phase

BRIEFING – COMMERCIAL RISKS FOR EXPLORERS AND DEVELOPERS IN EMERGING JURISDICTIONS

BACKGROUND:

As part of our business intelligence activities, prompted by our attendance at a recent European mining and investment conference[i], Ph-ase conducted an informal study of attendees[ii], to identify the commercial risk profiles that companies are exposed to in the course of exploring and developing resources assets.

The purpose of the study we conducted was to:

1. Build a general profile of the regions that exploration and resource development is being conducted in and how they expose explorers and developers to particular commercial risk profiles; and,
2. Prompt some thought about what advice we might give to our clients, or to identify questions they may wish to ask themselves in response to those risks.

This study was not intended to be a complete risk analysis nor was it intended to demonstrate every risk that developers are potentially exposed to in any particular jurisdiction or their full range of activities. This briefing note however provides insight on the general profile of commercial risks in jurisdictions that explorers and developers are operating in.

METHODOLOGY:

By assessing the primary location of operations for our sample set of explorers and developers, we grouped host countries into risk profile categories using readily available national risk data. The major risk indices[iii] we referred to were:

1. **Perceived corruption ranking:** Grand, Petty, and Political.(Transparency International, 2013);
2. **Protection of investor ranking:** Disclosure, Liability and Legal Action.(World Bank, 2013); and,
3. **Enforceability of Contracts ranking:** Procedures, Time, Cost. (World Bank, 2013).

We chose these data sets both for the reliability of their sources, and as being generally relevant across most commercial activities associated with exploration and development.

Each of these data sets ranked countries from One (being the best) to respectively, 177, and 186 (being the worst), with the bottom-end figure equaling the total number of countries assessed. As a ranking, such measures provide limited insight in to specific national risks, however, as risk 'profile', they provide effective risk indicators.

After averaging the national ranks across all three indices noted above, to determine each country's score **('Score')**, the group's countries naturally split broadly into thirds. Group One became comprised of the lowest risk countries, (principally Canada, USA, Europe), Group Two is the next third (principally South America), and Group Three (principally Africa) completing the set. These Groups are illustrated in Appendix A.

Note that Central Asia and the FSU we underrepresented in our sample group, and were therefore excluded. However, the practical responses to these risks are as applicable in Central Asia and the FSU as they are in the sample group used in this Ph-ase Brief.

Following determination of the Score we then assessed the collective number of participant in each of the three Groups to provide a weighted average that accounts for multiple operators in any once country; this effectively equalizes the risk measure across the collective

WHAT WE FOUND:

Our first observation was that of the 73 exploration and/or development organizations we sampled, 57% were operating in Group Two or Three countries. This is notable as it supports what we already knew: 'That explorers and developers commonly operate in higher risk areas'.

What we found more interesting were <u>the scale implications</u> for risk for those operating in Groups Two and Three (the majority).

Figure 1- Average Score by Group

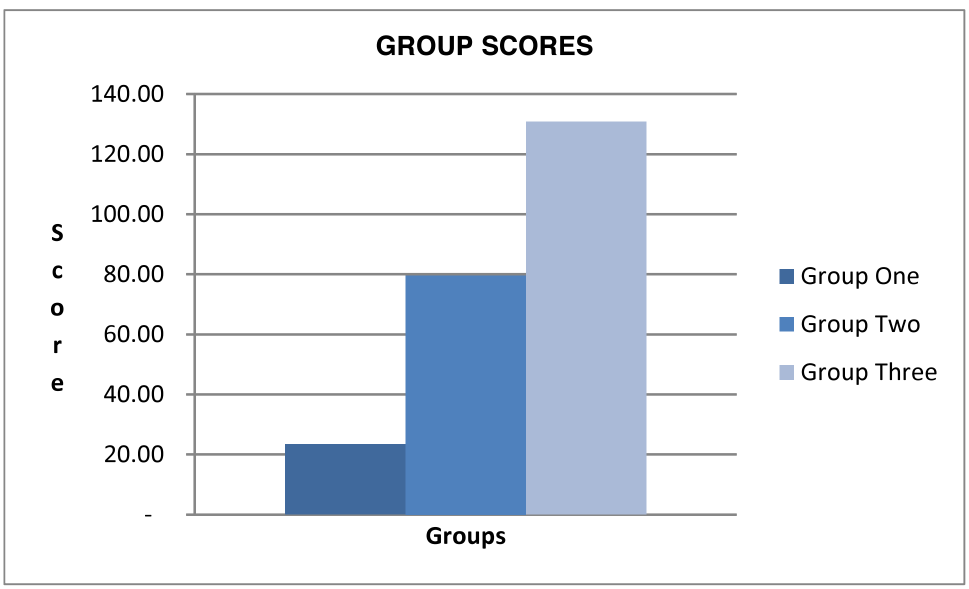

Figure 1 shows the Score for each of the Groups. Note that the difference in *average* Score between Group One and Group Two and Three countries is substantial. In fact, the average Score for Group Three countries is 4.58 times that of Group One's. Explorers and developers operating outside of Group One countries (the majority) are therefore not simply operating in a more risky environment, they are actually <u>exposed to a step change in risk profile.</u>

Also, while splitting the countries into thirds suggests a linear increase in risk, we would argue that the risks associated with operating in a Group Two[iv], rather than a Group One nation, would be <u>substantially greater than a straight line factor would imply</u> - an example here is comparing the risk of expropriation in Spain (Rank 65.7) as opposed to Canada (Rank 12).

Taking this concept further, we believe that the risk of operating in a Group Three country is greater than in a Group One, by a margin substantially wider than what the ranking differential would imply. In this case we might offer the Democratic Republic of the Congo as an example (Rank 159.3), against Turkey (41.7); is the DRC only four times more of a risk to operate in than Turkey?

What we also found interesting was the volume of countries being operated in outside of Group One, as compared with Group One's fairly homogenous membership. Group One shared six countries between 31 companies. Groups Two and Three shared 27 countries between 42 companies. We believe this has significant implications for those operating in the latter group, both in terms of corporate isolation and variety of challenges.[v]

Finally, and by way of general observation, we noted that the real exposure to these risks is not limited to the junior explorers and developers we reviewed, but extends to their direct investors and shareholders. We would suggest that even a quick consideration of 'who owns whom' would indicate that the risk profile we have been looking at has further-reaching ramifications.

HOW TO RESPOND:

One ever-apparent factor in our work with junior and mid-tier explorers and developers is their limited team size, and their heavy workload. In the case of risk management, our experience has been that this can manifest in a focus on managing *localized,* (task, machinery, people) rather than national risk. We also know, given their limited team size, that simply providing a long list of 'must do' risk-management activities is an impractical offering.

For this Ph-ase Brief, we've listed the top five risks that, in our experience, are overlooked at the planning stage, or missed because of time pressure. We've also provided a number of questions that companies may wish to ask themselves, and we believe that doing is a wise exercise for management groups and individual managers alike.

<u>Business Intelligence- Know Who You Are Doing Business With</u>

At the risk of oversimplifying the issue, the majority of commercial arrangements are entered into by organizations who know very little in practical terms, about each other; what is their background? What are their objectives? While the business norms and legislative frameworks we operate in, in low risk nations, can somewhat reduce the risks associated with this, in our Group Two and Three countries the prospect is markedly different.

1. How much do we know about our host jurisdiction partners?
2. How much do we know about our investors?

3. Have we satisfied ourselves that our in-country personnel are of a character that aligns with our company values and will represent us in an appropriate manner?
4. Have we conducted thorough background checks on our in-country personnel?
5. Have we confirmed the bona fides of all representatives and stakeholders associated with our project?

Political Risk - Protect Your Investment from Political Involvement

It's hard to think of an industry more exposed to sovereign risk than exploration and development, and at the extreme end of the scale, the impact of such an event is catastrophic. However, what is perhaps a more prevalent risk impact is the leverage that can be applied by sovereigns in lieu of full-blown nationalization of an asset, the impact that risk has on the cost of doing business, and the cost of capital.

1. What measures do we have in place to mitigate government expropriation?
2. What steps have we taken to tie our interests to those of our host nation?
3. What is our contingency plan?
4. How have we communicated our sovereign risk management strategy to the investment community?
5. How watertight are our license predicating legislative compliance management processes?

Contracts stability – Secure your arrangements with local authorities and stakeholders

The enforceability of contracts is a significant consideration in establishing and operating businesses in host jurisdictions. Explorers and developers can sometimes overlook the fact that key contracts (and their enforceability) are matters of relevance beyond inter-entity transactions and agreements, and play a critical role in allowing businesses to operate within bureaucratic frameworks.

1. Are our commercial teams fully briefed on commercial contract risk within the jurisdiction?
2. Do we have commercial strategies for dealing with contract enforceability issues that live outside of our contract suite?
3. Are our visa, immigration, and industrial relations arrangements sound? What is our contingency plan?
4. What happens if government royalties increase or embargoes are put in place?
5. Are our agreed tariffs and duties reliable? How deeply are we exposed if not?

Isolation – Build security from Industry Relationships

We noted above that the Group Two- and Three-exposed companies were spread across a large number of countries. We would argue that healthy competition between rival organizations in a common country still leaves room for mutual consideration and longer-term cooperation on matters of risk, especially personal security risk.

1. Have we established a network of nearby or similarly placed companies and trans-national organizations for risk management purposes?
2. Are we involved in broader international efforts to understand and reduce the risks associated with the business of exploring and developing?

An important non-commercial risk that can never be overlooked is **Security – Have Fail-Safe Processes in Place**

Often, from a resources industry perspective, when we think of security risks we think of operational risks, in particular armed cross-border conflict, sabotage, and civil war. What can often be overlooked are the implications of risk to personnel, through accidental interference with narcotics trade, organized crime generally, kidnapping for ransom and terrorism. In terms of our sample group, fourteen of the nations carry specific US State Department kidnap warnings, including a specific reference to mining exploration activities. (US State Department, 2013)

1. Have we thoroughly assessed personal security risk?
2. Do we have a 24hr call-in process? What If we haven't heard from someone on site for a couple of days - or in the case of transit, a couple of hours beyond their arrival time?
3. Do we have adequate procedures for dealing with travel mishaps – missed connections and the like?
4. Do we need a permanent security detail?
5. Do our personnel spend time in off-shore capital cities? Is it necessary for them to maintain a low profile, and have we trained them to do so?

The outputs from asking these questions will vary from company to company and project to project, Ph-ase is able to support our clients assess and management these commercial risks through a combination of our Risk Management, Compliance Management and Contract Management services.

For more information on national risk management matters, contact Ewan Cameron. ewan@ph-ase.com

Special thanks to Russel Risk Consultants for their contributions and invaluable support.

APPENDIX A. – SUMMARY OF FIGURES

Summary Data - National Rankings & Average Score - Risk Across Three Indices

Rank [vii]	Group	Operation Location	Corruption Ranking	Protection of Inv	Enf Contracts	Score	Grp Average
1	1	**United States**	19	6	11	12.0	**23.4**
2	1	**Canada**	9	4	58	23.7	
3	1	**United Kingdom**	14	10	56	26.7	
4	1	**Portugal**	33	52	24	36.3	
5	1	**Turkey**	53	34	38	41.7	
6	1	**Ghana**	63	34	43	46.7	
7	2	**China**	80	98	19	65.7	**79.6**
8	2	**Spain**	40	98	59	65.7	
9	2	**Peru**	83	16	105	68.0	
10	2	**Namibia**	57	80	69	68.7	
11	2	**Mexico**	106	68	71	81.7	
12	2	**Tanzania**	111	98	42	83.7	
13	2	**Colombia**	94	6	155	85.0	
14	2	**Argentina**	106	98	57	87.0	
15	2	**Serbia**	72	80	116	89.3	
16	2	**Brazil**	72	80	121	91.0	
17	2	**Zambia**	83	80	120	94.3	
18	2	**Morocco**	91	115	83	96.3	
19	3	**Dominican Republic**	123	98	81	100.7	**130.8**
20	3	**Ethiopia**	111	157	44	104.0	
21	3	**Nicaragua**	127	138	47	104.0	
22	3	**Indonesia**	114	52	147	104.3	
23	3	**Mozambique**	119	52	145	105.3	
24	3	**Mauritania**	119	147	75	113.7	
25	3	**Papua New Guinea**	144	68	168	126.7	
26	3	**Liberia**	83	147	165	131.7	
27	3	**Zimbabwe**	157	128	118	134.3	
28	3	**Niger**	106	157	143	135.3	
29	3	**Mali**	127	147	140	138.0	
30	3	**Togo**	123	147	153	141.0	
31	3	**Cameroon**	144	128	175	149.0	
32	3	**Guinea-Bissau**	163	138	148	149.7	
33	3	**Congo, Dem. Rep.**	154	147	177	159.3	

DISCLAIMER

THIS BRIEF REFERENCES INFORMATION SOURCES PUBLICLY AVAILABLE AT THE TIME IT WAS WRITTEN IN DECEMBER 2013, AND THE CIRCUMSTANCES DETAILED IN THOSE SOURCES AT THAT TIME. PH-ASE PRIVATE LIMITED ("PH-ASE") IS NOT RESPONSIBLE FOR CONFIRMING THE ACCURACY OF INFORMATION AND DATA SUPPLIED BY THIRD PARTIES OR OTHERWISE IN THE PUBLIC DOMAIN AND DOES NOT ATTEST TO OR ASSUME RESPONSIBILITY FOR THE ACCURACY OF SUCH INFORMATION OR DATA. PH-ASE ALSO DOES NOT ATTEST TO OR ASSUME RESPONSIBILITY FOR THE ACCURACY OF ANY RECOMMENDATIONS OR OPINIONS CONTAINED IN THIS BRIEF OR OTHERWISE EXPRESSED BY PH-ASE OR ITS EMPLOYEES OR AGENTS, TO THE EXTENT RECOMMENDATIONS OR OPINIONS ARE BASED IN WHOLE OR IN PART UPON SUCH INFORMATION OR DATA. PH-ASE PROVIDES THIS BRIEF FOR GENERAL INFORMATION ONLY, AND IT DOES NOT CONSTITUTE FORMAL ADVICE IN RESPECT OF ANY RISK RELATED MATTER. PH-ASE MAKES NO GUARANTEES, REPRESENTATIONS OR WARRANTIES AND ALL REPRESENTATIONS, GUARANTEES AND/OR WARRANTIES WHETHER EXPRESS OR IMPLIED ARE SPECIFICALLY DISCLAIMED. THIS BRIEF IS TO BE READ, USED AND/OR RELIED UP AT IT USERS SOLE RISK.

REFERENCES

Bloomberg. (2013). *2013 Political & Economic Risk Analytics.*
Transparency International. (2013). *Corruption Perceptions Index.* Transparency International.
US State Department. (2013). *Country Specific Information.* US State Department.
World Bank. (2013). *Economy Rankings - Doing Business.* The World Bank.

---

[i] Mines and Money London 2013

[ii] The group selected represented all companies identifiable as Explorers or Developers, predominantly operating outside of Australia, Central Asia and the FSU, totalling 73, or ~10% of the total number of delegates. The group was not 'controlled', and many factors could be raised to suggest varying levels of accuracy, including a bias toward the company profile attending *that* particular conference, in *that* location. For our purposes, we felt that the sample group was however reasonably representative of the marketplace as a whole.

[iii] We felt that these were sensible measures of national risk, in light of what we know to be, (and what our clients and partners confirm are), some of the main the risks of doing business as explorers and developers.

[iv] Many countries fitting into the Group Two category border those in Group Three. We note that one of our data group Group Two companies holds mining leases which exactly align with the border of a Group Three nation well known for civil war. We suspect that a war focussed data set would have had a worsening effect on many of the Group Two countries' scores.

[v] Note that the majority of companies operating in Group One countries operated principally in individual countries, the majority of the remainder operated across multiple borders.

[Vii] Rank this study