

Mongolia puzzle only partly solved

Chris Cann in London, [23 February 2010](#)



Oyu Tolgoi mine headframe ...
the project is finally moving forward.

THE weather's average and the neighbours can be a bit rowdy at times, but since a landmark deal cleared the way for the huge Oyu Tolgoi project in October last year, Mongolia has looked like an increasingly fashionable mining address. For a long time, mining scribes rarely mentioned Mongolia, and when they did it was typically to marvel at the mineral wealth but denigrate the bureaucracy and non-existent infrastructure. The discovery and painstaking early development of Oyu Tolgoi by Ivanhoe Mines (and more recently with project partner Rio Tinto) had previously propagated the Mongolian cliché, but the project may now have helped push that old chestnut into the

past through Rio/Ivanhoe's agreeing terms with the government that could see two Western companies develop one of Asia's richest assets.

For anyone not following Ivanhoe's stop-start progress in Mongolia, you should know that the Oyu Tolgoi porphyry deposit was discovered about nine years ago and so far 79 billion pounds of copper along with 45 million ounces of gold have been logged. Negotiations with the government over the development of a mining operation had been lingering for more than six years when last year's 'Stability Agreement' was signed. The long-winded process was attributed largely to Mongolia's snail-paced bureaucratic system and an act of protectionism (a 68% windfall tax). On the other side, detractors of Ivanhoe chief Robert Friedland accused him of stubbornly refusing to give up a necessary stake in the asset to the government. The Stability Agreement has thrown out the windfall tax, created a stable environment for Oyu Tolgoi's development and ongoing operation, and will see Mongolia buy a 34% stake in the project.

"Ivanhoe has forged the way there in a lot of respects, though the company has certainly had its ups and downs with government regulations," Graham Clow, head of mining at global consultancy Scott Wilson, said. He said the seemingly endless red tape through which Ivanhoe had fought was a necessary part of the government's development as it learnt to deal with large-scale foreign investment.

Origo Partners head of mining Luke Leslie told *HighGrade* Ivanhoe's experience had "definitely put people off in the past" and, up until the agreement, he doubted whether the company would be successful. "That was a bad example that put a lot of people off and that's why the earlier rush on Mongolia stopped and people pulled out," he said. "But because of what's happened with [the Stability Agreement] a lot of people are getting interested again."

Origo is one of those groups getting its oar straight back in the water having invested \$US15 million for a 21% stake in privately-owned Gobi Coal and Energy. Gobi Coal and Energy owns two high quality coking and thermal coal deposits (Shinejinst and Zeegt) about 133km apart in the south-western Bayanhongor region of Mongolia. The deposits contain an aggregate 322 million tonnes of JORC resources across the indicated and inferred categories, which consist of high calorific value and low sulphur coal with a 60:40 thermal/coking coal split.

This investment is typical of the immediate opportunity in Mongolia where high quality bulk commodities can be exported directly into ready markets in China, according to Leslie. "This is really a China story – 75% of Mongolia's exports go to China. There are rich copper belts that run across [Mongolia] and premium coal in the west. The big Chinese strategic sovereign funds are after the bulks and you've got a lot of coal there, you've got good copper and quite a bit of iron ore."

Leslie said south-west Mongolia had the best coal resources but, adding to Mongolia's well-documented infrastructure shortcomings, China also had very little in the way of rail and roads in the north-west that would allow coal imports to be distributed to greedy markets across China. With the stimulus packages rolled out as part of China's resistance to the global economic crisis, however, that situation is likely to change significantly by 2012 – about the time when Gobi Coal and Energy and several other coal hopefuls expect to be up and running.

Origo has set up an office in the Mongolian capital, Ulaanbaatar, and is actively looking for more investment opportunities similar to Gobi Coal and Energy with the view of putting together a project pipeline in that south-west corridor. The investment group has the backing of financial institutions worldwide that have indicated their willingness to get involved should similar opportunities arise. Meanwhile, Toronto-listed Ivanhoe subsidiary (65%) SouthGobi Energy Resources raised nearly half a billion dollars to expand its Ovoot Tolgoi coal project in Mongolia's south-west with a secondary listing in Hong Kong late last month. Ovoot Tolgoi is just 40km from the Chinese border with 181.7Mt in surface underground measured resources.

Copper has historically been the chief mineral export through the large state-owned Erdenet mine and coal promises to shape much of the country's future, but to think Mongolia is limited to these commodities would be grossly inaccurate. Some 6000 mineral occurrences have been registered across 80 different minerals including gold, iron ore, tungsten, molybdenum, phosphate, uranium, and oil on top of major copper and coal discoveries, according to market intelligence group Lexology. Last year there were exploration licences out on more than a third of the country.



The interest in mineral opportunities and the deal at Oyu Tolgoi is in no small part down to the current government that was installed in 2008. The Mongolian People's Revolutionary Party won the majority of seats in a controversial 2008 legislative election and took the helm of a 'Grand Coalition' with the Democratic Party. Sanjaagiin Bayar, as prime minister, was credited as the main driver of the Oyu Tolgoi deal before health issues forced his resignation in the month it was signed. Former foreign minister and businessman

Ivanhoe Mines has put Mongolia on the world mining map, or vice versa.

Sukhbaatar Batbold took the reins and immediately signalled his intent by citing mining developments as the key to lower unemployment and economic recovery. "This really is an exciting period of time for Mongolia," Leslie said. "No one has ever doubted how phenomenally rich it is in resources and it seems that the government is taking a more proactive, central role. We met with potential investors in London just before Christmas and

they were all asking us about Mongolia because they've all been watching Ivanhoe really closely. They want to know how to get into Mongolia and what kind of projects are out there [because] people don't actually know a lot about the projects and the new regime."

Guidance from people on the ground in Mongolia is vital for investors looking for opportunities in Mongolia because though investment has been made easier, it's still not easy.

The swing in government attitude has been a big step forward for Mongolia's development as a hospitable investment destination but there have been two major decisions made in the last nine months that contradict this shift. Only a fortnight ago, the government decided to abandon an auction of a 49% stake in the world's largest undeveloped coal resource at Tavan Tolgoi in favour of a contract mining option overseen by state-owned company, Erdenes, which will retain 100%. The project, which has long been considered too big for one company to develop on its own, had some of the world's biggest mining names lining up to bid including BHP Billiton, Vale, Peabody, Shenhua out of China, Jindal (India) and Sojitz (Japan). This follows on from a decision last July to enforce a government interest of an incredible 51% on all uranium mines that had been assisted at any stage by state funding and 34% of those developed without assistance. And the kicker: that stake is handed over for nothing.

Andy Davidson is an analyst with Numis Securities who worked for Robert Friedland in Mongolia seven years ago. He speculated that "fully embracing" capitalism would be a lengthy process for Mongolia, a former Soviet state for 70 years before the collapse of the Soviet Union 20 years ago. "The risk in developing nations that don't have a fully developed mining code and have a strong left-wing influence is that you're going to get calls for nationalisation to a greater or lesser degree, particularly with a surge in commodity prices." Davidson cited Zambia, Tanzania and recently South Africa as other places where nationalistic legislation or rumblings had raised eyebrows in the mining industry.

In addition, the consensus-driven government culture means that issues are still passed through too many sets of hands at central and provincial level before a decision is reached. This can be particularly troublesome considering vital rail infrastructure will run through several regions. Add to this the current government set-up of a 'Grand Coalition' and it is not hard to believe that permits for straight-forward developments take about two years to come through. Oyu Tolgoi was not straight-forward.

The last rail development was put in by the Russians just after the Second World War and, while a few key rail developments are working their way tediously through the approvals process, only 1800km of rail is in operation across the country at the moment. The lack of infrastructure poses a serious problem for grassroots mineral development in Mongolia because it's unlikely that anything less than a world class discovery will warrant the hefty capital expenditure for development. Investors know this and therefore target big late-stage exploration or early development projects where resources and risks are known.

The smaller end of town in most cases is going to have to wait for the bigger boys like Ivanhoe and Rio at Oyu Tolgoi or Gobi Coal and Energy to get their approvals through the Mongolian system and turn them into railway lines. Those larger groups will in turn have to exercise patience as Mongolian bureaucracy comes to terms with free-market capitalism. The good news is that unlike previous years, companies with financial backing are increasingly looking to Mongolia, they're finding elephants, they're putting in approvals and before too long they're could be rail and roads running from the farthest corners of Mongolia – most likely straight into China.

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