IMANI ALERT: Government Must Clarify A Whole Lot in the Bauxite-Barter Deal with China. IMANI Recommends How Government Should Proceed

CHINA IS NOT THE PROBLEM

The entry of China as a major actor on the international development scene is a highly positive trend, despite the shrill protests of some Western propaganda outlets. IMANI's perception of the China factor is influenced by the belief that China brings much needed "diversification" to the sources of international development finance.

OUR LEADERS MUST BE THOROUGH

As staunch critics of the "development cooperation model" pushed by the West in Africa for decades now, we have always welcomed China's strictly transactional approach as a means to unsettle the status quo. But there is a caveat. African leaders, in Ghana and elsewhere, need to take responsibility for whether or not Africans get a good deal. There are no "multilateral development institutions" and jargons of "good governance" to hide behind now. Africa and Ghana need leaders that are savvy, detail-oriented, and strategically brilliant to avoid being out-negotiated, dominated and out-maneuvered by Chinese negotiators, who are among the best in the World. That is why IMANI continues to put the spotlight on Government actions involving Chinese dealmaking.

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In the discharge of our civic duty, IMANI has pledged to be thorough in reviewing every bit of every deal in the Sino-Ghanaian relationship that we consider strategic. Just as we did in the case of the CDB loan.

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UNFINISHED BUSINESS

The first point to clarify about the Sinohydro deal is how **tentative** the legal and commercial arrangement is at present. From our checks in Parliament, only the Master Project Support Agreement (MPSA) has so far been laid. Each road, bridge, hospital, flyover/interchange or other project planned to be developed under the agreement (a full list of which appears in Appendix 3 to the MPSA) requires its own EPC agreement which, as an "international business transaction" under our laws, ought to be presented to Parliament. No such EPC agreement has been submitted to Parliament for scrutiny and approval. At least **fifty** of them are expected if the full project is to be successfully executed.

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The second point to note is that a tentative "financing agreement" was annexed to the MPSA complete with a far-ranging disclaimer. This "term sheet", as the drafters refer to it, merely provides the broad contours of the commercial terms of the facility. A cursory read through establishes a very simple point: **NONE OF THE AGREEMENTS CURRENTLY BEFORE PARLIAMENT CONSTITUTES A LOAN AGREEMENT**. The appeal to the IMF by the minority in Parliament, whilst understandable given the importance for clarity, may well turn out to justify our position. Unless as we explain that given the complexity of the deal, the government may have unknown to the country actually entered a loan agreement to actualize the deal. That would be shocking.

What is also true from an assessment of the “term sheet” is that the Government of Ghana and Sinohydro **DO INTEND TO ENTER INTO A LOAN AGREEMENT**. To the extent that Sinohydro hasn’t yet committed to the actual financing in the MPSA, the agreement before parliament cannot be construed as a LOAN agreement. However, Ghana must enter a loan agreement to keep this deal alive. We explain below.

So that readers can understand the basis of our conclusions for themselves, we have attached the key extracts from the MPSA that clarify these points.

IN OTHER WORDS, THIS IS A WORK IN PROGRESS; WE ARE DEALING WITH A COMPLEX TRANSACTION WITH MULTIPLE PAYMENT MODES ENVISAGED, and the Government needs to communicate accordingly. We invite Government to be clear about this and also advise that Parliamentarians seek to understand the whole scheme instead of set themselves up to frustrate it. If Government doesn’t convince us with their diligence and present a good final product, we will all say so; for now, however, this is unfinished business and the current analysis therefore focuses on the provisions Ghana has already consented to, and the risks they present to the envisioned scheme.

AGREEMENTS SO FAR

The MPSA is clear that Sinohydro and the Government of Ghana will enter into a facility agreement which shall fully outline the “debtor” obligations of Ghana. One of the terms that Ghana has already agreed to in advance of the “definitive agreement” is the willingness to pay the full amount of money billed to it by Sinohydro regardless of whether it manages to obtain enough finance from selling refined bauxite or not. In fact, the whole bauxite element of this arrangement is thus incidental. Sinohydro expects to be paid, in hard currency, whether or not Ghana mines any bauxite, and whether or not it refines any portion of what it mines.

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For the avoidance of doubt, it means that Sinohydro expects to be paid the dollar amounts of the project costs in currency and not in refined bauxite. Whatever “barter” arrangements the Government has in mind are therefore not actually captured in the MPSA.

The flow of funds has been designated this way:
A. Sinohydro finds a bank willing to support this whole endeavor.
B. Ghana sets up an escrow account with the bank, including signing the requisite agreements that should allow release of funds from the account without further recourse to Ghana if needs be.
C. Sinohydro insures the risk of default at Ghana’s ultimate cost (the envisaged premium is a whopping 9%).
D. Sinohydro completes a EPC project.
E. Sinohydro issues an “interim payment certificate” (IPC) to the Government of Ghana, which approves same.
F. Either Sinohydro or Ghana presents this IPC to the nominated bank.

G. The bank checks that Ghana is not in default of the escrow terms.
H. Sinohydro gets paid by the Bank.
I. Ghana maintains a balance of 8.5% of the total debt amount in the escrow account at all times as collateral to ensure that the next IPC submitted by Sinohydro shall be paid. The amount stays static throughout the repayment period/loan tenor and is not adjusted based on amount outstanding. End of story!!!

THIS IS SERIOUS, SINOHYDRO WONT JOKE WITH REPAYMENT

Government says it intends to fund the escrow with money made from selling refined bauxite. Sinohydro is checking to confirm if this is a plausible arrangement, but the truth is that in the end it doesn't really care much for bauxite so long as the Government finds a way to keep the escrow balance at the agreed level in the way that Sinohydro has proposed.

SINO-HYDRO DOES NOT WANT TO HEAR STORIES!!!
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Clearly, as the "creditor", Sinohydro foresees a situation where Government bungles the so-called "integrated bauxite project" and fails to make enough proceeds from the project. Should that happen, Sinohydro does not want to be hear any stories. It insists, as already explained briefly above, that Ghana establishes a current account, on an escrow basis, with a nominated bank, that shall always hold about $500 million ("two repayments" out of the anticipated 24 repayments over the life of the agreement/repayment period/tenor) as collateral evidencing the Government's ability to continue servicing the principal and interest. These are clear lender-borrower terms, not "barter" terms.

In short, Ghana has not yet entered into a loan agreement with Sinohydro, but it must do so soon, according to the initial agreement approved by Parliament. To repeat: Ghana must sign the definitive financing agreement envisaged under the MPSA before the engagement with Sinohydro can be considered consummated.

The tentativeness of the current agreement (MPSA) approved by Parliament is also clearly marked by the fact that senior officials of Sinohydro did not sign or witness the document. In Chinese organizational and corporate culture, this is telling.

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GREY AREAS – NEED CLARIFYING

Below, we outline other important features of the deal which require some clarification. The details of these features are key as any misunderstanding or failure of a meeting of minds among the parties would be catastrophic.

1. The current government policy, at least as outlined by the Vice President during his recent speech at the Ghana Economic Forum, envisages that Sinohydro shall secure the financing for the long list of projects from a major Chinese bank, and obtain the signoff

of SINOSURE (the risk guarantee agency of China), and then start developing the projects AHEAD of Ghana finding the resources to mine the bauxite and refine the ore into alumina. But a careful reading of the MPSA and its annexures suggests that a satisfactory liquidity plan must be established and communicated by the Ghanaians and approved by Sinohydro and SINOSURE before the flow of resources for the project pre-financing can commence. Thus, until these processes have been completed, the completion of the full complement of projects IS NOT ASSURED (except under the "early work" arrangement, which we shall touch upon later). There is a very real danger of projects being commenced for show and then aborted midstream. Question is, on what basis is Government claiming that $500 million has been released and projects due to commence by December 2018 when so much work remains outstanding? What exactly is the rush?

2. The time needed to finance and execute a bauxite mine - alumina refinery complex shall most certainly exceed the three-year horizon, which constitutes the grace period, after which repayments are expected to commence. Considering that the Government is even now putting together the RFP to invite partners, one wonders how bauxite refining can even be considered a serious source of financial capacity to repay the $2 billion facility. Considering how many similar deals since 2006 have fallen through the cracks, including some with very competent partners, such as Alcoa, Alara, and Vimetco, the likelihood of smooth sailing arrangements within the grace period is almost nil. If building the complex was easy, Bosai and Ghana Bauxite Company would not have reneged on several promises to commence activity towards that direction. In fact, the continued insistence by the Chinese partners in Ghana Bauxite Company that bauxite production in Ghana is a loss-making venture is hardly a signal of confidence to international investors.

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More critically, how much is Ghana hoping to invest in this integrated bauxite venture itself? It is unrealistic to expect a strategic partner to bear most of the risks and costs of developing this "integrated bauxite project" and then when proceeds are realized hand them over to the Government to deposit in an escrow account for use in servicing Chinese debt.

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Any partner shall prioritise servicing of their own cost of capital and will demand a dividend-free or payback-free horizon, depending on the precise JV-structure, for at least a couple of years. Considering that at least a billion dollars is required to build even the most rudimentary bauxite mining cum alumina refining complex, the availability of "free cashflows" from the project to service the Sinohydro repayment obligations will most certainly not be assured by the end of the 3-year grace period. Our calculations suggest 5 years at least, by which time Ghana is expected to have already paid 1 billion dollars to Sinohydro in partial fulfilment of its repayment obligations.

3. The above situation is even more precarious if further consideration is to be accorded the provisions in the MPSA that an Accounts Receivable Finance Agreement (ARFA) between Sinohydro and the financing bank (which, recall, is at this point still unknown) is needed to seal the escrow arrangements whereby all proceeds from the refined alumina shall be relinquished to a potential Chinese Bank.

The simple fact is that Ghana must show clear evidence of a credible liquidity plan, which must involve a credible strategy to finance the extraction and refining of bauxite within the shortest period of time in order to pay back the debts accrued against the Interim Payment Certificates covering each discrete EPC project.

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4. The government of Ghana has so far been woefully remiss in showing that it has entered into any definitive plan with any strategic partner to build the bauxite mine - alumina refinery complex that should give full comfort to a financing bank that its liquidity plan is on course. It says that this late in the day it is still “preparing an RFP for publication”, through which instrument it seeks to invite investors willing to come and mine the bauxite, refine same and hand over a sizeable chunk of the proceeds to the Ghanaian government for onward remittance to the Chinese bank. However, the enthusiasm with which government officials have communicated about drawdowns on the facility before close of year leaves one to question if Sinohydro has indeed issued any notice of disbursement commencement. That of course could mean that the government has entered into a definitive loan agreement with Sinohydro, without Parliamentary approval, a shocking prospect.

5. The speed with which a joint venture between the Government of Ghana and a credible mining investor can be concluded so that the bauxite mining and refining can commence, and proceeds from the sale of the refined bauxite paid into the escrow account to meet the repayment timeline of Sinohydro at the end of the three-year grace period is entirely dependent on the quality of the assumptions and data underlying the Government’s commercial strategy in this matter. Sadly, this is where the Government of Ghana has been found most wanting.

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6. The last time the Government of Ghana itself acquired access to a modern dataset on proven bauxite holdings in the country was in 1977 courtesy of Hungalu Aluterv-FKI. In making recent policy, the Government has been using resource estimate figures from “all over the place”, choosing often to favour Albert Kitson’s estimates from as far back as 1914, simply because it is easier then to extrapolate the 960 million metric tonnes of reserves figure Ghanaian political leaders have been using as backing for their $460 billion valuation of the country’s bauxite reserves.

7. This approach is rather shocking considering the availability of more recent due diligence data by a succession of private companies that have been assessing and appraising the main deposits at Nyinahin and Kyebi (including Atewa) over the last decade and half. The results of these exploratory surveys bring into serious doubt the Government’s preferred data.

Firstly, proven reserves in this country are in the range of about a third of their speculated quantity. Secondly, the usual assumption that Ghana’s generally gibbsite-rich bauxite is exceptional in its trihydrate content has not been validated. Gibbsite and other trihydrates are in the low 40% range, and monohydrates and silica content appear higher than usually thought. What does this mean in practice? More electricity and caustic soda, and therefore, somewhat higher costs of refining the bauxite into alumina. Had Government of Ghana invested in detailed and extensive mineralogical surveys itself, its datasets would have been more granular and the country could have done a better job of zoning in on more profitable reserves.

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8. The value of Ghana's bauxite reserves on their own is actually **in the low 20 billion dollar range**. The nature of reserves are such that not all deposits are actually recoverable, and the infrastructure requirements of refining all the recovered ore is so steep that using the value of the refined ore as the primary draw of attracting investment becomes rather naïve. It is true that if all of Ghana's bauxite were to be refined to alumina, the value would be in the $180 billion range. But this is a meaningless statistic. What matters is how much infrastructure by way of railways, port facilities, roads and transport vehicles we can build and buy to extract a certain quantity of bauxite every year (not all reserves are exploitable for geological reasons), and the size of the alumina refinery we can develop to refine the extracted bauxite. Not to talk of working capital, maintenance and operating costs of these mines, refineries and ancillary infrastructure.

Even the ROSIEST projections of alumina earnings, IF EVERYTHING WERE TO PROCEED PERFECTLY, yields about $3 billion a year for forty years. But the cost of realizing such a dream exceeds $40 billion in UPFRONT INVESTMENTS.

A more realistic assumption, IF MOST THINGS GO VERY WELL, is the building of a 1.5 million tonne alumina refinery and the mining of 4 million tons of bauxite to feed it. The rail and port infrastructure, as well as the refinery costs, altogether will exceed $10 billion. In return, Ghana can be assured of about $800 million per annum in alumina sales. How much of this Ghana receives, as its share within the joint venture, to service its $2 billion debt would depend on several factors, including its equity stake in the joint venture, the cost of financing the $10 billion capital raise, the operating costs of the mines and refineries, and the stability of alumina prices on the world market. What is known for certain is that it will take at least 5 years for Ghana to start earning anything from these massive investments to start repaying the loan if the RFP process was finalised tomorrow and the Joint Venture agreement concluded the next day. To the extent that the amount to be paid back to Sinohydro shall exceed $400 million per year, using the indicative interest and credit insurance rates in the MPSA as a guide, the question IMANI is asking the Government is simple: WHAT IS THE CONTINGENCY PLAN TO MEET THE REPAYMENT OBLIGATIONS ONCE THE GRACE PERIOD OF THREE YEARS IS OVER?

9. Another example of weak use of data and questionable analysis we have witnessed in recent days relates to the decision to sell aluminum ingots instead of alumina to repay the debt. Firstly, there is a glut of aluminum in the international markets making it possible to lose money when converting alumina to aluminum. For example, depending on the grade of bauxite, the 4 million tonnes of bauxite mentioned above may yield 600,000 tonnes of aluminum per year. At current prices, the proceeds from this will amount to about $1.2 billion. Sure, this is more than the $800 million one can earn on alumina, but the incremental costs of smelting alumina to aluminum, and the amortised costs of expanding the wrinkly smelter at Valco, should actually lead to diminishing profits under current domestic market conditions. To be precise, the gross profits to be real-

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ised if the chain was to terminate at the alumina phase shall be $350 million, whilst the gross profits should the chain extend to aluminum ingots shall be $150 million unless electricity subsidies were put in place, which would be untenable if the whole point is generating money to pay back debts. At any rate, the aluminum project may have a breakeven point of at least 3 years more compared to the alumina project. In short, Government policy looks scarily confused here.

10. The absence of a contingency liquidity plan is exposing Ghana to considerable financial risk in this whole project. We may wake up at some point to discover that unless we are willing to tolerate partially abandoned projects or judgment debts, then we must activate the “advance payment” clause in the MPSA for “early work” and thus commit to pay substantial sums to properly prosecute any part of our responsibilities under the foregoing agreement.

To think that the ‘agreed' management fee is expected to be reimbursed to the Creditor in the first four (4) instalments in equal amounts over the repayment period, without the management fee being known, further increases the financial risks the country is likely going to take on. One would have thought that securing the financing for the alumina complex, and subsequently selling the alumina for good returns will give the country an opportunity to obtain maximum returns to subsequently prosecute our road infrastructure projects contained in the MPSA (and with 90% local content instead of the 30% offered in the deal with Sinohydro). This of course will deliver better value under the current conditions and available information rather than the single sourcing of US$500million of road infrastructure contracts to Sinohydro ahead of the establishment of a clear liquidity plan. Especially when we are also committing ourselves to another $1.5 billion in sole-sourced infrastructure.

And yet all we have by way of a financing plan is some hazy projections based on alumina we don’t have and joint ventures we haven’t signed. Furthermore, the agreement envisages that Ghana must find $300 million (with only a vague commitment by Sinohydro that it shall assist) to support the development of the projects even before the repayment period has commenced. Would it not be much wiser to invest these funds in advancing the integrated bauxite project itself, seeing as it is the fulcrum around which everything turns? Why invest those monies in sole-sourced roads instead?

IMANI Recommendations

1. Government of Ghana should immediately clarify the sources and content of data and financial analysis assumptions currently supporting its policymaking in the bauxite-for-infrastructure strategy. With the Senior Minister saying one thing and the Vice President’s Office saying another, confusion is being unleashed upon the nation. The continued suggestion that this $2 billion undertaking is actually a fraction of a larger $10 billion project is particularly concerning as even the $2 billion project, in view of the findings in this paper, is, under current plans, a very difficult prospect.

2. The Government should as a matter of urgency publish its liquidity plan, including contingency arrangements, in the now very likely scenario that should the projects commence this year as envisaged, Ghana shall not be in a position come 2021 to commence paying Sinohydro for accumulated debts from the proceeds of “refined bauxite” sales.

3. Government should clarify the nature of the integrated bauxite complex. Does it terminate at alumina or at aluminum ingots stage? The Chinese almost never import aluminum, and aluminum prices have fared worse than alumina prices on the international markets. Aluminum smelting is at any rate heavily energy-intensive. An aluminum ingot

endpoint is one that also requires a "cheap energy" strategy in a country reeling under energy sector debts. Some coherence in policymaking here should be appreciated.

4. The Government should clarify when it intends to lay before parliament the actual financing, EPC, and definitive agreements with Sinohydro. It ought to update the relevant parliamentary committees whether Sinohydro has signed its own financing and guarantee agreements with SINOSURE and the nominated bank. Has a nominated bank in fact been found? What is its name? What are the terms of the escrow agreement between the Government of Ghana and this bank? When would that agreement be laid before Parliament? Whilst we do not agree with those who say that any mining of bauxite is incompatible with our environmental standards as a country, it is important however for the Ghanaian EPA to provide a framework for the evaluation of the various environmental and social impact assessments that have been conducted since the 70s on the various Nyinahin, Ejuanema, and Kyebi reserve geographies. Some of the environmental data that is being used to assert that any mining at all in Atewa, for instance, shall decimate the source of major river systems in Ghana originates from preliminary assessments (usually called "RAPs") and are far from definitive. The EPA should drive the conversation in this regard.

5. We call for the clarification by Government of the status of Messrs Huang Guanghai and Lin Xiuping in these discussions. What are their exact mandates, and to what extent are the executive committees and top hierarchy of Sinohydro bound by their commitments to the Ghanaian government beyond the tentative provisions in the tentative agreements sent to Parliament thus far? Considering the commitments the Government is being compelled to make at this stage, and given the absence of more cast iron agreements, these questions are very warranted.

The people of Ghana deserve answers and reactions to these modest questions and recommendations, as part of the necessary show of credibility required of the Government in its dealings with the Chinese in Ghana's best interests.