

Frontier's Strategy Note: 05/15/2015



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Oyu Tolgoi Deal with Rio Likely to Happen

Talks with Rio Tinto Group to approve the stalled USD 5.4 billion second phase of the Oyu Tolgoi copper mine could wrap up as soon as next week, says Mongolian Prime Minister Saikhanbileg Chimed.

A Rio delegation is coming in the country by next week and “I hope by this time we will finalize all ongoing issues because the principle agreements are already there,” Prime Minister said in an interview on Thursday with Bloomberg Mongolia TV in Ulaanbaatar. “We need to go through small technical issues, some procedural steps.”

Rio and the Mongolian government have been locked in discussions over a plenty of issues related to the copper mine, which is located at the doorstep of China, for over two years. The focus has been how to finance a USD 5.4 billion underground expansion of the mine to accompany the open pit operation which commenced production back in 2013.

Negotiations with the Mongolian government are dragging on, Rio Chief Executive Officer Sam Walsh said on Thursday at the company’s annual general meeting in Perth, Australia.

“We are narrowing down on the issues and I am hopeful that at the appropriate time for all involved that we will be able to bring that project into the board,” said Walsh, who visited the Oyu Tolgoi mine this March.

Sustainable Deal

“We don’t want to rush anything just for the sake of doing a deal because it has to be sustainable. It has to stand the test of time and that is seriously important,” Walsh commented.

Turquoise Hill Resources Ltd., which owns 66 percent of Oyu Tolgoi LLC, has seen its shares soar 44 percent in New York since the start of April amid speculation that a deal is close to be concluded. Rio controls the project through its 51 percent stake in the Company.

Mongolia, which has a 34 percent stake in the Oyu Tolgoi mine, has seen investment into the country plummet over the course of the dispute, with inbound foreign direct investment falling from USD 4.45 billion in 2012 to just USD 508 million last year.

“When moving and when making solutions on this project, I think big impacts will definitely change the overall picture of Mongolian development and Mongolian economy,” says PM Ch. Saikhanbileg.

In early April this year, Mongolian Prime Minister Chimediiin Saikhanbileg announced that his Cabinet has decided to proceed with the nearly USD 5 billion second phase at Oyu Tolgoi after two years of often bitter negotiations between the government and Anglo-Australian miner Rio Tinto.

Oyu Tolgoi phase II is a truly giant project according to an updated feasibility study including the underground expansion released in September shows recoverable copper of 24.9 billion pounds, 11.9 million ounces of gold and 78 million ounces of silver over a mine life of 41 years. If we calculate the value at today's metals prices, that's worth an eye-watering USD 92 billion.

A separate economic assessment to develop Oyu Tolgoi further and include other deposits at the property shows just what a rich find Oyu Tolgoi really was. This scenario provides a 94 year mine life and recoverable copper of 56.5 billion pounds, 27.9 million ounces of gold and 195.2 million ounces of silver, pushing the value of the mine to closer to USD 200 billion.

Oyu Tolgoi would certainly help Rio lighten its reliance on iron ore which is trading at near-decade lows and give it more exposure to copper the outlook of which is much brighter.

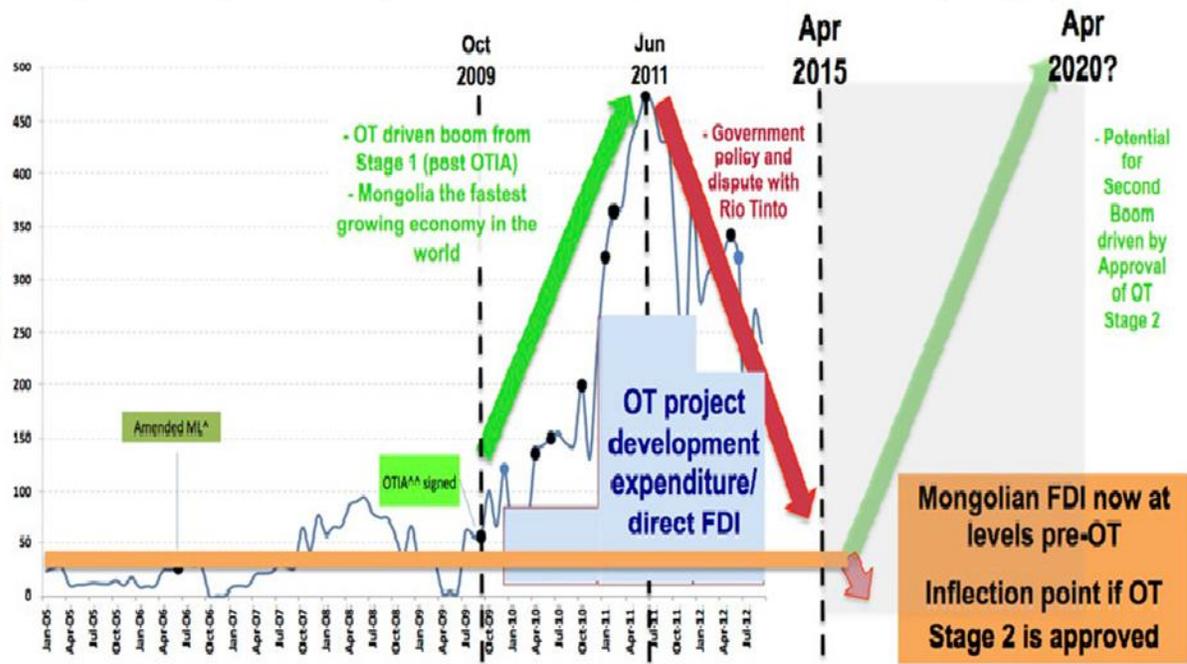
But as much as it's a great asset for the London and Melbourne-based company, this graphic prepared by Dale Choi of Independent Mongolian Metals & Mining Research, an Ulaanbaatar-based research company, shows just how vital the turquoise hill is to the nation of just over three million citizens:



“The OT effect”

Mongolia’s Foreign Investment Directly Depending on Oyu Tolgoi Project (FDI US\$/mth)

- **Mongolia was the worlds fastest growing economy, driven by OT Stage 1**
- **Mongolian FDI (and asset prices) are now at levels pre-OT Stage 1**
- **Resolution of dispute for OT Stage 2 provides for another period rapid growth, boom in Mongolian asset prices and improvement in the standard of living for the Mongolian people**



ON BIENNIAL BASIS, FDI INTO MONGOLIA COLLAPSED 88.6% IN 2012-2014 FROM \$4.45 BILLION TO \$0.5 BILLION

RESOLUTION OF 2.5 YEAR DISPUTE WOULD SEE ~\$6 BILLION INVESTED OVER 5 YEARS FOR OT STAGE 2 (EX INDIRECT BENEFITS)

ESTIMATES INCLUDING OT STAGE 2 SEE DIRECT GOVERNMENT SHARE OF 80% OF TOTAL PROJECT FREE CASH FLOW 2010-2021, >\$3 BILLION IN TAXES/ROYALTIES ALONE

Source: Independent Mining and Metals Analyst, Frontier Securities

What Is Oyu Tolgoi?

Oyu Tolgoi, located in Mongolia, is one of the world's largest new copper-gold mines. It's 66% owned by Turquoise Hill Resources (NYSE:TRQ) and 34% owned by the Government of Mongolia. Rio Tinto (NYSE:RIO) owns 50.8% of Turquoise Hill, and is the operator of Oyu Tolgoi.

There are a lot of different deposits that makes up Oyu Tolgoi, and this is a mine that could be in production for the next 50-75 years. Maybe even much longer depending on if more resources are discovered.

Right now, Oyu Tolgoi is just being mined as an open pit. In 2014, it produced 327 million pounds of copper and 589,000 ounces of gold. In 2015, it is expected to produce 385-430 million pounds of copper, and 600,000-700,000 ounces of gold.



Also, Mongolia has extended its cooperation with a World Bank insurer, overcoming another obstacle ahead of a \$5.4 billion expansion project to its largest mine, the Oyu Tolgoi copper deposit. The Multilateral Investment Guarantee Agency Mongolia (MIGA) said on Monday Mongolia had extended its cooperation with it from April 18.

MIGA provides insurance from political risk to investors such as those who would finance the underground mine at Oyu Tolgoi.

"It's our understanding that signing the current MIGA agreement is an essential precondition to project financing," said Nick Cousyn, chief operating officer at the Ulan Bator-based brokerage BDSec, in an email.

Rio chief Sam Walsh, while in Mongolia in March, said Rio would have to return to investors to negotiate a financing deal for the underground mine. Oyu Tolgoi last year missed a deadline to resolve disputes with the government for \$4 billion in project financing package from banks.

The International Monetary Foundation has projected 4.4 percent growth for Mongolia this year, without more foreign investment. That compares with 7.8 percent in 2014 and peak growth of 17.3 percent in 2011.

"This is another major issue solved by PM Saikhanbileg's administration, which dates back to when underground construction was halted in July 2013," Cousyn said.

MIGA's announcement came the same day that government-appointed Oyu Tolgoi board member Ganzorig Temuulen unexpectedly announced his resignation.

He was appointed deputy minister of mining in the new government in December. Analysts and officials cited Temuulen as telling Mongolian media that he had criticised the progress the government made in its relations with Rio because it would not lead to a deal beneficial enough to Mongolia and violated Mongolian laws.

Dale Choi, the head of Independent Mongolian Metals & Mining Research, said Temuulen's resignation could lead to "a united credible position of the Mongolian negotiations side".

Share price



Source: Google Finance, Frontier Securities



Conclusion

Given the positive reactions from the both sides, it is more likely for the second phase of the project to commence. Mongolia's economy is suffering due to FDI fall which is mostly affected by the dispute between the Government of Mongolia and Rio Tinto. If the policymakers in Mongolia adheres to the stable policy, then the mining projects supported by international giant mining companies will not have much hurdles. Similarly, the Tavan Tolgoi project is facing the same political hurdles.

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