

The Glencore IPO: Hubris On Zambia

We have gone through each of the 103 references to **Zambia** – the world’s seventh largest copper producing nation - in the 1,637 page prospectus of the massive upcoming IPO of Swiss commodities producer and trader **Glencore International AG** (possibly resulting in its market capitalization of \$61 billion).

Several references get our attention:

Pg. 174 reads, “There have been certain matters (e.g. overestimated production costs and transfer pricing issues) raised in relation to the amount of tax payable by **Mopani** (73.1 per cent, owned by Glencore) in a draft provisional report prepared by advisers for the **Zambian Revenue Authority**. Mopani is confident that the amount of tax it has paid has been correctly calculated and discussions continue with the **Zambian Revenue Authority** and all other interested parties to clarify and resolve these matters whether or not any assessments are issued. However, even if these matters are not resolved satisfactorily as Mopani expects, the Directors believe this would not have a material adverse impact on the Glencore Group. “

On *pg. 625* we learn, “Mopani currently has two large scale mining licenses, which entitles it to operate two mines and its associated infrastructure in compliance with current **Zambian Mining Legislation**.”

These two licenses – **Nkana** and **Mufilira** – were issued in 2000 and expire March 31, 2025.

Nkana is situated in the Copperbelt province of Zambia, actually in the world famous Copper-Cobalt Metallogenic **Zambia-Democratic Republic of Congo** Province. Concentrate from Nkana is transferred to Mufilira for further treatment.

On *pg. 629* we read that an audit of its operations revealed the following compliance risks to Glencore’s Nkana mine: “Effluent discharge to the environment, particularly from the acid plant and Cobalt Plant, high Cu and Co concentrations to the **North Uchi Stream** which drains to the **Kafue River**” (The problem here – not mentioned in the prospectus - is that the Kafue River sustains one of the world's most revered wildlife environments); “Spillage of tailings from the tailings pipeline, booster pump station and/or tailings bleeds points to the adjacent two streams”;

“Venting of flue gas from the Cobalt Plant direct to the atmosphere rather than via the acid plant results in SO₂ emissions consistently exceeding the long term limit of 1 000mg/NM³.”

And after reading all of this we then learn that *it won't be until 2015* that Glencore believes the emissions problem will be corrected.

Pg. 740 – which begins the section of the Miner's Report conducted on behalf of Glencore by **Golder Associates Africa (GAA)** - raised our eyebrows because it becomes clear that due to time constraints and the number of variables involved that estimates of mining site closure costs are extremely vague (GAA admits it was even forced to rely in great part on Google Earth maps to perform much of its work remotely). It also becomes clear that the guideline for a scenario for the handling of waste and pollution in the event of closure has yet to be provided by the Zambian government. We have very little faith from this reading that Glencore is clear on exactly what procedure it would follow in the event of a major environmental pollution problem leading to a site closure and what it would cost – financially and in terms of Zambian community stakeholders.

On *pg. 804* a passing but potentially explosive mention is made of sovereign risk, “The Republic of Zambia could be subject to developments that individually or in combination could create instability, whether economic or political.”

What becomes clear from a reading of the 103 references is that Glencore is well positioned, strategically, in between two countries that together represent over 5% of world copper production – Zambia and DRC- (Chile is the world leader at 35% annually) but *extremely vulnerable* to supply/logistical disruptions, external political factors, environmental compliance issues and unclear processes that would guide unfortunate or worst-case scenarios.

The timing for these problems could not be worse, we think, with the combination of the Glencore IPO – which has forced an open admission of these risks - and a heated Zambian election where the issue of corruption, tax avoidance, and environmental pollution are front-and-center.

This confluence of forces has galvanized an international anti-corporate movement that seems to be zeroing in on the Glencore presence in Zambia more and more each month (see the April 15th UK *Guardian* article, “We need greater transparency over tax payments: A complaint over tax payments by a Glencore subsidiary could prompt the Zambian government to undertake an audit of all mining companies to assess how much tax they owe” (<http://www.guardian.co.uk/global-development/poverty-matters/2011/apr/15/greater-transparency-over-tax-payments>) and headlines such as The *Daily Mail's* “Glencore Digs Deep To Clean Up Its Environmental Record.” (<http://www.dailymail.co.uk/money/article-1384915/Glencore-digs-deep-clean-environmental-record.html?ITO=socialnet-twitter-dmailmoney>)

See our April, 25, 2011 **APB, “Zambia's Election Year Outlook”** for more context but our growing sense is that Glencore's cozy relationship with Zambia's political establishment will be a very contentious issue, capable of significantly raising its costs – whether in ‘discretionary spending,’

compliance fees, public relations, back taxes, or even a symbolic temporary mining site closure. It just may be that Glencore becomes the campaign villain in this election that China was last decade.

In other words we don't necessarily share Glencore's apparent hubris, expressed on pg. 174, "However, even if these matters are not resolved satisfactorily....the Directors believe this would not have a material adverse impact on the Glencore Group."

Other mining companies operating in Zambia to keep an eye on as we approach fall elections are **Vedanta Resources PLC (VED.LN)** (Konkola Copper Mines); **First Quantum Minerals Ltd.** (FM.T - Kansanshi Copper Mines), **Equinox Minerals Ltd** (EQN.T -Lumwana Copper Mines) and both **Nonferrous Metals Co. (8306.HK)** and the **Yunnan Copper Group (000878.SZ)** of China.

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