# Mongolia tries to shake bad reputation and woo new FDI

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***If the giant Oyu Tolgoi copper-gold mine is a monument to Mongolia's rich mineral endowment, green shoots in its exploration landscape may be the clearest signs for some time that more positive investment sentiment is building after the damage done to the country's reputation earlier this decade.***

Back in 2010 a moratorium on new exploration licences effectively shut out explorers wanting to gain access to Mongolia's highly prospective geology. The government then revoked 106 exploration licences over the 2013-15 period. One company that has a different view of what is happening in Mongolia now, Kincora Copper, lost two of its three licences at the time. This, it said, resulted in a C$7 million (US$5.25 million) impairment and sterilisation of the West Kasulu target at its key Bronze Fox project.

Equitable resolution of the dispute of the licences was eventually achieved via a parliamentary amendment to the minerals law.

Despite Mongolia's volatile political environment the massive Oyu Tolgoi copper-gold openpit mine was built and a few junior miners that had ground before the moratorium continued to develop. Over the longer-term, Mongolia's mining industry has grown from a single major copper mine to include a handful of significant mines producing primarily coal and copper, as well as smaller volumes of gold, zinc and iron ore.

The view from outside is that the government and its attitudes have changed in the past few years.

While Mongolia's reputation for being difficult has stuck, the government is actively worked to attract foreign direct investment into mining, which is expected to become a more important economic pillar.

In 2018 the country had 3,078 valid mining and exploration licences, according to Kincora, which is undertaking the first modern district-scale copper exploration programme in the world-class Southern Gobi belt including advanced drilling at Bronze Fox.

Kincora said the restart of the Oyu Tolgoi stage two project in 2016 had acted as a catalyst, with a number of public and private companies raising funds in the years since through placements, equity offerings, rights issues and financing packages. The copper explorer itself raised US$9 million over the December 2016-June 2018 period. It said explorers were attracted to Mongolia for its relatively low barriers to entry, legislative stability, large volume of available land, and its tax regime.

Recent initiatives to attract further investment include the plan to float the state-owned Tavan Tolgoi coking coal mine on the New York and Hong Kong stock exchanges during the upcoming June quarter. Last year, the Mongolian government approved the sale of up to 30% of the mine's owner Erdene Tavan Tolgoi Corp through an IPO process to help ensure construction of the project's railway and roads, the lack of which have hindered the mine's development.

A change in attitudes toward Mongolia can be seen in Mining Journal Intelligence's World Risk Report (feat.MineHutte ratings) 2018, where Mongolia is ranked as the third best mining jurisdiction in Asia, after Japan and Korea.

The WRR awarded Mongolia a 58 out of 100 score, or a ‘B' rating (the top rating is ‘AAA'), in its **Investment** Risk Index, up from ‘CCC' in the 2017 edition.

However, globally it is still lacking, ranking 60th in the report's hard risk rating and 52 in the perceived risk rating.

TSX-listed Erdene Resource Development Corp CEO Peter Akerley said this could be explained by the fact that in the few instances when Mongolia had pushed forward with royalty or legal changes resulting in reduced investment, they had been quick to react.

"Unfortunately, this has created a perception that there is constant change whereas in reality there has been infrequent change to the actual fiscal regime … The threat of change is more frequent then actual change and more difficult to manage," he said.

Erdene has been involved in Mongolia for more than two decades and is busy developing the Khundii gold project, as well as a a number of other exploration projects in the Edren Terrane, one of the least prospected regions of Mongolia's section of the Central Asian Orogenic Belt (CAOB).

The belt hosts some of the world's largest gold and copper-gold deposits and offers the opportunity to uncover large, high-grade deposits near surface.

Khundii's prefeasibility study is due to kick off imminently, with a production decision expected by early 2020 and first gold output by early 2021.

## Changes in investor sentiment

Akerley told Mining Journal the unexplored world class CAOB had attracted the company to Mongolia in the first place and since then its exploration, as well as the efforts of others, had demonstrated the belt's potential through the discoveries of Oyu Tolgoi, Zuun Mod and Khundii.

He said there had been notable changes in the past 25 years, with Mongolia's GDP per capita expanding tenfold.

Akerley said the mining sector now generated 25% of the government budget and made up about 90% of the country's US$7 billion in exports, primarily to China.

ASX-listed Aspire Mining has been active in the country since 2010 and is developing the Ovoot and Nuurstei coking coal projects. Executive chairman David Paull has seen significant changes in investor sentiment.

"It has gone from a very hyped frenetic environment in 2010-11 to significant withdrawal of FDI to now there being some renewed interest. However, through this sentiment cycle the undoubted geological endowment has not changed," he said.

Ease of doing business and transparency in Mongolia have improved, with perceptions becoming more positive. Its governance category score in the 2018 WRR is evidence of this, up five points from 2017 to 69/100 and second in Asia only to Japan.

The WRR also awarded Mongolia a score of 58/100 in the fiscal category, which was a six-point improvement on 2017, but one of the lowest in Asia. It found the country has a good general business tax regime (72/100) and government participation/royalty rates (60/100), although economic growth was low (27/100).

Kincora said Mongolia needed globally competitive legislation to win back FDI.

In Paull's opinion, Mongolia's resource regulatory environment has been relatively consistent.

"While there can be regular changes in ministers, the underlying senior department directors provide operational stability," he said.

"The investment regime has had some missteps, but in the last few years has been constructive. But given this relatively good ranking it is surprising that there has not been more exploration occurring in Mongolia.

"There has been a lack of new exploration ground being made available which may be deterring additional investment," he said.

Mongolia allows for 100% foreign investment in resources other than uranium and Paull said it was relatively easy to establish companies to do business, though he cautioned there could be significant red tape, while regulatory regimes and interpretation of laws could evolve over time. He also viewed the tax rates at 25% to be reasonable and competitive globally.

"Royalties for coal are competitive and vary with coal prices. However, I understand that royalties for copper require adjustment to make them competitive," he said.

Akerley agreed Mongolia's corporate tax rate was comparable to other major mining jurisdictions with a maximum corporate rate of 25%, although gold royalty rates had ranged from 2.5% to 10%.

Erdene is a headquartered in Canada and benefits from the Canada-Mongolia Double Taxation Treaty and a Foreign Investment Protection Agreement, which minimises the tax and regulatory uncertainty associated with operating in Mongolia.

The company has also enjoyed a good relationship with the Mongolian government, with Akerley telling Mining Journal it had never faced any exploration hindrance or difficulty securing approvals to operate at any time during the past two decades, despite holding over 100 exploration licences, securing two mining licences and operating in multiple partnerships with domestic and international companies.

"Our company has worked hard to develop strong relationships with local communities, state governments, and national mining and business associations," he said.

This should set Erdene in good stead with its Khundii mining licence application, which has been submitted, with all approvals hopefully due by early 2020.

Mongolia's difficult reputation hasn't come from nowhere and not all companies have always enjoyed the experience of working in the country.

Rio Tinto's subsidiary Turquoise Hill Resources, which operates the Oyu Tolgoi openpit and is developing the underground section of the mine, has clearly had its issues.

Not only did the Mongolian government take a 34% project interest in Oyu Tolgoi in 2009 when it classified it as "strategic", but Turquoise Hill has also faced an uphill battle from its turbulent relationship with the government since, including a disputed $155 million tax bill and a cancelled power agreement.

Along with these issues, the company has also faced declining grades at the openpit, delays and rising development costs at the planned underground mine, and shareholder SailingStone Capital Partners calling for more independence from Rio, which owns 51%.

However, Turquoise Hill has remained adamant the 66%-owned mine will reach sustainable production rates by 2021.

Rio is also involved in Mongolia coal mining through subsidiary SouthGobi Resources, which runs the Ovoot Tolgoi coal mine.

The coal miner has also faced a slew of issues, mostly to do with the conduct of staff and alleged bribes to Mongolian state officials, with the company being suspended from trading in Toronto and Hong Kong in December.

Another company that didn't have the best experience and decided to up sticks was Centerra, which sold its Mongolia business unit in October for $35 million to "enhance the overall quality" of its portfolio. The sale came after years of permitting delays, local opposition to the Gatsuurt project and issues with keeping artisanal miners off its property.

It had previously written down the value of the Mongolia assets by $41.3 million in mid-2017 and reduced the carrying value to their estimated recoverable value of about $60 million.

### Infrastructure challenges

One area highlighted as a key deficiency in Mongolia is infrastructure.

The sparse country only scored 18/100 for infrastructure in the WRR, slightly better than the previous year's 11. It was rated 10/100 for its rails, roads and ports. Its energy security also still left a lot to be desired at 26/100.

Paull said transport access was critical and there was a significant infrastructure investment requirement in the "enormous" country.

"New resource developments are an important source of investment for new infrastructure but access to transport infrastructure needs to be a key consideration when investing," he said.

Paull said Mongolia's government had embraced public-private partnerships (PPPs) as a way to leverage commercial interests to assist with funding the infrastructure deficit and generate additional economic activity, which in turn drove additional infrastructure investment.

Aspire is doing its part to improve infrastructure through its 80%-owned Northern Railways, which is involved in one such PPP. It is part of a consortium developing the Erdenet to Ovoot railway, one section of a new rail corridor called the Northern Rail Corridor that links China to Russia through Mongolia.

The consortium is helping to progress financing, and railway design and construction, with Northern Railways responsible for the oversight of all aspects of pre-development, construction, and operation.

In June last year both Mongolia and Russia's Tuva Republic expressed support for the line, which forms part of a larger regional plan to create an international economic corridor to facilitate increased levels of trade between the Mongolia, Russia and China.

Erdene agreed the rail network needed to be expanded to connect the major bulk commodity resource centres with markets to the north and south, and PPPs were the most likely source of capital to accelerate this development.

Akerley said Mongolia had made "great strides" infrastructure-wise, developing a high-speed internet network and paved highways connecting provincial centres to the capital city, as well as several major mines, including Oyu Tolgoi, Tavan Tolgoi, Narin Sukhait, Erdenet and the eastern oil and gas regions.

"This is quite an accomplishment in the 18th largest country in the world," he said.

On energy, Akerley said Mongolia continued to rely on its neighbours for power and petroleum imports, but this was slowly changing through increased use of renewables, approved construction of new coal fired plants, and oil refining in the eastern part of the country.

"Mongolia has the natural resources to support a fully domestic energy supply which ideally will be developed as the necessary finances are generated from development of the resource industry," he said.

Paull added Mongolia had enormous opportunity to develop wind and solar renewables to contribute to the Asian Supergrid Project, with power demand rapidly growing in conjunction with economic growth.

According to Akerley, Mongolia has through a raft of changes and experiences developed a stakeholder group with a much greater understanding of the mining industry.

"This has its pros and cons, but overall results in greater transparency and a higher quality of development and greater shared benefits. It has led to a larger labour pool of skilled workers and a stronger infrastructure network and energy supply," he said.