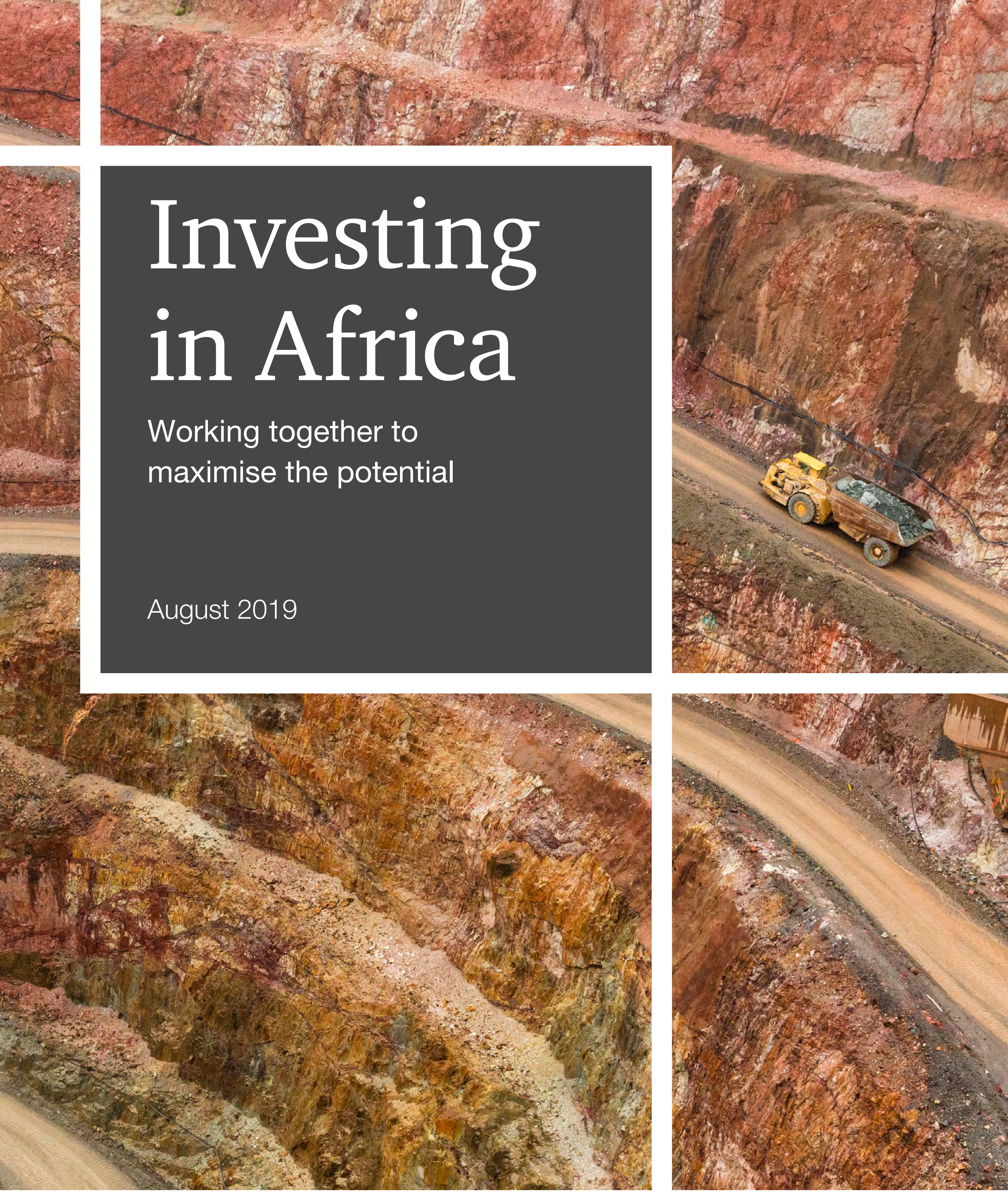


Investing in Africa

Working together to maximise the potential

August 2019

pwc

www.pwc.com.au

Contents

Foreword 3

The Investment Landscape 5

Background 6

Overview of Deals 8

Opportunities 12

Conclusion 18

Contributors 19

More references 20

Foreword

Currently, there is increasing uncertainty in relation to the state of the global economy, with forecasts of sustained lower economic growth. Conversely, the global mining industry is experiencing strong performance on the back of buoyant commodity prices. This is particularly true in Africa, which has enjoyed growing Foreign Direct Investment (FDI) – within the mining and resources sectors.

In previous PwC Australia-Africa practice publications ("Overtaxed" and "Two steps forward, one step back") we compared the domestic tax regime of several African jurisdictions through the modelling of a hypothetical gold mine, PwC Gold. We then compared the same jurisdictions against Australia to see how they stacked up in our "Battle of the Taxes" publication. This time, we are diving into the realities of actually buying into Africa from abroad.

The mobility of capital means that jurisdictions are competing to attract investment. With an influx of FDI into Africa underway, the imperative is now on each African country to ensure there is an environment that is conducive to foreign investment through creating certainty in the tax and legal regulatory frameworks in order to secure their share of the global capital contributing to growth in the local economy, the creation of jobs and development in communities.

African countries, like elsewhere, are seeking to build and maintain a sustainable revenue base through their tax system, that can be used to fund their country's long-term development requirements. However, difficulties arise in balancing the building of a substantial and reliable tax base with the need to provide a tax system that is globally competitive, efficient and certain, that at the same time assists to promote foreign investment and growth. While the resources assets may not be mobile, the capital that funds their development certainly is and will flow to the locations that are most attractive.

Cooperation between miners and governments has historically been key to the success of mining investments. Governments need to create an environment of stability and certainty, while companies should actively seek to build trust with their host government.

In this publication, we continue from the themes of our previous publications to identify how African governments and foreign investors can work together to build stability and trust so that all parties can benefit from the growth in Africa.

Key findings

Our findings show that the key ingredients for Africa to secure its share of global capital are

1. The certainty of fiscal regimes – in particular, the ability of African countries to develop a stable tax regime that provides certainty to miners through the entire life cycle (i.e. from entry right through to exit, including repatriation of profits along the way).
2. A stable and consistent legal system, with an ability to agree on mining conventions which assist the government and the private sector to work together collaboratively.
3. Infrastructure and socioeconomic stability – including the level of adherence to domestic laws.

The goal of this paper is to stimulate further discussion on how African governments and the mining sector can work together to achieve economic growth and attract foreign investment. The African opportunity is here and it is now. The only question is; how can this potential be maximised? The answer lies in a wide spectrum of stakeholders, most notably African governments and investors. This is because the opportunities in Africa, like elsewhere, are not without their challenges. By working together, miners and African governments can tackle uncertainty and build trust to enable both parties to benefit from the continued growth in Africa.

This paper also aims to outline how not only tax, but legal, infrastructure and socioeconomic realities significantly affect foreign direct investment. In summary, a sound regulatory framework is critical for attracting foreign direct investment in any jurisdiction and Africa is no different. Sound regulatory frameworks as well as strong institutions provide greater assurance for investors that the rule of law and property rights will be respected once they invest.

Greater uncertainty in the regulatory framework increases investors' assessed risk from investing in a number of African countries. In recent times there has been an increased push within Africa towards policies such as nationalisation of mines and changes to mining codes with unfavourable impacts on investor returns. Whilst some of these policies have not actually been implemented, many investors factor this in their assessment of risk relating to projects in Africa which plays some part in reducing the level of investment flowing into the continent.

An increase in certainty in the regulatory regimes of African jurisdictions would ensure an environment that promotes investment and contributes to growing the taxation pie in the host country.

Only a collaborative approach to solving these challenges will help sustain African governments and investors with their mutual goal of economic growth, employment, nation building development and profits from operation.

> **"By working together, miners and African governments can tackle uncertainty and build trust to enable both parties to benefit from the continued growth in Africa.**

The investment Landscape

Africa is a standout in a global economy that is lagging.

Whilst the global economy is forecast to grow, the pace of growth remains subdued with the IMF forecasting a growth rate of 3.2% in 2019. This growth forecast is made up of 1.9% growth for advanced economies and 4.1% growth for emerging and developing economies such as those of Africa. Slow growth in the advanced economies is driven among other factors, by rising trade tensions between China and the US as well as the ongoing uncertainty relating to Brexit. Africa on the other hand presents an opportunity for the astute investor given its endowment of natural resources as well as being home to over 1.2 billion people and boasting some of the youngest and rapidly growing populations in the world[1].

A look at global foreign investment (**FDI**) paints a subdued picture for the world economy with 2018 global FDI falling by 13% to US$1.3 trillion, to mark the third consecutive year of the downward trend. FDI flows to developed economies declined by 27%, reaching 15 year lows with FDI flows to Europe halving to US$200 billion whilst the US declined by 9% to US$252 billion.

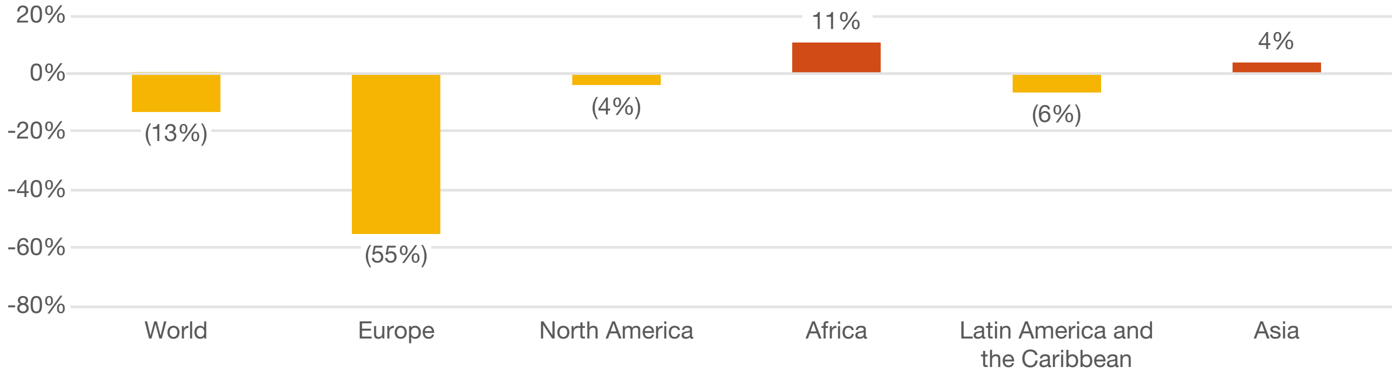
Against this backdrop, Africa has been the exception to the rule with FDI flows rising by 11% in 2018 to US$46 billion. Key points to note with respect to Africa, according to the United Nations Conference on Trade and Development's (**UNCTAD**) World Investment Report include the following:

- Growing demand and prices of some commodities, as well as sustained non-resource-seeking investments in a few countries, were largely responsible for the higher FDI flows to the continent;
- Multinational Enterprises (**MNE**) from developing economies were increasingly active in Africa, although investors from developed countries remained the major players;
- the expected acceleration of economic growth in Africa, progress towards the implementation of the African Continental Free Trade Area Agreement (**ACFTAA**) and the possibility of some large announced greenfield investments materialising, could result in higher FDI flows to the continent[2].

The ACFTAA is a trade agreement between 54 member states with the goal of creating a single market followed by free movement and a single currency union[2]. The implementation of the ACFTAA is expected to facilitate FDI from external market seeking entities setting up local operations in Africa to benefit from the African open market. UNCTAD reports that announced greenfield investments in Africa total US$75 billion in 2018. Of this amount, US$16.8 billion relates to mining, quarrying and petroleum.

Clearly the investment sentiment towards Africa is positive in light of the current global economic environment characterised by low growth in developed economies. This presents a good opportunity for sustained growth in FDI flows into Africa which presents better growth opportunities than the developed economies. This is moreso for Africa's mining sector given the relatively strong commodity price environment and Africa's mineral resources endowment.

Year on Year FDI Growth by region, 2017 - 2018



Source: UNCTAD World Investment Report 2019

Background

We are taking it a step further.

Due to the overwhelmingly positive feedback received from our previous publications, we have decided to take our analysis a step further and provide key insights concerning the realities of investing into Africa from abroad, the role that African governments need to play, and the opportunities and practical difficulties which investors should consider when buying into African jurisdictions.

Introducing PwC Gold

Our gold mine has the following key factors (all amounts are US$):

- Open pit mine, with processing plant on site to produce gold doray;
- Exploration costs of $30 million have been incurred to date;
- Four year permitting and approvals process, during which development costs of $150 million incurred to construct the mine and processing plant;
- Production of 200,000 ounces p.a.;
- Assumed real gold price of $1,275 per ounce*;
- Cash costs of $595 per ounce and All In Sustaining Costs (AISC) of $795;
- The mine employs 1,100 local staff and 11 expatriates.
- Cash flows discounted to present value using an 8% discount rate.

*gold price has been kept the same for consistency purposes.

Based on analysis performed across a number of mining companies, we have assumed a minimum required Internal Rate of Return (IRR) of 25%.

Additionally, we analysed the potential factors that could benefit both governments and the private sector in Australia and Africa alike, to provide continued growth and opportunity for the global mining industry.

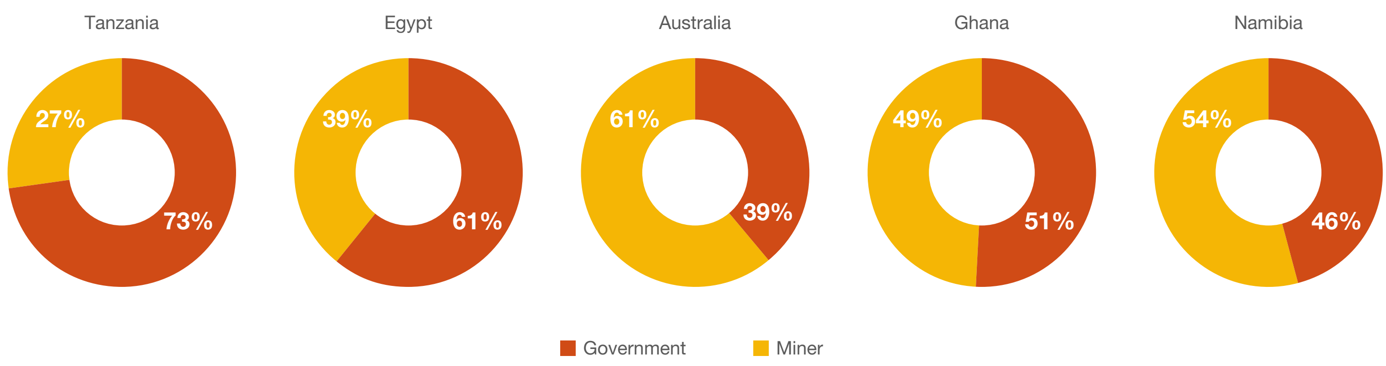
A summary of the findings is shown in the tables below:

2018 Internal Rate of Return (IRR) and total government revenue generated by country

Country	Project IRR	Would the mine be developed?	Government revenue generated (US$m)	IRR trend since 2017
Australia	26.2%	✓	371	–
Ghana	24.2%	Maybe	487	No change
Tanzania	18.1%	✗	694	↓
Namibia	25.3%	✓	435	No change
Egypt	20.0%	✗	579	No change

Source: PwC Analysis

2018 Revenue split between the government and the miner



Source: PwC analysis

For the purpose of this publication, we have not limited our comments to specific countries, but rather, considerations that should be made by all mining companies looking to invest on the continent.
From an investor perspective, we have discussed some of the considerations required to invest in African mining operations from a taxation, and legal perspective. This includes an overview of recent transactions, a discussion of topical tax issues in Africa, such as change of control provisions, withholding taxes and capital gains tax, and an overview of topical issues in the legal space, such as negotiation of mining codes.

Overview of deals

US$5 billion Africa FDI growth for 2018.

To showcase the current state of investment in Africa and in particular the mining sector in Africa we have assessed, in the first instance, the overview of investment flows into Africa at a macroeconomic level across all industries. Later in this section, we take a closer look at major deals completed in the last three years, particularly in the mining sector.

Snapshot of FDI in 2018: Africa's stake in global FDI pie on the up

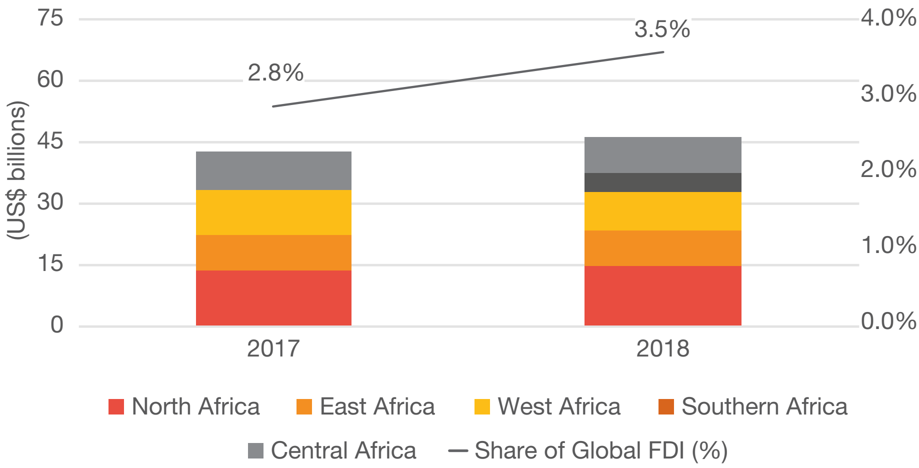
As discussed earlier, FDI in Africa has shown an upward trend over the last few years up from US$41 billion in 2017 to US$46 billion in 2018.

North Africa and West Africa have broadly maintained their levels of FDI and in 2018 account for most of the continent's FDI with Egypt's oil and gas industry boosting North Africa's FDI. A rebound in South African FDI after years of decline has contributed to the increase for Southern Africa in FY18. Out West, Francophone Africa is behind most investment flows in West Africa.

Chinese competition for African investments will only grow

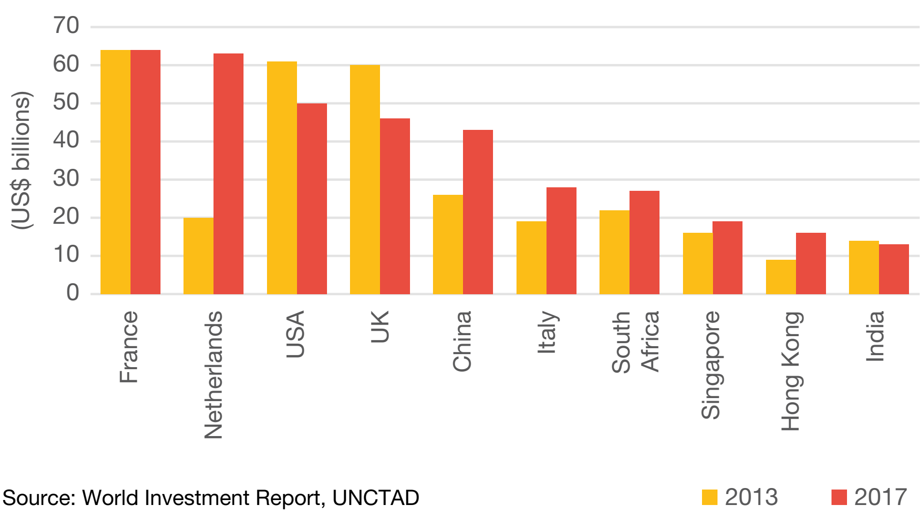
Europe nations, and France, the UK and the Netherlands in particular, are the biggest investors into Africa, followed by the USA and China. A key takeaway from this graph relates to China which has seen significant growth. Given the size of the Chinese economy and its ongoing infrastructure development based growth, Chinese investment in Africa is not yet where it could be based on FDI levels of similar size economies. Europe and the USA are developed economies and yet they have more FDI stock than China currently does. As such, despite its well-documented investment in resources projects in Africa, Chinese investment is expected to continue to grow. An example is the majority (80%) acquisition of the Democratic Republic of Congo's Tenke copper and cobalt mine by China Molybdenum – investing over US$3.7 billion[3]. This deal provided the Chinese investor with access to one of the largest known copper and cobalt deposits in the world.

FDI Flows by Region



Source: UNCTAD

Top 10 Investor Economies by FDI Stock



Source: World Investment Report, UNCTAD

Mining sector attracting more interest from investors

In our analysis, we have also considered announced greenfield FDI projects to assess the outlook of the investment landscape going forward. The table below shows a summary of greenfield FDI announced in 2018.

Overall, the announced greenfield FDI has decreased in 2018 due to a decline in services driven by the electricity gas and water sector. However, the mining, quarrying and petroleum sectors have shown a marked increase of 58% in 2018. A relatively strong commodity price environment has been helpful in sustaining this trend. The mining sector trend is consistent with the trend in FDI flows discussed earlier and reflects investor confidence in the mining industry in Africa.

Announced greenfield FDI projects by industry (US$m)

Sector/Industry	Announced greenfield FDI (US$m)	
	2017	2018
Total	**83,044**	**75,722**
Primary	10,587	16,794
Mining, quarrying and petroleum	**10,587**	**16,778**
Other	–	16
Manufacturing	20,583	32,996
Chemical and chemical products	6,175	11,006
Coke and refined petroleum products	1,472	6,480
Food, beverages and tobacco	1,990	4,982
Metals and metals products	1,078	3,919
Other	9,868	6,609
Services	51,874	25,932
Business services	2,539	5,291
Construction	5,667	4,789
Electricity, gas and water	37,073	5,697
Transport, storage and communications	3,656	4,243
Other	2,939	5,912

Source: UNCTAD

Recent deals in the African mining industry

After analysing the overarching trends in FDI into Africa, we have taken a closer look at some of the major deals and transactions involving the acquisition of African mining projects over the past three years.

As such, we have limited the scope of our analysis to transactions relating to the acquisition of equity interests since 2017 in the mining and oil and gas industries. Based on this, the total value of the transactions within the scope of our analysis amounts to approximately US $47 billion.

Selected major African resources deals at a glance

Barrick – Randgold merger

Post merger, Barrick Gold and Randgold shareholders will own 66.6% and 33.4% of the new Barrick company respectively on a fully diluted basis

Barrick Gold Corporation (NYSE: ABX) announced its plans to merge with Randgold, an Africa-focused gold mining company, in a share-for-share deal valued at US$6.5 billion. The deal will result in the formation of a new company, "new Barrick," which will be listed on both the New York and Toronto exchanges. The new entity is expected to be an industry-leading gold company with a focus on Tier One Gold assets, with the lowest total cash cost and one of the highest adjusted EBITDA margins in the industry. The transaction was completed on 1 January 2019.

Anglo American Platinum acquire remaining JV interest from Glencore and Kagiso

Rustenburg Platinum Mines Limited acquires the Mototolo JV from Glencore and Kagiso

Anglo American Platinum's wholly owned subsidiary Rustenburg Platinum Mines Limited acquired the remaining 50% interest in the Mototolo JV from Glencore and Kagiso Platinum, increasing Anglo American Platinum's interest in the low cost, high-quality Platinum Gold Metals JV in South Africa to 100%. The transaction was closed in late 2018.

Resolute announces acquisition of Senegal gold project

Resolute will acquire all of the shares of Toro Gold by way of a takeover for US$274 million comprising US$130 million of cash and 142.5 million freely tradeable Resolute shares

On 31 July 2019, Resolute announced that it had signed a binding agreement (Implementation Agreement) with Toro Gold Limited (Toro Gold) pursuant to which Resolute will acquire all of the shares of Toro Gold. The deal was closed in August 2019.

Source: S&P Capital IQ

The recently announced acquisition of Toro Gold by Resolute Mining Limited adds to a growing list of Australian investments into Africa and also reflects Australian investor confidence in the mining industry in Africa. The other transactions represent some of the largest deals in the mining industry in Africa over the last year and also reflect investor confidence in that industry. It is interesting to note that most of the investment destinations in the transactions above such as Ghana, South Africa and Senegal rank below the 50th percentile of Transparency International's Corruption Perceptions Index. This shows that whilst risk return payoffs are important in attracting investments, strong institutions also help boost investor confidence.

Investment by Region

The graph above shows the distribution of mining investment inflows by regional destination.

Some key insights from the analysis are as follows:

- West Africa received the largest portion of deals mainly driven by oil and gas as well as gold projects.
- The merger between Randgold Resources Limited and Barrick Gold (Holdings) Limited discussed earlier accounted for a significant portion of deals in Africa during this period.
- In Southern Africa, investment inflows are driven by a more diverse range of minerals from nickel, gold, platinum and cobalt with most investment inflows over the period concentrated in South Africa. A notable transaction in this region included the acquisition of the remaining interests of the Mototolo platinum mine by Anglo American's Rustendurg Platinum Mines from Glencore and Kagiso in 2018.
- More than 90% of investment inflows into North Africa relate to Egypt and Algeria with Morocco a distant third. Most of the investment in this region is driven by oil and gas projects.

Investment in East and Central Africa is considerably low. For Central Africa, persistent conflicts and political instability appears to be the main driver of the low levels of investment. This also discourages exploration activity and infrastructure development which is critical for sustained investment inflows into that region.

Australia's active role in the African mining sector

Australia's investment in the extractives sector in Africa is well documented. Submissions to the recent Senate Enquiry on Australia's trade and investment relationships with the countries of Africa indicated that at least 170 Australian listed companies operate in 35 countries across the African continent with the scale of exploration, extraction and processing from current and potential investment estimated to be worth more than A$40 billion[2].

Further, Australian companies have had a high (in comparison to its size) level of involvement in transactions, comprising 11% or 47 of the 431 transactions within the scope of our analysis.

As of 2015, Australia was estimated to hold interest in approximately 55 operating mines across the continent whilst also accounting for approximately 505 exploration projects. As a result of Australia's strength in the extractives sector, Australian companies have developed expertise in a range of supporting functions. The mining equipment, technology and services (METS) sector has become an important industry in its own right[2].

Australia has well documented in country experience in African extractive projects and its contribution in the African mining industry spans from investment to mining expertise and this is set to continue.

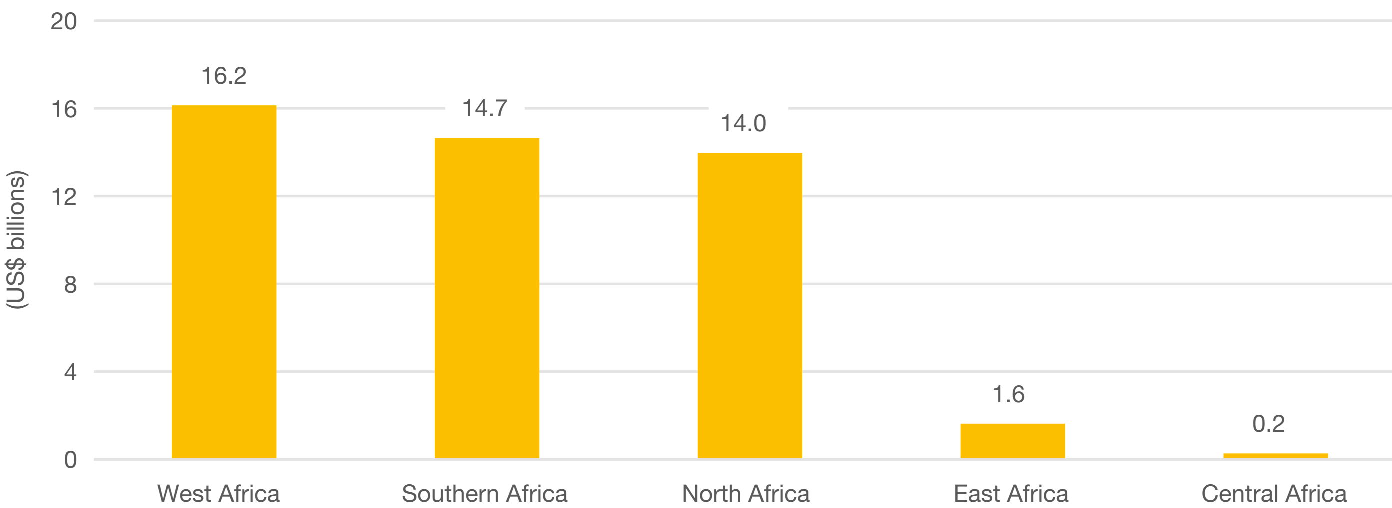
Deals overview – A positive outlook

Our assessment of the investment landscape as detailed above reflects positive sentiment towards investment in Africa. From our analysis, some of our key takeaways include the following:

- subdued global growth which may lower risk aversion as investors seek growth prospects;
- the increase in FDI into Africa in 2018 against a backdrop of declining global FDI;
- the gap between China's economic size and (relatively) low levels of FDI stock in Africa when compared to Europe or the USA;
- the strong commodity price environment which has fuelled demand for African investments, particularly mining, from a diverse range of investors; and
- the keen interest in the African mining industry from Australia in particular, among others.

All of these items point towards a possible sustained increase in investment in Africa. For each African country, it is important that conditions be conducive for investment in order to gain a fair share of investment inflows.

African mining transaction by investment destination



Source: S&P Capital IQ

Opportunities

With indicators pointing towards a surge of FDI into Africa, governments can attract global capital by ensuring their jurisdictions are "investment-friendly".

In last year's publication, Battle of the Taxes, we determined whether several African jurisdictions would provide a suitable investment opportunity for our hypothetical gold mine PwC Gold from an in-country perspective.

We showed that as a mining investment prospect, Ghana was just below the required threshold for investment and Tanzania and Egypt were both out. This left just Namibia and Australia as viable options with Australia ultimately edging out the African countries analysed.

In the following section, we have discussed what areas African governments could focus on to help make them an attractive option for foreign investors and make our PwC Gold a reality in their country along with the taxes, jobs and FDI that comes with it. We have broken down our analysis into tax, legal and other practical considerations.

Tax

Uncertainty in tax regimes

The interpretation of tax law is complicated at the best of times with changes and new legislation needing constant monitoring. The OECD has placed significant focus on the need for tax certainty.

The OECD's 2017 publication (2017 report) on tax certainty and the subsequent updates in 2018 and 2019, suggest that tax certainty remains a key influence on investment and other commercial decisions and can also have a significant impact on economic growth.

Tax uncertainty can give rise to a poor general relationship between business and the tax authority. In this context, greater transparency with respect to the tax affairs of multinationals, coupled with a more cooperative approach to tax compliance has a great potential to reduce uncertainty for companies, assist tax administrations to in focussing their resources better and promoting a culture of greater trust. Update on Tax Certainty – IMF/OECD Report for the G20 Finance Ministers and Central Bank Governors

In the 2019 update to the OECD's 2017 tax certainty publication, it was concluded that inconsistent treatment by tax authorities, a lack of expertise in international taxation and conflicts between tax authorities on their interpretations of international tax standards continue to be a high priority concern of businesses around the world. In addition, the update drew conclusions regarding tax uncertainty in developing countries were drawn from survey data.

Some relevant major observations made in the publication included:

- the tax system was an important factor influencing investment and location decisions in Africa;
- tax uncertainty appears to have a more frequent impact on investment decisions in Africa compared to OECD countries; and
- tax uncertainty appears more likely to increase the risk premium or hurdle rate for investments in Africa.

As recommended by the OECD in their report, the governments in African jurisdictions could address any uncertainty in their tax systems by creating a fiscal environment conducive to foreign investment and economic growth.

Current tax challenges

When a foreign investor looks to buy into another jurisdiction, it is imperative they have an understanding of the tax environment into which they will be entering. We have outlined some of the common tax challenges that foreign mining investors face when buying into or exiting African jurisdictions which may influence investment and other commercial decisions.

Entry and exit tax challenges

Change of Control provisions/Capital Gains Tax (CGT)

In jurisdictions where Change of Control (or otherwise known as non-resident CGT) provisions are present, a change of control of (typically) more than 50% within a prescribed time frame can trigger a deemed disposal of either the African subsidiary or of all the underlying assets of an entity at market value. Due to the nature of investing in mining projects, there is often a relatively low cost base (as investment value is typically added post acquisition through exploration and development) which can mean that a disposal at market value of the interest in the mining project can lead to a substantial gain and result in companies reconsidering whether to invest at all. In essence, if a change of control occurs, and there is a deemed disposal, it can result in a large tax bill for either the incoming party, the in-country entity, or both. The operation of these provisions can be problematic when a company is looking to buy into Africa.

Many of the relatively newly enacted change of control provisions in Africa (e.g Francophone Africa such as Mali and Burkina Faso) have been introduced with relatively little or no guidance. This results in tax uncertainty and can have an adverse impact on the willingness of companies to invest as there is a need for more return to justify the risk.

By way of contrast, a number of countries around the world have relatively prescriptive change of control/non-resident CGT rules which seek to tax such gains. The prescriptive nature of such rules make it easier for companies to navigate and quantify risks, meaning they can make investment decisions with a high level of certainty.

In addition, we often see many multinational enterprises undertaking internal reorganisations to streamline their investment and to minimise complex structures typically inherited through acquisitions.

Many countries provide flexibility through the application of CGT rollover provisions which allow for concessional treatment of capital gains when undertaking internal reorganisations. However, we note that some African countries do not offer such flexibility, particularly in West Africa, which can mean that internal restructuring is not as accommodating as it could be. In practice, this means that when buying into Africa, it can be difficult to restructure internally without being subject to the application of CGT.

Residency and Substance requirements

In a deal context, when a company invests into Africa via an acquisition, typically this involves the acquisition of a holding company structure which often can involve a number of jurisdictions. It is more important than ever that adequate due diligence is undertaken to determine whether the residency and local substance requirements of each entity in the target's structure are met.

Failing to meet such residency and/or local substance requirements can result in the holding company being tax resident in a jurisdiction other than its place of incorporation, which could result in double taxation (amongst other adverse tax outcomes). This challenge is not only limited to African investments, but any investment made globally. This is often where the consideration of whether a Double Taxation Agreement (DTA) applies is undertaken.

A DTA a bilateral agreement between two jurisdictions facilitate trade and investment by lowering tax barriers to the international flow of goods and services and assist in avoiding double taxation and fostering cooperation between two jurisdictions' tax authorities by enforcing their respective tax laws.

However, as part of the coordinated actions by governments to tackle concerns over base erosion and profit shifting (BEPS), and recommendations led by the OECD, many countries have signed up to the “Multilateral Convention to Implement Tax Treaty Related Measures to Prevent Base Erosion and Profit Shifting” (the Multilateral Instrument, MLI) which impact the applicability of DTAs.

The Multilateral Instrument (MLI) is a multilateral treaty that enables jurisdictions to swiftly modify their bilateral treaties to implement measures designed to better address multinational tax avoidance. Before the MLI can have any impact on the DTA between two jurisdictions, the MLI must have entered into force for each of the two jurisdictions. While some of the articles contained in the MLI are minimum standards, and thus mandatory, most are optional. If two signatory jurisdictions have elected to adopt matching optional articles, the MLI operates to modify, but not directly amend the nominated treaty clauses. It is key that investors understand the extent to which the MLI applies to the jurisdiction they are looking to invest in.

In light of the introduction of the MLI and the commonly used principal purpose test (PPT) (an anti-avoidance rule based on the principal purpose of transactions or arrangements) adopted in most MLI’s, in order to successfully claim DTA benefits (if any), it is critical to ensure that adequate economic substance is maintained in relevant jurisdictions in global structures. The denial of benefits under a DTA (e.g. where the PPT provisions are not satisfied for example) may result in significant tax leakage when repatriating profits from Africa to a foreign parent and as such, monitoring of the meeting satisfaction of substance (and other MLI) requirements are an important ongoing consideration.

It should be noted that very few African countries have agreed to sign up to the MLI. With reference to our previous publications, Ghana, Namibia and Tanzania (by way of example) have not signed up to the MLI. Further, very few African countries have in fact ratified the MLI (http://www.oecd.org/tax/treaties/beps-mli-signatories-and-parties.pdf)

As a result, at a time when Africa is expected to see continued investment countries are lagging behind global peers in terms of introducing OECD recommended international tax measures such as the MLI. This adds to the risk factors considered by foreign investors when contemplating the appropriate location (and return) for their capital.

Furthermore, the uncertainty in tax systems can make it hard for investors to rely on existing DTAs between African countries and foreign jurisdictions when investing into African as their existence is not guaranteed into the future.

It is also important to highlight that Australia (a country which (as highlighted above) has significant investments in Africa) only has one DTA with an African country, South Africa.

Registration duties

Registration duties are generally applicable to documents brought into being for the purpose of recording transactions. Registration and other relevant duties are applicable in several African jurisdictions but vary in rate and in documents to which it applies. The application of registration duties can substantially impact investors buying into a jurisdiction.

Australia, and several other jurisdictions around the world, have largely done away with registration duties and have now impose some form of “stamp duty”. By way of example, stamp duty is applicable (in Australia) mainly using “landholder” type regimes which ensure that taxpayers are not paying duties on every acquisition. The previous methodology of imposing flat rate registration duty on acquisitions is an antiquated approach as it impedes investment, as such, jurisdictions that still employ it should consider moving to a stamp duty regime to promote foreign investment.

Repatriation of profits

Generally, the lack of treaty relief available for interest and dividend withholding taxes results in the significant “leakage” in the repatriation of profits out of Africa to foreign jurisdictions. This represents a challenge for investors as they will generally require a higher initial return from a project to justify the leakage.

VAT input tax credit restrictions

When investing as a mining company, it is important to understand the unique operation of some African VAT regimes. In particular, many African countries operate on the prerequisite that output tax is charged before input tax can be claimed.

The denial of input tax credits until a point in time at which an output tax has been charged (i.e. until when revenue is derived or when mining “sales” commences) can negatively affect mining businesses that have large outlays in the initial stages of a project – for example, if VAT refunds are not provided whilst a mining company is developing/constructing a mine, and the VAT rate is 20%, that investor needs to fund an additional 20% of capital for its investment. The denial of these input tax credits and its negative cash flow impact can be a key factor in deciding whether a jurisdiction poses a viable investment option.

In summary

To summarise the above, for African governments to steer the flow of FDI to their respective country, they could work together with miners to address the elements of instability and uncertainty that deter foreign investment. In the arena of tax, uncertainty is often created through inconsistencies in the tax law and lack of guidance from the tax authorities. By addressing any uncertainty in the tax regime, we will be a step closer to seeing investments such as PwC Gold becoming a reality.

Legal

Certainty of legal framework

Mining Codes, State Agreements and Legislation

A critical aspect of making an investment decision in relation to any stage of a mining project is having a detailed understanding of the underlying legislative basis for the arrangements between the mining company and the sovereign government.

This decision-making lens is applied by a mining company at each stage throughout the life of a mining project, from the decision to first invest in an exploration project, to expenditure associated with obtaining a better understanding of the mineral prospectivity of that project, to making the final investment decision to mine. This same decision-making lens is also applied by lenders and financiers to mining companies and mining services companies, and also by sophisticated shareholders in these mining companies, mining services companies and financing companies.

All of these companies are seeking to ensure that they understand the risks and opportunities associated with making a decision to invest and stay invested in that mining project or company, and will be comparing a decision to invest in one opportunity against the risk, opportunity and potential return on investment relating to another opportunity that it may have access to. As such, Africa, like the rest of the world, is in a global competition for capital.

In recent years there have been instances of sovereign governments changing the underlying legislative basis for the arrangements between the mining company and the sovereign government. Whilst mining companies and their stakeholders understand that sovereign governments will amend legislation and regulation in order to effect change where it is required or appropriate, for example, to increase applicable standards to render these consistent with international practice, such as in relation to environmental rehabilitation obligations, or to increase local capacity and capability, where the changes are sudden, unexpected or have significant unintended consequences, it has the effect of stalling investment into those mining projects.

The flow on effect from this may be less overall investment into that jurisdiction as a whole. Where a government wishes to embark on a significant change to mining codes or legislation, it should consider the benefits associated with undertaking strategic stakeholder discussions to ensure that policy changes, once enacted, have the intended effect of improving regulation in the relevant jurisdiction.

Jurisdictions in Africa are not alone in making such changes. In Australia, the Federal Government enacted the Australian Domestic Gas Security Mechanism, which was intended to restrict the export of gas from certain identified LNG Projects in Australia in order for the domestic market to be supplied with sufficient gas as a first priority. The impact on Australia's perceived sovereign risk was immediate, and whilst this security mechanism has never been used, it remains as part of Australia's domestic law and is a factor that all participants in LNG Projects in Australia now take into account in assessing continued investment in their projects here, and further expansion of those projects.

Other considerations

Socio-Political stability

Socio-political stability is important as it provides investors with a predictable environment in which to operate. This ensures that the rule of law can be upheld and provides investors with comfort that they will realise returns on their investments. It is therefore essential for African governments to create stable political environments to lower the risks associated with operating in their countries which has a flow on effect on cost of capital.

Quality of infrastructure

Infrastructure plays a key part in the investment decision process with investors typically preferring to invest in countries with good infrastructure such as roads, rail, ports, schools and hospitals. Good infrastructure reduces the amount of capital required to begin operations as often times the burden of developing the infrastructure falls on mining companies. In recent times, we are seeing shared infrastructure use as means to assist in funding infrastructure.

The importance of infrastructure can be seen from the historically large share of African mining investments allocated to South Africa (which has considerably better infrastructure than the rest of Africa) outlined above in our Deals summary.

Distribution channels

African governments could assist in ensuring that sufficient infrastructure is available to enable mine operators to bring their products to market.

This includes both physical infrastructure investment as well as conditions such as efficient processing of borders when products are exported or imported as well as fair tariffs for the movement of goods between borders. This is particularly important in Africa, where countries are "landlocked".

Availability of technology required to maintain competitiveness

Like many other industries, access to technology plays a key factor in assessing the viability of mining projects as African mining operations continue to keep up with relevant technological developments in order to remain competitive. It is therefore important for African governments to continue to focus on the availability of technology in their countries. This can be achieved through exemptions on tariffs relating to the importation of critical mining equipment as well as strong legislation to protect intellectual property, which encourages innovation.

Security

Security is a major consideration for many projects given political instability encountered in a number of jurisdictions on the African continent. Security issues may also arise from projects being located in remote areas where law enforcement may be a challenge for local authorities. As a result, many projects require significant investment in private security to ensure a safe environment for people to operate and work in, and to also protect valuable mining assets and the passage of minerals from the mine site to local and international markets.

It is imperative for African governments to improve national security and reduce the need for private security which increases operating costs and somewhat reinforces the perception of high risk associated with investing in certain parts of Africa.

Energy

For mining projects to operate, there needs to be access to power and it needs to be reliable. This is a challenge for many developing countries and Africa is no exception. An example is South Africa where the mining industry is one of the biggest consumers of power and power outages in recent times have risked production levels and in turn thousands of jobs. A solution in some cases has been for mines to generate their own power. This has its advantages and disadvantages. In some cases, private power generation has worked well when regulations allow for mines to build their own power plants and also supply to local communities. However this may be a loss for all stakeholders as the national power utilities will lose the large mining customers which impacts their viability whilst the mining companies are likely to have higher costs of production from private power generation. It is therefore important for African governments to provide power supplies and deliver on adequacy, reliability on price.

Conclusion

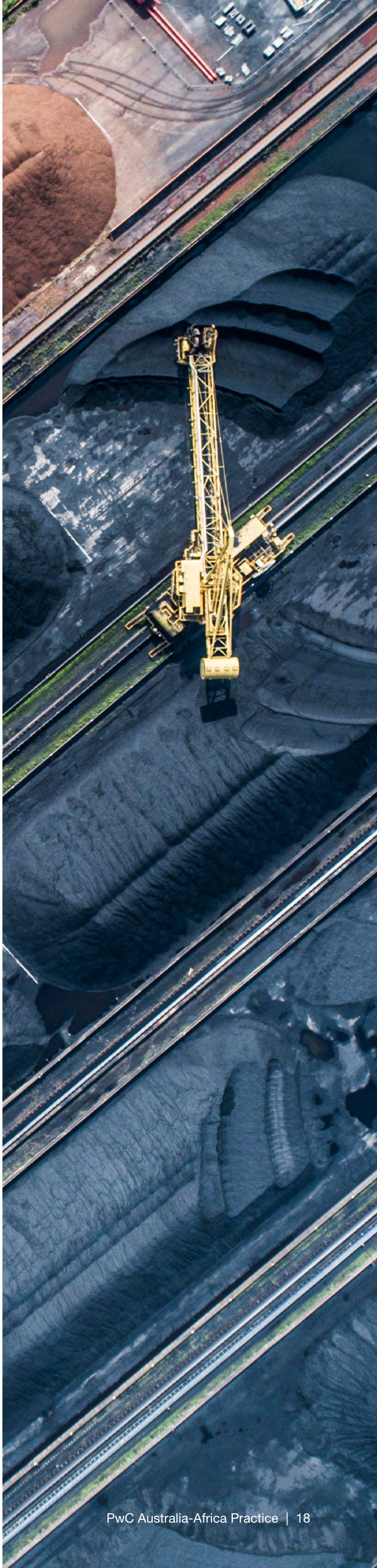
What conclusions can be drawn from our analysis?

Our analysis has considered the opportunities and challenges when it comes to investing in Africa. As an investment destination, the case for Africa is clear! The numbers point towards an upward trend; FDI is on the up in terms of both existing FDI stock and forecast greenfield FDI. We have also seen some of the biggest deals occur such as the multi-billion dollar Barrick Gold – Randgold merger which presents a case of positive sentiment. The African opportunity is here and it is now, with competition for investment likely to only increase over time.

Given its sheer landmass, young demographic, rising middle class, and imponderable resources, Africa's potential is without doubt. The only question is how can this potential be maximised. The answer lies in a wide spectrum of stakeholders, most notably African governments and investors. This is because the opportunities in Africa, like elsewhere, are not without their challenges. Miners and African governments can work together to tackle uncertainty and build trust to enable both parties to benefit from continued growth.

An increase in certainty in the regulatory regimes of African jurisdictions would ensure an environment that promotes investment and contributes to growth.

Only a collaborative approach to solving these challenges will help sustain African governments and investors with their mutual goal of economic growth, employment, nation building development and profits from operation.



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