CRITICAL RESOURCE

Getting socio-political due diligence right

Seven deadly sins in companies' approaches to assessing political and stakeholder challenges

Edward Bickham, Senior Adviser, Critical Resource

Critical Resource: overview

Our belief: companies can unlock major commercial value by managing stakeholders and politics strategically, systematically and responsibly

What we do

- We work with clients to achieve their commercial goals by understanding and resolving potential stakeholder challenges

Who we are

- Team of global and country experts, with a track record at some of the world's most politically-complex resource projects

Clients since 2013 include:

- bhpbilliton
- Chevron
- First Quantum Minerals Ltd.
- Resource Capital Funds
- Anglo American
- Rio Tinto
- Gold Fields
- Kosmos Energy
- giz
- MMG

Our senior advisory panel:

Lord Browne – former CEO of BP

Prof Sir Paul Collier – global authority on resources & development

Bill Emmott – former Editor of *The Economist*

Why companies turn to us:

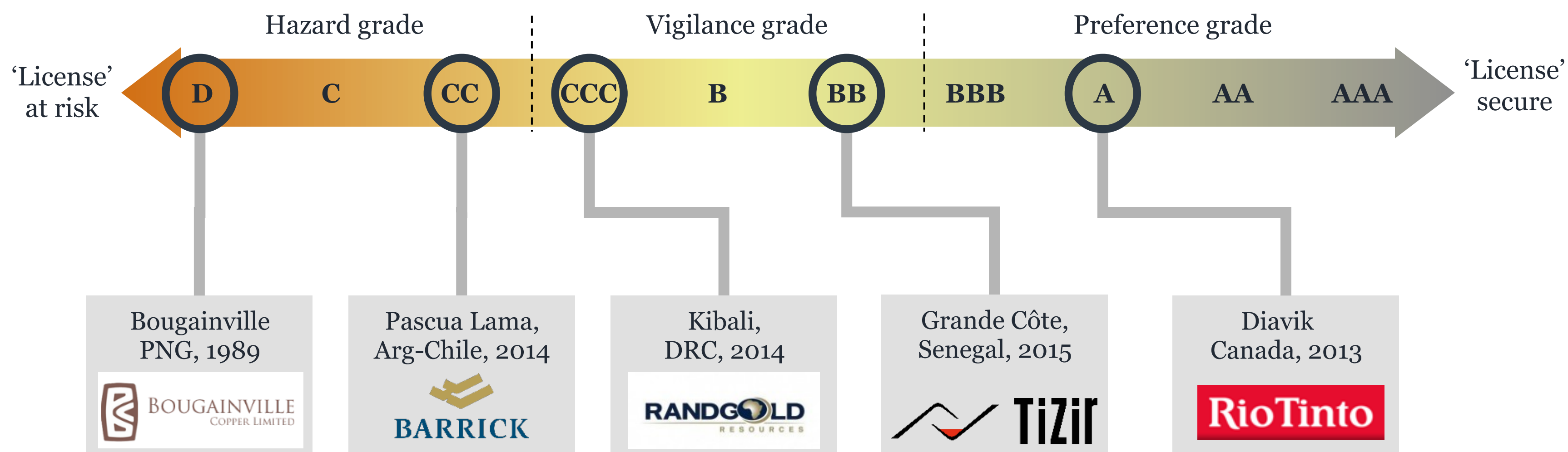
- Sole focus on extractives
- Rigour: industry-leading toolkit, methodologies, database of 200+ projects
- Knowledge: world-leading experts in resource issues and politics in over 75 countries
- Credibility: established relationships with investors, NGOs, SRIs, IFIs etc.

LicenseSecure: a uniquely-rigorous methodology

***LicenseSecure* : a methodology developed by Critical Resource for assessing stakeholder, political and reputational risk at the asset level**

- Database of 250+ assets (and growing) provides **global scope**, and many comparison projects
- 150+ indicators cover **full range of risks** (e.g., political, social, environmental, fiscal)
- AAA-D rating – succinct benchmarking tool for **rapid comparison** of project risk
- Scoring based on 6 categories covering both **external risk** and strength of mitigation by **company management**

We use the *LicenseSecure* scale to benchmark an asset's overall 'socio-political license to operate'



Getting socio-political due-diligence right: cautionary tales

73% of delays to world's largest 190 oil and gas projects due to 'above ground' risk (*Goldman Sachs, 2009*)

Social conflicts can lead to losses of **~$20m a week** at major $multi-bn mining projects (*Harvard University, 2011*)

Anglo American: Minas Rio, Brazil

- Intended as a transformative acquisition
- Delivered late and over budget (**$ 8.4 bn**) in part because of under-estimation of complexity of regulatory and land acquisition processes

Rio Tinto: Benga Coal, Mozambique

- Rio Tinto paid **$4.2 billion** for Riversdale Mining in 2011
- Government veto of barging, combined with technical problems, resulted in Rio selling for just **$50m** in 2014

Petrobras: Block 31 'Yasuni' Ecuador

- In 2002 Petrobras purchased licenses in Yasuni National Park – investing **US$200** million
- After sustained environmental opposition, government made work within Yasuni illegal. Petrobras was forced to return the block

Mistake #1: Taking a simplistic country-level view

- Focusing solely on national-level risks neglects asset-specific, or regional, risks – as well as opportunities.

- A post-acquisition review for a client in Peru, showed the company had over-looked important local dynamics.
- While the national and regional governments were supportive, the influential local mayor was significantly opposed.

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Mistake #2: Failing to anticipate political shifts

- Politicians and/or personal relationships between key political figures or interest groups and company personnel can change – surprisingly quickly.

- Repsol acquired a majority stake in YPF while the company enjoyed good relations with President Nestor Kirchner.
- But Argentina expropriated Repsol's stake in 2012 under Christina Fernandes.

- A mining project in Central America failed to plan for alternative outcomes in presidential elections.
- When the opposition candidate won – against expectations – it had to quickly build relationships and broaden its intelligence gathering.

Mistake #3: Being ‘self-centred’ and unable to understand dynamics between stakeholders

- Failure to ‘get’ stakeholders who don’t share a company’s perspective, or to understand relationships or rivalries *between* stakeholders can blind companies to key issues.

- As part of its due diligence, a company looking to acquire an asset in Latin America met with supportive government officials and community members hand-picked by the vendor.
- It failed to pick up deep community opposition and struggled to manage resistance leading to costly delays.

- Community jealousies at the Tintaya mine in Peru – which began under a previous owner – led to persistent disruption as rival groups have sought competing benefit packages.
- Under Xstrata’s ownership problems persisted. Glencore is now in the process of closing the mine.

Mistake #4: Underestimating legacy issues

- Local environmental damage or legacy of poor relationships can haunt acquirers, with opposed or predatory attitudes already entrenched.

- Gabriel Resources has spent $100s of millions at Rosia Montana project since 1999.
- The company failed to understand concerns over cyanide and has struggled with NGO and political opposition.

- Acquisition of the Cerrejon coal mine was dogged by issues from poorly-handled community resettlement.
- Current owners have sought to address negative social impacts. But there is still resentment locally and active campaigns internationally.

Mistake #5: Missing opportunities to turn around 'diamonds in the rough'

- Assessing only the risks posed by external factors without looking at mitigation strategies means companies can miss potential opportunities.

- An oil company was awarded a concession in a political context considered initially too 'hot to handle'.
- Implementing a proactive political risk management strategy enabled it to secure a successful farm-in with an international investor.

- Bougainville Copper Ltd's mine has remained closed since 1989: local grievances escalated into a civil war in PNG.
- The mine could present a major opportunity for a new owner (albeit an extremely risky one).

Mistake #6: The 'Year Zero' mentality

- Post-acquisition, purchasers often look to transplant new external affairs teams and processes, or to review commitments previously given.
- Delays or changes to project plans can undermine support from government or communities.

- The new owner of a multi-billion $ mining asset in Latin America is reportedly struggling to untangle a complex web of community commitments.
- Local communities engaged in disruptive direct action against former owners due to unrealistic expectations.
- The new owner is having to navigate this challenge, in tandem with reviewing generous social investment pledges.

Mistake #7: Allowing deal excitement to exclude political factors

- In the throes of thrashing out a commercially compelling opportunity, companies can sometimes be seduced by supposedly incontrovertible legal advice but forget that political considerations play a key role.

- BHP Billiton experienced political backlash when it bid for Potash Corporation of Saskatchewan in 2011.
- Provincial government believed the deal would not provide sufficient benefit to the region.
- The federal government blocked the $39bn deal, and BHP was left nursing transaction costs of $350m.
- This followed an earlier block by regulators of a tie-up between BHP Billiton and Rio Tinto's iron ore assets.

Contact

To learn more about Critical Resource
and how we can help, please contact us:

Edward.Bickham@c-resource.com

Website: www.c-resource.com