Friday August 1 2008

Hallgarten & Company

Sector Coverage

Christopher Ecclestone
cecclestone@hallgartenco.com

Minefields in LatAm:
Dodging the political pitfalls

Minefields in LatAm

Not everything that ticks goes "boom"!

- The truism would seem to be that those countries with booming outsized revenues from energy are those that also imagine they have most latitude to say "no" to mining
- Countries like Mexico have "been there and done that" and realize that mining provides more jobs in a wide range across the country that oil and gas production does not. Moreover mining provides tax revenues when energy revenues start to go into decline. Mexico's dinosaur Pemex should be a lesson to all those countries in LatAm that imagine they can "do without" mining.
- There is a lot of press focus on travails of miners in LatAm. However, the vast bulk of foreign and local miners are doing quite well and are finding professional and encouraging national administrations. The exceptions are obvious, with Venezuela being the leading offender. It has made itself a no-go zone and will see mining investment, and the skill-sets it brings, wither and fade away.
- One of the biggest problems at the moment is a rising tide of industrial disputes resulting in serious and extended stoppages at some of the major mines in Peru and Mexico. This is not a factor investors can avoid merely by focusing on political risk.
- Environmental issues are important and the days of dumping waste near the local peasantry are long gone. Offenders in this category will quickly find themselves blockaded by locals carrying pitchforks and encounter bad local publicity that they may never live down.
- Thus, the problems for miners in LatAm are relatively low-key and definitely "dealable". A few parties have been caught by erratic political actions, but the vast bulk of miners are plowing on with benign government oversight. Investors should not confuse self-inflicted problems of some miners, which they choose to dress up as "interference", as reasons for avoiding any potential mining zone in the region.

'In this way only was the power of the local authorities vindicated amongst the great body of strong-limbed foreigners who dug the earth, blasted the rocks, drove the engines for the "progressive and patriotic undertaking"

Nostromo, Joseph Conrad

Some things change… some do not..

For those venturing into the waters of Latin American there is one volume and one alone, that they should read up in advance. The book in question in Nostromo, the masterwork of Joseph Conrad, in which a cavalcade or the idealists and the venal parade their hopes, suspicions and demagoguery on the subject of "the silver of the mountain", the output of a famed mine in the breakaway province of Costaguana. Conrad welds a narrative, from his fleeting visit to Venezuela, which takes elements of the tumultuous (recent) pasts of Colombia, Argentina, Uruguay, Chile, Peru, Venezuela, Paraguay and a yet to be born Panama and creates a fictional land in which control of the loot is struggled over by the PTBs, both local, regional and international.

Some things never change. LatAm is not an area short of capital but remarkably local entrepreneurs (even in Chile) would prefer to dedicate their investment dollars to service industries rather than staples like mining. Those who have taken the plunge (Peruvian businessman being the most prominent and

Brazil's Eike Batista and Votorantim being other adventurous examples) have been handsomely rewarded. One can scarcely take the high ground of demanding local ownership when no local owners are interested. Thus the choice of "capitalist" to develop mines falls to either the State (in all its mediocrity) or foreigners. Some things do not change from Conrad's day until ours.

A key driver for meddlesome local administrations is the other sources of income that the national or regional government's may have. It is no coincidence that the three most problematic countries (Bolivia, Ecuador and Venezuela) are all currently raking in mountains of cash from State ownership of the means of production in the oil and natgas industries. This encourages the flawed thinking that mining is not a 'must-have" but an elective in the economic mix. This view is downright dumb as mining usually is taking place in other parts of the country from where the oil is, and the energy bonanza is usually producing few jobs (and particularly not for unskilled labour). Moreover the infrastructure built out by mining companies is totally different from that of oil enterprises. The roads, railways and ports that mining engenders have multiple uses and benefits while the oil/gas industry pipelines are industry specific. Still one can see how the illusion of prosperity at the Treasury level can lead local *caudillos* to imagine there are industries that they can "toss back" in the water.

So the picture is muddied. It's a patchwork of benign politicians, malevolent ones, and companies with something to offer while others that ride roughshod over locals. From this it is sometimes quiet a task to work out who is hard done by and who is exploiting whom. The minefields in LatAm have to be carefully trodden. This is some sort of a roadmap as to where not to step.

Brazil – bathing in Vale's golden glow

Maybe foreign miners are benefiting at this moment in history from a particularly virulent outburst of confidence by Brazilians in themselves. Such is this wave of self-confidence, in a country that bathes in the stuff, that interlopers are not regarded as a threat. And indeed they are not a threat but an asset, but that hasn't stopped politicians and populists and the rabble in the past from agitating against foreigners across the continent.

Life has been made hard for nationalists by CVRD (now Vale) buying INCo, and some other international assets. Brazil can scarcely baulk at Canadian miners exploring its territory, when the largest mine in Canada is owned by Brazilians. In any case, there seems to be little interest in putting roadblocks in the way, thus far. We have not heard of major corruption issues in obtaining approvals either. It should be remembered that Brazil, despite its current glamour status, is the country in LatAm most rocked by political corruption scandals at the moment.

The only two impediments that we know of in Brazil at the moment are the ban on uranium mining by foreigners (a policy that Mexico also upholds) and the "frontier" ownership rule. The latter is not well known, probably because Brazil is so big and the easy pickings are not in the darkest jungle. However there is a law (which only one company we know of has had to grapple with (Lara Exploration – LRA.v), which requires that companies operating in a 150 km strip around the borders of Brazil must be majority Brazilian-owned. From what we hear this is currently grappled with by the use of what Argentines would call *testaferros* (essentially front men). It is a frustrating rule that smacks of the old days in most Latin mining jurisdictions when "do-nothing" locals were given a bonanza for essentially renting out their citizenship. While not much is happening in these zones at the moment, the borders with Bolivia and Venezuela are enormously prospective. There may be some logic though in ensuring that entities with a multinational perspective don't start meddling to move borders to suit where their deposits are governed from. History has shown this can turn out for the worst in LatAm with the Chilea/Peru/Bolivia wars of the 19th century (over nitrates), the Paraguayan/Bolivian wars of the 1930s (over oil) and the current rumblings of Venezuela towards Guyana (over all and sundry).

Twenty years ago, the problem in Brazil (besides instability) would have been the *garimpeiros*. Time after time we meet companies that highlight the ex-*garimpeiro* nature of their sites. The shrinkage of this problem is graphically illustrated by minesites that once had 12,000 of these guys now having 50 or 100 still picking over the bones in panning operations. This group have gone as far as they could go and have largely grabbed the easy pickings on known deposits. We know of some companies who have co-opted the last stragglers into site remediation work and some who use them as finders for outlying outcrops, but this is definitely low-tech stuff. One company paid up (a mere few millions) to get their hands on a deposit even though the title of the *garimpeiros* was dubious to say the least. It just seemed like good politics and ensured they would not be hanging around and become a social issue when building a new mining camp.

Beyond these minor issues, most miners have found the state administrations to be enormously receptive. Despite the supposed boom in the Brazilian economy the goodies have always been poorly distributed and the northern states of Brazil are diabolically poor and don't even have an export trade in bananas. It has gotten through to Brazilian politicians far more than in other Latin regions that mining, the bigger the better, brings infrastructure which would have no rationale in normal situations and which otherwise they would have to borrow money to build. We do not want to speak too soon, but at least for the moment, there is a generally favorable meeting of the minds between the Federal, State and local governments that paints mining as a great activity to have.

Argentina – varying province by province

The bad press Argentina gets for its mining restrictions generally comes from uninformed media sources that give the impression of some sort of monolithic resistance to mining activities. In fact Argentina's openness to mining is not in doubt. The regulations on local mining are at the provincial level. If a specific province is adverse to mining then it's a zone to be avoided. At the moment the worst "no go" zone is La Pampa, where we only know of one player, Orocobre (ORE.ax). This province won't allow any open-cut mining of any sort. Ironically it is Argentina's largest producer of salt, but this comes from lakebed mining. La Rioja is another problem spot, as are the well-documented problems in Chubut and Mendoza. On the other hand, there are some provinces, which welcome miners with open arms and relish with glee the addition of restrictions in the "problem" provinces as it means more exploration for them. The best places to go fossicking in Argentina are Jujuy (where Silver Standard is developing its massive Pirquitas mine), Catamarca (where the Bajo de la Alumbrera mine has been operating for over ten years), San Juan (with a myriad of miners moving and shaking), Salta (nothing much in production but open to exploration and development) and Santa Cruz (where a swathe of precious metals mines and projects are moving ahead).

One area of the economy for which the Cristina Fernandez de Kirchner administration has a benign attitude is the evolving mining industry. With both the President and the former President (her husband Nestor Kirchner) coming from the province of Santa Cruz, this is no surprise. With sector activity up 400% in the last 30 months, the great hope pre-election was that Cristina's term in office would see this fledgling sprout some decent plumage and take flight. This will only happen though if some of the local *caudillos* are brought to heel.

Eschewing metaphors for a moment, the official government mining board plans mining to quadruple through 2015. More importantly most of that activity will be based around producing mines and not just exploration as is currently the majority case, therefore those that plan these things are looking to hike mining exports to a healthy U$16.3Bn (which would represent around 6.7% of total current Argentine GDP).

Recently however, some of the provinces with large extraction projects for gold, silver, copper, lead, zinc and all the other metals one can imagine have been making a right old Gore-like nuisance of themselves. The renegade provinces have played the pesky environmental card since Nestor Kirchner came to office and banned the use of cyanide, effectively shutting down all plans for metals extraction on a commercial basis. To make matters worse, when Meridian Gold (MDG) lost an appeal case in front of the Argentine Supreme Court in 2007, the judges also ratified the precedent of provincial government decisions over dicta handed down from the Federal government in Buenos Aires. The fact that Argentine provincial governments have wide ranging autonomy is sometimes lost on foreign observers (it was certainly lost on Meridian), but it is in fact a basic building block of the Argentine republic and helps to explain why governors like Adolfo Rodriguez Saa of San Luis (of the seven-day presidency) can run a balanced budget for decades while all around are losing theirs.

Mendoza – grape growers rule the roost

Going forward, we sadly see little hope for Mendoza mining projects; the province's wine lobby is far too powerful and will play the environment card successfully from now until Greenpeace rules the world. It is strongly suspected that the real reason they don't want mining in the region is that mining companies will vacuum away the cheap labour they exploit for the *vendange* every year is beside the point and isn't often said out loud. Some mining companies claim to us this will be overturned. For the moment projects in this province are not worth throwing more money at.

Chubut – maybe seeing the light

Chubut has two legal issues on mining running at the moment. Firstly the 2003 ban on the use of cyanide. Secondly the three-year ban on mine production of any type that has around one more year to run (but exploration and resource definition etc is allowed). We would also note that the ban only covered the far west of the province, but has made explorers nervous enough to regard it de facto as a total province ban.

The Esquel project run by "Minera El Desquite" (originally Meridian and thus now Yamana) is permanently derailed. The local town (big on skiing industry and trying to promote ecotourism) is very much against the project. The locals voted 81% against the mine in a 2003 referendum, and the sentiment hasn't changed at all. That referendum weighs heavily on the local governor and out-trumps any plans Yamana, the government of Chubut or the Federal government might have of moving the project forward. Bottom line; it's not going to happen.

Aquiline's (AQI.to) Ag/Pb/Hg "Navidad" project is much more likely to get the go-ahead, especially now the ownership case versus IMA has been cleared up to all intent and purposes. The governor of Chubut, Mario Das Neves was re-elected last year (with 77% of the vote) and has hitherto been a Kirchnerite who toed the line with national government. Moreover in a speech several weeks ago at the Canadian embassy, Das Neves was saying all the right things, and made clear signs that he was looking forward to cutting ribbons at Navidad.

The Patagonia Gold (PGD.L) project is also likely to get a green light to develop further, but will still have to overcome the ban on cyanide use at some time in the future. All the same, it's in a far better position than Yamana at Esquel. Other projects will be in the same position.

Chubut has been clearly earmarked by Federal government as part of the next stage of mining development program in Argentina. The country as a whole plans to quadruple mining exports by 2015.

The local Chubut political view is the following; the governor and company wants mining. They realize now the mistake they made by allowing locals around a projected site to vote in referendum style (ie Esquel) and that's not going to happen again. National and local government will be hot (or even very hot) on the green issues of any project, but they'll keep any decisions to go ahead "in house", and the local peoples around the Aquiline, Patagonia Gold, etc projects are not going to get a veto *per se*.

Local government will be hot on environmental issues for two reasons. Firstly, they really do care themselves about not screwing up the environment (it's not just lip-service). Secondly, the environmental groups in western Chubut are well organized and know how to kick up a fuss on a national and even international level. Das Neves wants to keep his nose very clean (as a sidebar, he has aspirations of a run for Argentine President in 2011). On the other hand, most residents in the larger cities in the East of

Chubut (Trelew, Puerto Madryn etc) are pretty much indifferent to the cause of the environmental groups; militancy only extends to the small towns and villages in the west of Chubut where the projects are situated. This will give a considerable advantage to Das Neves when he starts pushing the green lights through the local parliament.

Das Neves has made recent noises saying that although the Esquel project is a "no", he wants to develop other mining projects in the region. Das Neves has also been separating Esquel from other mining proposed mining projects in speeches and smallish governmental decisions (such as where to place limit boundaries in the study zone for the current land survey). Thus he is widely expected to OK at least two of the major projects slated for development in Chubut may be approved soon. Protest groups in far-flung western Argentine villages may well kick and scream, but national eyes will oversee environmental compliance from now and on there will be no more local referendums in this brave new world of mining.

La Rioja – Machiavellian squabbles stir the dust

The Argentine province of La Rioja has gone from being the cradle of the current mining boom to yet another of the "no-go" zones. Carlos Menem, the President from 1989 to 1997 had formerly been the governor of this state. He took his pack of cronies to BA in 1989 and overhauled the Federal mining law in his own image. This stodgy piece of legislation had stifled mining development since 1947. With his minister of mining, Angel Mazza, he single-handedly revived the sector and passed control back to the provinces. Mazza went back to become governor of the province. Turmoil in March 2006 resulted in an overturning of the Mazza regime and a ban coming into effect on all mining using cyanide. La Rioja is host to the Famatina (Barrick Gold) prospect amongst others. The ban is plainly ridiculous and, more than most other provinces, was actually just a case of local political dogfights with mining being collateral damage. This leads us to suspect that it may be overturned at some point. The province has yet to adjust to the fact that it has fallen off the Menem gravy train when the cash flowed its way in a massive tide. Now its back to growing olives and taking long siestas, neither of which put any significant money in the province's coffers. The aggravation is only heightened by Catamarca next door enjoying the bounty (tax and job-wise) from the Alumbrera mine and multiple exploration efforts going on in its territory.

La Pampa –doomed to irrelevance

The Australian miner Orocobre (ORE.ax) is the only party we know of that has been negatively impacted by the draconian mining ban in this province. Well, those most negatively impacted are the inhabitants of this "road to nowhere" province but they are too dumb to know it and are not likely to change until everyone else has. The consolation for Orocobre is that their prospect in the province sounded like a dog to us. The real excitement should be at their lithium/potash salt lake way up north in Jujuy.

Chile – "own" goals the chief threat

In Chile the roadblocks to mining these days are the result of government inaction rather than government action. For those who like to see Chile through rose coloured glasses (and a few inches thick at that) the mere mention of electricity shortages brings a stream of invective against Argentina. Little energy is left in these people to do some real navel-gazing and wonder why Chile wandered down a path of low energy investment when it was obvious that Argentine energy supplies were finite. Moreover, Chile had a very sweet deal on Argentine gas which resulted in Argentina exporting gas to Chile at lower prices than Argentina was paying to import gas from Bolivia to make up for the demand growth in Argentina that hadn't been foreseen when the original supply deal with Chile was signed. Chile also has made its own bed in relations with Bolivia. Basically, it seized the coastline of Bolivia in the 1880s to ensure that the burgeoning nitrate trade was Chile's and total intransigence in negotiations with Bolivia and Peru since (right up until this year) puts it in a position of weakness. Bolivia can easily sell to Argentina or Brazil and need offer nothing to Chile.

Fecklessness on the forward planning front is compounded by Chile being hamstrung on the nuclear option by its high earthquake frequency. Hydro has always been an option but just having massive mountains doesn’t mean an endless supply of meltwater. Chile is in a difficult position and its now impacting mining activities there, as miners must think as much of potential water and energy supplies as mine grades. This adds a significant extra cost factor, which makes Chile (with its strong currency) one of the highest cost places in Latam to operate.

Beyond the logistical issues, Chile’s government at the national and regional levels is very pro-mining. It’s in the blood.

Colombia – relatively clear sailing if you don’t get kidnapped

The minefields in Colombian are quite literal. Besides those the other potential problems fade into insignificance. However, the problems of guerillas and drug gangs reduce significantly the amount of accessible exploration territory in what should be a natural beehive of activity. The chance of kidnapping or worse has restricted the range through which foreign miners can operate. By our count there are around 20 Canadian miners with that profess to be principally interested in Colombia. This is substantially less than in Argentina. Colombia has become almost synonymous with coal in the continent as it is notably well-endowed with this resource. Most of it however has been developed by locals. We would also note that more than a few of the “Canadian” miners are actually controlled and managed by Colombian interests that found it easier to tap the Toronto market than Bogota during the mining rush of recent years. The Bolsa in Bogota from what we hear is trying to close that gap using domestic funding sources as an attraction for primary and secondary listings.

The foreign miners have not found many obstacles aside from the “no-go” zones in operating in Colombia. The most serious problem we know of related to Coalcorp (CCJ.to). This company has run into environmental opposition to its plans to build new port facilities, most particularly a coal loader at the World Heritage listed port of Cartagena. Not unsurprising considering that cruise ships pull in and are a major money-spinner in their search for unspoilt colonial atmosphere. Coal loaders don’t fit in the picture.

The proof that Colombia is not a backwater for mining (though it may be for juniors) is that BHP Billiton have their Cerro Matoso mine in the country which produces 4% of the world’s ferronickel. In 2006, Xstrata coughed up US$1.7bn to a one third stake in the Cerrejon coal mine. Not small beans and not small players. The worst that these groups have encountered has been industrial disputes. However, these are something that should not be under-estimated as the new virus spreading through LatAm mining. This problem can usually be solved with cold hard cash. However, with the commodity reflation currently marking time the latitude that miners have to make catch-up wage and conditions demand is limited to carving the money out of margins, from here on out, rather than by price hiking. Well, at least for the time being..

Paraguay – barely radioactive

For Graham Greene readers Paraguay is the ultimate in insularity. It also figures highly in the rankings of corruption. However, it is almost irrelevant in the mining sphere, with Cue Minerals uranium hunting and Latin American Minerals gold project being the only exploration activity we have heard of there. To our knowledge neither of these companies has had any particular problems (besides their dire share price!).

Bolivia – on the cusp of indecision

Evo Morales has scared the living daylights out of the international press who have passed their fears onto the investment community. The fact that he was “indigenous”, which seemed to imply troglodyte to the wider world, is somewhat of a red herring. We could say that Evo’s former career as a coca leaf grower makes him not only export-oriented but also a commodity producer!

On a more serious note the chief “retrograde” step that he made from the capitalist perspective was his renationalisation of the oil & gas assets that were stripped from YPF-Bolivia in the 1990s and sold off for a song at the instigation of our old buddies the IMF (remember them?). Ironically these assets are now the root cause of the dramatic improvement in the fiscal situation as neighbours like Chile, Argentina and Brazil vie (well, more like a cat-fight) for Bolivia’s natgas exports. The further irony (akin to Ecuador) is that the nationalization has been a good thing for the holders of the country’s sovereign debt as it has improved the credit standing and ensured the ongoing cashflow to meet interest and principal payments.

The nationalization has been extrapolated onto the mining sector. He has not helped by using the “n” word when appealing to the cheap seats at rallies. Bolivia of course is one of the mining nations *par excellence* with the word “Bolivia” being almost synonymous with tin and historically linked with massive silver mining at the legendary Potosi mine. Despite the bad press, mining by foreigners bubbles along in Bolivia with the most prominent exponent being Apex Silver (SIL), which seems to have found a niche in the heart of Evo. However, Evo is also battling a massive secessionist movement in the lowlands. Most of the traditional mining has been in the Altiplano though the lowland is home to El Mutun, one of the largest iron ore deposits in the world (as yet unexploited by Jindal Steel, its Indian owners). This site was initially being developed by EBX (MMX) of Brazil and was shut down by Morales on environmental grounds. Local protesters seized three Bolivian ministers and held them hostage demanding the site reopen. Now how’s that for a turnabout in the old story of hostile locals!

The last serious nationalization talk relating to mining was back early 2007, which leads us to think that he has put the plan on the backburner. YPF-B was the real prize. A collection of putative mining projects owned by foreigners would be most likely to remain on the drawing board particularly if taken over by the slow-moving Comibol (the State mining enterprise) where the metals prices on their website have not been updated since early May!

Shakespeare would venture that nationalization “should be made of sterner stuff”.

Peru – labor and local relations the sticking point

This country has been the veritable Garden of Eden for foreign and local miners in recent years. Things have not been so peachy in recent months though with a rising tide of environmental squabbles and labor issues leading to some slowdowns (or shutdowns) in production.

The government generally has a light touch. There was a royalties’ scare a few years back but the companies have come to accept that the rate at the time was heavily in their favour. It certainly helps to have royalty hikes in the middle of the price reflation rather than at the end (like the Argentine export levy recently dumped on “old” mines).

The latest environmental scare was related to the Coricancho mine of Gold Hawk (GCK.v) which had to shut down the site and suspend 600 workers when fears were broadcast that the tailings dam would collapse and send waste tumbling down into Lima’s water supply. A provisional tailings dump was created and the waste diverted but it was not the type of scandal that any company needs. While Gold Hawk will live to fight another day as it has 600 plus mouths to feed other startup mines will be made to jump through hoops to ensure that a repeat does not occur. The government was ultimately pacified but they have to show a mix of panic and concern or the populace will think they are in the pockets of the miners. We would note that of all the Latin American economies the one whose fortunes have been most transformed by the metals reflation has been Peru’s. This fact is not lost on the politicians.

Mexico – virtually untrammeled access

The Treasure of the Sierra Madre is “the” classic story of mining in Latin America or anywhere and its not a pretty tale. The main characters come to grief mainly through their own venality and limited local intervention. Despite this horror story the hills of the Sierra Madre are now crawling with foreigners and the amounts of metal they are talking about are truly massive. Despite a bad reputation in the past for interventionism the Mexican government has removed itself from the fray and left the industry to develop in leaps and bounds within one of the most liberal mining regimes in the world. Moreover, the development seems to be occurring with minimal bad vibrations towards the foreign-owned miners. If anything, bad news seems only to dog the major local players, and chiefly in the form of industrial disputes.

Until 1994, mining operations in Mexico had to majority local ownership. The number of local players was severely limited (principally Industrias Peñoles and Group Mexico) and they were scrabbling to make a buck with the disastrously low international prices for base metals and silver. Thus they had little inclination or cash to put towards JVs with foreigners no matter how prospective the sites might be. Their fortunes have dramatically improved since then, but it is still almost a truism that the local majors are not only not doing much in terms of adding new projects (while foreigners are showing just how easy it is to find sizeable deposits in Mexico) but neither are they teaming up with some of the less resourced foreigners to exploit their projects while the foreigners pass through a difficult financing situation.

Of course, having the NAFTA treaty as a backstop has also helped to stymie any trend towards backsliding on foreign ownership. However, from all we hear and read there is little negative sentiment against the up and coming miners. Indeed, local communities are desperate to see old sites reopened and there is enormous cooperation with miners in getting projects approved and activated.

Another interesting factor we find is the dichotomy in labor relations. These have been a hot factor for large domestically-owned miners. The foreigners have been scarcely impacted. Grupo Mexico has had its Cananea copper complex closed down for a year now. It seems almost as if there is a personal war going on between Napoleon Gomez the head of the miner's union and the company. Its gone so far that Gomez has fled to Canada to escape corruption charges. It's a somewhat ironic bolthole for a gadfly of the mining industry. In any case, the mining union has been hands off (thus far) in its interest in the foreigners operating in Mexico.

Most reports we hear from Mexico signal strong local support provided that environmental issues are handled well. An example of problems on this front recently was Minefinders (MFN) where their launch of the Dolores mine was derailed by a blockade by protestors (seemingly not locals). This is one of a handful of encounters of this type we have heard of and, interestingly, the blockade was razed by intervention of the Chihuahua state government, clearly showing which side officialdom chooses in these struggles. We have heard reports elsewhere of "mafia-like" environmentalist "invasions" that are little more than shakedowns of the mining companies that prompt a pay-off to the extortionists to go away. These have not been aired publicly as the companies have made the payoff that then only allows the perpetrators to move onto the next victim. This is an issue that the miners should not keep hushed up but should agitate with the State governments to eliminate. It would be interesting to know how much of "cost escalation" is actually made up of these payments.

Ecuador – sound rules unsoundly "sold"

The mining scene in Ecuador has been made unnecessarily complicated by the rule changes that the Correa government has agonized over for months now. Nothing in this country is as straightforward as it should be. Part of the problem was an indigenous movement that sprang up in recent years and led to agitation that toppled several governments. Indigenous movements in the region are a mixed bag with some activists wanting a bigger part of the spoils while others seem happy to have no spoils for anyone and "let's all live in grass huts". One would think that subsistence communities would welcome some jobs locally that do not necessitate moving away to become urban fringe slum dwellers. We suspect that is true but not if the deal is badly propositioned by the mining companies or done in an insensitive way. Quite often the new mining camp is full of workers brought in from other areas and the locals are left to peer through the barbed wire at what might have been. This goes not only for Ecuador but also for Bolivia and in some places in Peru. Inclusion and local benefits are the key tools mining companies have to win hearts and minds.

The result in Ecuador is made murkier (as in Bolivia and Venezuela) by the energy boom. Having seized back certain oil and gas assets from foreigners, the Correa government is flush with cash and thinks it has the luxury of picking and choosing who will mine and who will not or whether to have any mining at all.

The manifestations of this was the earlier debate on royalties (with talk of a windfall tax) and the proposed mining concession legislation that limits miners to exploiting only a limited number of sites at any given time. We have dealt with the royalty tax before. It had some goofy elements that indicated that the government initially did not know that costs were inflating at the same time as commodity prices were reflating. That was giving some reconsideration and we paid some small part in resetting that agenda while the foreign miners went into catatonic state under the influence of bad journalistic reporting.

The new concession law is the brainchild of the Minister of Energy and Petroleum, Galo Chiriboga. It has been torturous in arriving and been through various iterations (and resultant media scares). Most of its details are 100% confirmed, and a few parts remain "most probable". We shall summarise here its status:

1) The law is ready. Correa has inspected it. It will be published "any day now".

2) The "three concession maximum" rule has been scrapped. In its place there is a mechanism that will allow a larger concession area in the exploration phase, but when the company begins focussing on particular areas of its concession, the unused areas will lapse. By the time the miner is actually producing, its total concession area will be reduced to 5,000 hectares approx. This sounds sensible in that it allows the explorers to do their job correctly, and then it allows the government to take back what isn't wanted by the company at a later stage.

3) The concessions that have been taken back by the government in the last few months will be submitted to tender again. The companies that lost the concessions can bid for them again, but on equal terms with other bidders. This is different from previous information that said the ex-holders would get right of first refusal.

4) The concessions will have a 25 to 30 year time limit. They will also be subject to a 10-year "use it or lose it" clause.

5) There will be no forced joint venture with the state.

6) The law will be ratified and enter into active operation in September 2008, almost certainly before Ecuador votes on its separate draft constitution. The mining law will be passed into law by the interim "Congresillo". In real terms, this means miners can get back to work in two months' time. Not the best situation, but by no means the worst either.

7) The environmental controls will be strict by world standards. This will be a main promotion point of the national government to the great unwashed. It will be making very strong noises about the severity of environmental controls that miners will have to abide by, and the penalties/immediate closures they would suffer by breaking these laws. However for responsible modern, medium and large-scale mining, these regulations will not be too difficult to comply with successfully.

8) The state mining company will be set up from scratch before the mining law becomes active. It will concentrate on non-metallic mining only (e.g. cement, clay, brickworks etc).

9) Royalties will be due on gross profit. The limit on royalties is either 5% or 6%. There is no windfall tax in the new law.

10) There will be mandatory minimum investments to be made on all concessions. If those minimums are not met, the concession is lost.

So the bottom line here is a piece of legislation that would probably wash in any legislature around the world excepting the concession-limit which is rather novel. We can understand the rationale behind this too, as Ecuador is one of the smallest countries in LatAm and to maximize activity it is better to have as many players having access as possible. It is an old LatAm habit of miners (big and small) to bite off more than they can chew and then go into “dog in the manger” phase. And its not just miners if we look at the pathetic *Sitting Bull* attitude of Repsol on its Argentine exploration blocks which has lead to virtual stasis in exploration in Argentine oil and gas since the 1990s.

At the current time, Ecuador remains highly prospective but may remain that way. The country’s oil reserves are interesting but not overwhelming (moreover they scarcely make jobs) so Correa should take to heart the adage that the devil makes work for idle hands. Seemingly not all are convinced that Ecuador is a washout as Kinross just threw $1.2bn at a bid for Aurelian, the largest independent player in the country. The evolution of Aurelian’s Fruta del Norte mine and Iamgold’s Quimsacocha would go a long way towards making Ecuador less of a theoretical mining location and more of a profit-center for the Ecuadorian finance ministry. Nothing focuses the mind like some royalty checks rolling in..

Uruguay – a limited sample to go by

The Uruguayan mining scene consists of Uruguay Minerals (UME.to) and that is about all, to our knowledge. UME has had some industrial problems but no governmental roadblocks of note.

Venezuela

Bringing up the rear both literally and figuratively is the land of Don Hugo. Frankly it is easier to make a foreign investment in Cuba than in Venezuela. Hugo thinks he can pick and choose his favorites and is now cuddling up to the Russians and quasi-Russians at Rusoro (RML.v). It’s not so much the blood rushing to his head as the oil. While the few unfortunate miners already trapped in the place try to make the best of a bad situation, no one else will go near Venezuela with a barge pole. This means that even “after Hugo” or in the unlikely event that oil goes down sufficiently to no longer prop up his economic scheme of things, the country will have no pipeline of projects. This would put it five years behind the game even if it were so disposed as to countenance getting real.

It is well known that Hugo is ill-disposed towards the US, but he is now leaving even parties that were neutral towards him with their noses out of joint. Canada has long flirted with Cuba on the mining front and yet Chavez has chosen to kick sand in the face of the Toronto and Vancouver investment community. The travails of Crystallex (KRY) are something else again. While the company engendered sympathy for a long while, its single-minded persistence in chasing the Venezuelan mirage while abandoning diversification (it left the fantastic mine that Uruguay Minerals now own slip away) makes it look feckless and suspect of poor corporate governance.

Another example, but on the industrial front, of Chavez biting friendly hands was his recent takeover of Sidor, managed to leave Argentina disgruntled. He may pay top dollar for the things he nationalizes but still the investors aren’t there to sell out they are there for market penetration or economy of scale reasons.

With the current administration’s penchant for rubbing both friend and foe up the wrong way even stocks with a forcefield, like Rusoro, are ones to be avoided. In short, Venezuela is radioactive.

Conclusion

So is LatAm any more of a minefield than anywhere else? Certainly it seems like there are a plethora of administrations to appease and consider in deciding where to explore and then site a mine. However, this comes with the territory when it is as richly endowed as Latin America is with mineral resources. There is no doubt for us as to whether we would prefer to explore or operate in any country in Latin America *vis a vis* Russia, for example. Ironically the only country in LatAm with equivalent or worse investor protection is Venezuela, that is sidling up to a quasi-Russian mining company while sending everyone else packing.

PR in mining has traditionally been the charming of investors. Now it's the charming of the locals that is the key task. Even maneuvering in a difficult environment like Bolivia can bring benefits if one can cut off *nationalisers* at the pass by getting local PTBs to get behind the project and see it in their best interests. If the national government is intractable then one can either retreat or put exploration on a care and maintenance basis until the demagogues fall. The latter is something one can almost be assured will happen sooner or later. Bolivia and Ecuador in particular have a reputation for having "revolving door" presidencies.

So know your local politicians well and be prepared to come bearing gifts. In the old days knowing the President's Swiss bank account number usually did the trick (particularly in Zaire) but now the goodies have to be tangible and reach those who ultimately will be working and living in the vicinity of the new mine. Ignore this at your peril..

Important disclosures

I, Christopher Ecclestone, hereby certify that the views expressed in this research report accurately reflect my personal views about the subject securities and issuers. I also certify that no part of my compensation was, is, or will be, directly or indirectly, related to the specific recommendations or view expressed in this research report.

Hallgarten's Equity Research rating system consists of LONG, SHORT and NEUTRAL recommendations. LONG suggests capital appreciation to our target price during the next twelve months, while SHORT suggests capital depreciation to our target price during the next twelve months. NEUTRAL denotes a stock that is not likely to provide outstanding performance in either direction during the next twelve months, or it is a stock that we do not wish to place a rating on at the present time. Information contained herein is based on sources that we believe to be reliable, but we do not guarantee their accuracy. Prices and opinions concerning the composition of market sectors included in this report reflect the judgments of this date and are subject to change without notice. This report is for information puposes only and is not intended as an offer to sell or as a solicitation to buy securities.

Hallgarten & Company or persons associated with it may own securities of the securities described herein and may make purchases or sales while this report is in circulation. Hallgarten policy does not permit any analyst to own shares in any company that he/she covers. Additional information is available upon request.

Web access at:

Research: www.hallgartenco.com

60 Madison Ave, 6th Floor, New York, NY, 10010