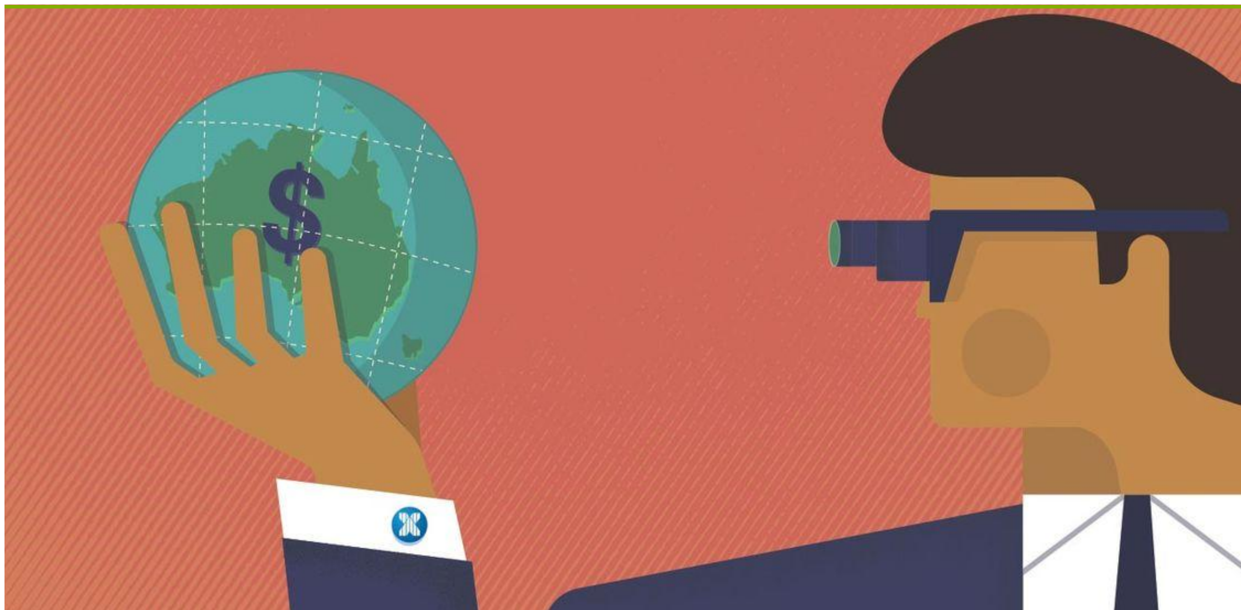

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The updated Mining Journal World Risk Report (feat. MineHutte ratings), published in October, rated the Democratic Republic of the Congo (DRC) as the riskiest of the 99 jurisdictions analysed. Seven Canadian provinces and three US states made up the 10 lowest risk places in which miners do business.

According to the International Copper Study Group, only four countries - Chile, Peru, China and the US - mined more copper in 2018 than the DRC. The central African country is also the source of more than 60% of the world's cobalt, according to the US Geological Survey. Gold and lithium mineralisation are also attracting recent corporate attention.

The DRC stands out as the country with the widest disparity between its risk profile, as assessed by the Mining Journal Investment Risk Index, and its standing as a contributor to mining output.

To be fair, the DRC did register some lowered legal, social and fiscal risks from a year earlier, but the limited improvement was not enough to escape the lowest possible rating on the Mining Journal scale.

Taken at face value, the country's 'D' rating, is a warning for mining companies to give the DRC a wide berth.

Of course, risk should not be an automatic investment disqualifier. Risk can be sensibly embraced, albeit cautiously, if the compensation is adequate. As well as being a warning, country risk ratings are guideposts for how much compensation investors should seek in return for their capital.

Companies looking to develop assets in the DRC should be using higher return hurdles for decision making purposes than they would if they had been located in more favourably rated jurisdictions. That does not happen.

The Mining Journal report itself drew attention to how "many in the industry would swear blind by the opportunity there outweighing any risks one might face".

A strong industry aversion to project specific or country risk assessment is evident across the board in selected hurdle rates

TSXV-listed Alphamin Resources produced a feasibility study in March 2017 that valued its Bisie tin project using an 8% cost of equity. A July 2018 definitive feasibility study by ASX-listed Kasbah Resources also used an 8% cost of equity in evaluating its Achmmach tin project in Morocco.

Aswath Damodaran of the Stern School of Business at New York University has estimated the difference in equity risk premium between the DRC and Morocco at 5.6 percentage points.

There is no reflection in the Bisie and Achmmach evaluations of Damodaran's market assessment, Morocco's far healthier BBB rating under the Mining Journal risk assessment framework or the BBB- S&P rating for Morocco compared to its lowly CCC+ rating of the DRC.

It must be said that the qualitative risk reporting by TSX-listed companies under the NI 43-101 standard is vastly superior to what ASX-listed companies are normally prepared to disclose. Details of a May 2019 scoping study by AVZ Minerals for the Manono lithium-tin project only refers to DRC risk in the small print of the disclaimer in the company's public release. Still, the more thoroughgoing risk analysis evident in the Canadian reports does not translate into financial valuations.

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A February 2019 pre-feasibility study by TSX-listed Ivanhoe Mines for the Kakula copper mine in the DRC also used an 8% cost of equity just as dual-listed Copper Mountain Mining did in October 2018 for a project in Queensland and ASX-listed Superior Lake resources has done in August 2019 for a restart of base metal mining operations in Ontario.

AIM-listed Armadale Capital used a 5% discount rate in a February 2016 feasibility study for the Mpokoto feasibility study, another DRC asset, just as companies commonly do for projects in North America or Australia, seemingly oblivious to the idea that financial hurdles should better reflect the reality on the ground.

Public equity markets should play a role in guiding companies' views about risk. If companies choosing to operate in the DRC were priced at a substantial discount to those with similar assets in other localities, directors would factor in the negative impact on their market values of a move to the DRC as well as the positive impact of uncovering potentially superior assets.

Unfortunately, the risk profiling function of the market for mining equities has been severely handicapped by the persistent weakness in sector prices. The median share price fall since the beginning of 2011 of mining companies currently listed on the ASX, for example, is 90%. This unprecedented bunching of market values near historically low levels, no matter where projects are located, reduces the extent to which prices can reflect specific corporate risk characteristics. There is little price penalty from a business shift to the DRC.

Despite its egregiously poor rating, a DRC relocation could be a step up in asset quality and even overall risk attributes, in some circumstances. Six ASX-listed companies currently active in the DRC display typical signs of prior strategic distress, including relatively recent name changes to help blur earlier corporate misadventures. Another opted for the DRC after a planned switch in business activities from mining to technology fell through at the last moment.

Ironically, the DRC has become a preferred destination for some of the least successful mining businesses looking to rejuvenate their flagging fortunes after having been unable to meet the challenges faced in easier jurisdictions. This poses risks for the DRC itself.

When asked, investors usually refer to management quality or track record as the most important factor in judging mining investment prospects. To the extent the DRC becomes a refuge for companies with limited project management experience, the country's development potential is hampered.

The legacy of having attracted some of the industry's less-skilled practitioners, including some who have deliberately downplayed the riskiness of their endeavours, might haunt future DRC governments trying to rehabilitate the country's investment standing.

These are circumstances in which governments become understandably impatient and policies

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