

INVESTING IN AFRICA

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INTRODUCTION

This paper will provide a view of investing in Africa in the current market climate, through the eyes of the Lion Selection Group. The discussion will focus on three main areas:

- the Lion Selection Group;
- the investment climate (and market conditions) for resources; and
- why Lion Selection Group would invest in Africa.

LION SELECTION GROUP LIMITED

Lion Selection Group Limited is a \$100 million company which listed on the Australian Stock Exchange on 24 July 1997 (Figure 1). Both the Chairman, Ewen Tyler, and Managing Director, Robin Widdup, have extensive experience in Africa with a range of commodities.

Lion Selection Group Limited (Lion Selection) is a resource investment company aiming to emulate several of the successful mining houses — such as Selection Trust of Chester Beatty, which provides some of the foundation to our company's name, Consolidated Goldfields of Cecil Rhodes, and Anglo American Corporation of Ernest Oppenheimer. Chester Beatty chose the name of his successful mining investment company quite simply, by insisting that “the company would be *selective* in all of their projects and investments”. Nothing has changed in 83 years — Lion Selection will be equally as selective. Unlike those other companies, Lion Selection Group works under an umbrella provided by a Pooled Development Fund (PDF). This has some strategic advantages for both investors and “investees” alike.

For the investors Lion Selection provides exposure to SMEs (Small and Medium Enterprises), with the advantage that profits on the sale of Lion Selection stock are free of capital gains tax and distributions are free of income tax. The company will provide considerable leverage to a basket of emerging mining and exploration companies. For “investees” the benefits are numerous, as will be outlined, especially if Lion is *first call* on a company's list.

As can be seen in Figure 1, Lion Selection already has its first investment — Australian Selection. That company, which shall operate as a global resources fund, is 100% owned by Lion Selection. It is not

restricted by the PDF guidelines, and target investments include listed companies, unlisted companies, and seed capital.

The business end of Lion Selection is managed largely by Selection (LSG) Management Pty Limited (Figure 1). Others will be employed as Lion Selection grows. Between them, the Board and Management team have over 75 years investment industry experience, and 123 years resource industry experience.

Lion Selection will focus mainly on base and precious metals. There will be no investments in pure coal or pure oil and gas companies. It is envisaged that, over a period of about five years, Lion Selection shall have accumulated between 10 and 15 investments each roughly in the range of \$5 million to \$10 million. These figures are only a guide as some investments, such as seed capital, may be much less.

Lion aims to invest in companies with good upside potential arising from sound projects from grass roots projects through to developed operations. Resource service providers will also be assessed. Preference will be to invest at an early stage in a company's development, and may thus include seed capital, either for unlisted or for listed companies (or for projects). Lion Selection is not interested in taking over companies, but can be regarded as a big brother which has an interest in the development of its “investee” companies and to see the realisation of that company's growth. A range of services can be provided to the company.

Lion Selection Group has 3 key target areas: Australasia; Africa; and Asia.

Two main rules will influence investment decisions and strategy. A first rule is to pick good people and good managers — people who can be trusted. A last rule is to seek value and growth potential.

MARKET CONDITIONS

It is appropriate to review the old “exploration clock” to see where the resource finance sector is in the cycle. In reviewing the Australian sector first, the ASX Gold Index had fallen from 2174 points 18 months ago to 1298 points in August 1997 — a 40% decline. Worse still, the All Resources Index, which includes the highly performing energy sector and some base metals companies, has fallen from 1431 points eighteen months ago to 1391 points (down 2.9%) by August 1997. The percentage of the All Ordinaries Index represented by the Resource sector has fallen from

33.6% to 26.1% over the same time frame. One could say that “there is room for improvement”. Other global resource sectors have also suffered but in a much shorter time frame — Canada lost \$6 billion in market capitalisation almost overnight in the middle of 1996.

On the basis of what has just been noted, Lion Selection believes that the old “exploration clock” has just ticked past 12 o’clock (“crash”), thank goodness. Lion Selection would place the time at half past twelve. It can be said that the hours on this clockface can get a little distorted. Looking forward, company liquidations can be expected (but hopefully not), declining exploration (already evident at the 1997 Diggers and Dealers Conference in Kalgoorlie), delays with new developments (WMC St Ives expansion), and evidence of companies committing the old “high-grading sin”. This environment is conducive to mergers, takeovers and rationalisation. (At one stage, Lion Selection noted 10 failed floats within a week, following the Australian Treasurer’s remarks.)

However, all is not doom and gloom. Such an environment is good for a new mining investment house; and Lion Selection will be a welcome sight to those in the industry in whom we invest. At a time when the lenders are tightening their money belts, and the equity markets are starved of liquidity, at least one company is prepared to roar.

Always remember that the other side of the clock paints a rosy picture.

What are some of the negatives which have left the hands at half past twelve on the exploration clock?

- **Bre-X.** Little needs to be said: salting is as old as the industry. Unfortunately it is necessary to recover from some of the tarnish caused by this situation — thankfully it was a Canadian company operating well away from Africa. (The fallout has made both regions more fertile for investments and exploration, but there has been a degree of Canadian, and international, liquidity removal.)
- **European Monetary Union (EMU).** (Perhaps this is **European Monetary Uncertainty**.) This has played right into the hands of the hedge funds. Central Bank gold sales have triggered gold fund redemptions. “Uncertainty is volatility which is hedge fund Nirvana” — ask any currency trader operating in Thailand, Malaysia or the Philippines.

In Australia both Federal and State governments have hurt investor confidence with the introduction of the Western Australian gold royalty, the diesel fuel rebate fiasco, and native title to name a few factors or uncertainties. It was pleasing to see Premier Court soften his stance on the gold royalty at the 1997 Diggers and Dealers Conference. The consequent increase in exploration spending being carried out offshore by Australian companies is seen as a benefit to Lion Selection. Those Australian companies doing the trail blazing in Africa, and quite successfully, are creating opportunities along the way.

The act of perceived ignorance and naiveté towards one of Australia’s major export industries by the Reserve Bank of Australia did not help the image of Australia in the eyes of the global investor. Comments by Australian authorities that gold is thought to no longer to be an alternative currency or store of wealth, contrasts with the EMU view. The United States (of America) Federal Reserve seems to share the EMU view.

All of this leads to a decline in available finance for exploration and development, and a tightening of loan covenants by inwardly concerned bankers, especially for companies operating offshore. Thus there is a shrinking of global exploration funds, influenced by the lower gold price (cash downturn) and following Bre-X. However, it will benefit Lion Selection and its “investee” companies because the Lion Selection philosophy is straightforward and vanilla. Lion Selection is effectively your lender of “first resort”. Compare the Lion Selection attitude towards the provision of capital to that of financial intermediaries. Lion Selection has a common interest with the mining industry.

INVESTING IN AFRICA

Geology and political factors

A quick check list of relevant factors for Africa provides important parameters for decisions about resources exploration and investment. It is one of the largest continents and has enormous diversity, not only culturally, but also geologically. It has a dynamic history, with mining at its very heart. Looking down the report card Africa scores 10/10 for geological and mineral potential. Just look at some of the big mines such as Kloof, Vaal Reefs, Katanga, and Venetia. The variety of commodities includes gold, platinum, chromium, copper, diamonds and so on. Africa is a major player in many fields of the metal industry.

Australian mining companies have also enjoyed success in recent times with significant new discoveries and developments, some of which have been discussed in this volume (eg, Burgess and Rozman; and Marston and Woolrich).

Political risk varies from country to country. In Australia companies and investors find it much easier to operate in a democratic regime and align thinking and business activities accordingly. To this end countries such as Ghana, South Africa, and Zimbabwe have enjoyed considerable interest from Australian mining companies. However, other political regimes need to be assessed differently. At the end of the day, security of people and assets, and an ability to do business in an efficient manner, are essential ingredients. Should these criteria be acceptable, Lion Selection is more than content to assess investments in countries outside the standard democratic system. After all, mines are where you find them — you don't get a choice in location, only in development. At this point in time, Lion Selection assesses the political risk of Africa to be 5/10, but there are large variances — Libya is 0/10 whilst Ghana is at the other end of the spectrum. *“Political risk is manageable.”*

In conjunction with political risk and geology, other assessments come into play. Two important issues are the “taxation and royalty environment”, and the “country's infrastructure”. Some countries are better than others. Several countries are starting to open their doors, adopting new, modern, mining regulations and business operating rules which are in line with other developing mining countries around the globe, eg, Ghana, and Tanzania. In the latter case — Resolute Limited, took the lead in developing a mining code and a business framework with the government suitable for offshore investors. Clearly all shall be watching the development of the Golden Pride mine (Kennedy, this volume) with great interest and wish them well. Infrastructure is critical. A developed or developing infrastructure is important/vital for many reasons, including communications and reduced capex. A government willing to assist in improving infrastructure will reap the rewards of increasing developments and the associated spin-offs for the local economy. Chile, for example, was quick to capitalise on this fact. Lion Selection rates Africa's infrastructure as 6/10 in the areas which immediately interest the company.

Lastly, would you live there? Perhaps the quickest assessment is the “Geologist's Index”. Put simply, several African countries (Zimbabwe, Zambia and Ghana) used as examples do offer the necessities of a geologist's life, albeit that the geologist should do due diligence in some of these areas.

This brief discussion has dealt with some of the features that Lion Selection assesses but perhaps it is important to look how Lion Selection views Africa in a global context. In looking at the various regions, Australia (and Australasia) will always be close to the company — its our own backyard and to us it's the lowest risk. Probably 50% of Lion Selection's investments will be in Australia. The Americas are not considered a suitable environment for Lion Selection's needs. This is because the company believes that it would be difficult to compete with the Canadian and United States companies in their own time zone. They have firm commitments within the Americas and links are well established. Europe is on the doorstep of many mining companies and is not a conducive environment for Lion Selection, again on a competitive basis. Companies the size of North Limited have demonstrated it is possible to make excellent investments in the Americas and Europe but at a scale that is more than Lion Selection can consider at this point in time. Lion Selection is comfortable with parts of Middle, and East, Asia and believe that from India to Korea there are substantial opportunities in roughly similar time zones, in which Australia is the best English-speaking mining hub from which to operate. The CIS quite frankly is too hard at this point in time, tenure is uncertain, political risk is high, and infrastructure is difficult. China is in the same boat.

On a relative basis, Africa deserves a good ranking for an Australian (or European) company.

Africa — geographic and financial advantages

Africa has geographic and financial advantages — it is in a similar time zone to London, and the United Kingdom financial market, plus the Europeans have a history in Africa. It is difficult for the North Americans (even from Vancouver), being well away from their usual areas of operation, but they will travel when money is involved.

Clearly Johannesburg in South Africa is a structural hub supplying resource and some financial expertise but with restrictions upon investments. Africa is ideally situated relative to Australia, particularly Perth — which is a major mining service centre. Africa is also well located with regard to the Australian and Asian financial markets.

Australia has similar geology to Africa and therefore the right expertise. Furthermore, the climatic conditions of Africa are also equivalent to those in Australia “except perhaps atop Mount Kenya”. So again Australia's exploration expertise can be readily

African Priority List

- Group 1 (good) Ghana, Côte d'Ivoire, Tanzania, Zimbabwe,
Zambia, Botswana, Namibia, Burkina Faso
- Group 2 Zaire, Mozambique, Angola, Kenya, Egypt, Mali
(don't know yet)
- Group 3 (no go) Sudan, Sierra Leone, Nigeria, Libya, Liberia,
Algeria
- Group 4 (Others) being considered

Figure 2. Priority list developed by Lion Selection Group Limited for investment in African countries.

extended to Africa. Several Australian exploration and mining companies are already established in Africa.

In assessing Africa as a region for investment (especially relative to Australia), the Lion Selection Group has recognised:

- good, compatible geography;
- good geology with similarities to Australia;
- good exploration potential;
- good climate;
- an established track record for Australian companies, especially on the west coast;
- a history of mining in many African countries; and
- excellent potential which can be recognised from the spate of new discoveries and developments.

In assessing Africa, Lion Selection has developed a priority list of countries which is highlighted in Figure 2. Those countries not shown on the list are uncertain. This priority list will be constantly reviewed in conjunction with 'country risk assessments' being progressively undertaken.

CONCLUSION

In summary, the Lion Selection Group is now a new mining investment company which is looking to invest in Australia, Africa and Asia. The philosophy is straightforward and vanilla.

- First call.
- Provision of finance through purchase of equity capital — shares and company options.

- Happy for companies to maintain operator status (although Lion Selection may divest as companies become mature operators).
- Takeovers are not on the agenda.
- Lion Selection Group Ltd will be a long term investor.

Lion Selection considers the current market climate is conducive to investment globally. Lion Selection is attracted to Africa — it is exciting, with good geology, an improving political climate (although some areas still remain unsuitable for investing), and big potential. Africa represents a wonderful opportunity for Australian resource specialists. Lion Selection Group will be investing in Africa, and invites approaches on a first call basis, not a last call.

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