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Mining in Africa

The DRC: Unlimited potential or relentless turmoil?

By Anthony Vaccaro

The recent killings of eight UN peacekeepers in the Democratic Republic of the Congo reminded the world of the chaotic flux at work in the country. Every time optimism begins to take hold in the DRC, ethnic tensions and violent over-spill from neighbouring countries resurface -- rekindling doubt as to whether the nation will ever become stable.

Only a month earlier, enthusiasm was high as the country completed its first foray into democracy. Citizens voted in favour of a new constitution, which will likely pave the way to presidential elections in June.

But with a landmass roughly the size of Western Europe, and the fourth largest population in Africa, the Congo is a vast area with deep divisions. Even the vote on the new constitution had its detractors, as a section of the troubled eastern part of the country did not participate.

Despite continuing uncertainty, rising commodity prices and ever-decreasing deposits in stable countries are pushing investors to consider the DRC as a viable investment option.

The Congo's importance to Africa's future -- its size, centrality and massive hydroelectric potential, among other features, have led many to posit that its stabilization would help calm much of the surrounding region -- has made it host to the UN's largest and most costly peacekeeping mission. Over 15,000 troops are stationed in the country, largely concentrated in the volatile northeastern section near the Rwandan border, and the World Bank, International Monetary Fund (IMF), United States Agency for International Development (USAID) and the Paris Club are committing billions to social and economic revival.

But not everyone is convinced that foreign intervention, no matter how well intentioned, can bring lasting peace.

"My personal belief is that the DRC will always be an African disaster," says a source familiar with central and southern Africa, who did not want to be named. "Education levels and standards are some of the very worst by African measures. The nation remains very tribally divided. The only way forward will come by way of internal self-development, not aid, and therein lies the problem."

The source continues: "Education should be the core process to create better standards for the future. We need to recognize that these are things that will take literally a generation or more to create."

But others believe the DRC is rounding a corner. Frontier Strategy Group -- an above-ground risk-management firm with a focus on resource industries -- says that while serious issues loom, if managed correctly, the country offers an upside that is hard to ignore.

"Our sense is that if things pan out in the DRC, it has the potential to be the Saudi Arabia equivalent in the mining sector," says Alex Gorbansky, managing director and head of the African mining division with Frontier. "But it's too early to start cheering -- even if the elections are peaceful and successful."

Based in Cambridge, Mass., Frontier believes Africa as a whole will see more investment in the coming year as renewed socialism in South America -- and the nationalization of resources that could ensue -- drives investment away from that continent.

"The wisest thing to understand is that it's not one country," offers Gorbansky. Frontier has mapped out the power centres in the region to better identify and understand the regional situations companies might find themselves in. He says it's important to try to determine how different power centres -- whether they be local warlords or politicians -- benefit from a given truce or other such agreement.

Such analysis will be all the more relevant as the recently approved constitution moves the country towards decentralization, hence giving greater power to local authorities. While the shift is meant to address differing cultures in the country, Frontier says it could result in new hurdles as companies will have to negotiate with both local and national governments.

In addition, Gorbansky cautions that the relative lack of commotion around the constitutional referendum could have more to do with factions regrouping, re-arming and weighing their support levels, and less to do with a willingness to endorse peace.

The other cautionary note Gorbansky sounds is the increasing influence of Chinese interests in the area. Gorbansky notes that Chinese business institutions are not bound by the same better-business practices most Western companies abide by. That not only gives the Chinese a leg up in securing deals, it also can contribute to a more corrupt, less transparent business environment.

Still, overall, Gorbansky sees the DRC as moving in the right direction.

"It's getting a little bit better, but it's hard for it to get worse," he says. "It's doable to succeed there, but it's hard."

Despite cautionary elements, Tony Lesiak, an analyst with UBS Securities, sees investor tolerance for the DRC on the rise.

"With the lack of exploration spending the last five to six years, it represents an opportunity to get big assets for lower valuations," Lesiak says.

However, he cautioned, the large size of deposits to be had in the DRC can be a hindrance, as they require substantial capital investment and long-term commitment -- which companies and investors may be reluctant to make, given the country's instability.

"The problem is some assets warrant big investment -- being so robust and with such spectacular grades," he says. "Investment will start small and then be reinvested if the initial investment works out. No one will plow a billion dollars in."

Lesiak says the long-term goals for the DRC have to remain realistic -- like lowering the political discount rate so that it's comparable with the rate used for countries like neighbouring Zambia.

Currently, Lesiak uses a 15% political discount for projects in the DRC -- a percentage he says is on the high end of the spectrum.

"I don't think anybody believes it's Nevada," he says.

While clearly not Nevada, the political risk associated with the Congo has had little effect on the fortunes of companies operating in the region. Even **Anvil Mining** (AVM-T) -- which had a much-publicized brush with violent factions recently -- has largely recovered the market capital it lost around the time of its ordeal.

Anvil's shares have risen roughly 35% or $1.65 since July 2005. They are currently trading in the $6.00-$6.25 range.

Banro boom

But one of the biggest foreign investor success stories to date is **Banro** (BAA-T, BAA-X).

The company has recovered from a precarious position in the late '90s to build a stable and highly prospective project.

In 1998, as the Congo collapsed into civil war, Banro's property was expropriated.

Banro successfully sued the DRC government in a U.S. federal court for US$420 million, but instead of claiming the funds, came to a settlement with the newly installed government of

Joseph Kabila in 2003 -- a government which was looking to encourage foreign investment in the country.

The agreement saw Banro give the DRC significant assets -- including the operating Klima tin mine -- in return, receiving a 25-year mining convention which, Banro says, is in many ways superior to the mining code which has since governed mining transactions.

The convention gives Banro 100% ownership of its properties, relieves it from paying tax on production for the first 10 years, and exempts the company from exploration surface fees -- saving the company $1.3 million per year.

The benefits can be passed on to other companies in the event of a joint venture and are renewable for another 25 years as of 2027.

Banro has four properties along the Twangiza-Namoya gold belt in the eastern Congo. To date, Banro has identified 2.45 million oz. of measured and indicated resources, plus inferred resources of 5.48 million oz. The company is continuing its exploration program.

The attractiveness of the deal, combined with the significance of the deposits, has given Banro's shares strong momentum since summer 2005.

Since June 2005, Banro shares have risen roughly $7.60, climbing from the $3.50 range to its current perch just above $11.

Banro's chairman and director, Simon Village, explains such investment by way of straight mining economics. With the mining industry facing the big question of how to create company growth -- given the fact there have been few major gold discoveries in the last 10 years -- the turn to mineral-rich, but riskier countries becomes a near necessity.

"Here's an industry producing eighty-million ounces. For it to remain in a growth mode it needs to replace them every year," Village says. "One of the things I believe you need to put into that equation is the development and discovery of a few new belts. It's belts that will provide that capacity, not single individual projects."

Banro believes it has just such a belt. And while Twangiza-Namoya is located in the eastern section of the country, it is far enough away from hot spots to the north and along the Rwandan border to be free of any disruptions recently.

Village explains that the region Banro operates in contains only one ethnic group and one common language.

"We've seen a remarkable transition over the last two years. We've seen a government established where previously, there wasn't one," Village says. "This is a country in transition and in reform. One needs to be patient."

Other North American companies with projects in the DRC include: **Adastra Minerals** (AAA-T, AMZIF-O), **BRC Diamond** (BRC-V), **First Quantum Minerals** (FM-T, FQVLF-O), **Melkior Resources** (MKR-V, MKRIF-O), **Moto Goldmines** (MGL-T, MTOGF-O), **Phelps Dodge** (PD-N), **Rubicon Minerals** (RMX-V, RBY-X), **SouthernEra Diamonds** (SDM-T, SDMFF-O), and **Tenke Mining** (TNK-T, TNKDF-O).