



Should Investors Be Worried About First Quantum Minerals Limited?

Description

It's been a rough time for many commodities as of late: Gold is under \$1,300 oil is slumping and now another metal is under pressure, copper. But it's not only market fluctuation causing trouble here but taxes and for **First Quantum Minerals Limited** ([TSX: FM](#)), that could make life very difficult.

Zambia is the second-largest copper producing nation in the world and as part of its 2015 budget, Zambian Finance Minister Alexander Chikwanda announced that royalties would be increasing from 6% to 20% for open pit mining and from 6% to 8% for underground mining. This comes after the government raised royalty rates from 3% to 6% in 2012.

For mining companies, this is a massive blow, especially that the 20% mineral royalty is on gross revenues and doesn't include the 30% corporate processing and smelting tax. In Canada, this would be the equivalent of PST being charged on an item not just on the end user but at every level of the supply chain (manufacturer, wholesaler, retail, and consumer).

A crumbling cornerstone

In 2013, Zambia contributed \$1.4 billion of First Quantum's total revenues of \$3.5 billion, making Zambia the company's top-producing region. But ever-increasing taxes are quickly cutting into its shrinking profits. Zambia took \$83 million in taxes from First Quantum in 2013, a year that saw the company's tax rate go from 30% to 41% and 2014 will be even higher.

The rationale for the Zambian government's new tax regime is the falling of price and demand for copper, as the metal makes up 70% of the country's export earnings. This has led to rampant inflation, an 18% drop in currency value, and a budget deficit equal to 5.5% of GDP. The government is determined to make up the shortfall somehow. This could be a picture of how Russia could react with being faced with the recent drop in oil prices, oil that makes up almost half of government income.

Growing discontent

Even before this announcement, First Quantum had begun to grow weary of the Zambian government's fiscal practices, including the government's withholding of over \$600 million in VAT

refunds from mining firms. In response to these decisions, First Quantum has delayed over \$1.5 billion worth of capital projects in the country. This comes on the heels of 2013, when First Quantum spent \$1.6 billion in the country to upgrade its facilities to be able to process 400,000 ounces annually.

First Quantum is also sitting on \$350 million worth of copper concentrates due to the implementation on the additional 10% export duty on semi-processed copper ore — a pile that will potentially increase as there appears to be no relief in sight.

China cooling down

The big culprit for the falling price appears to be the slowdown in the Chinese economy, housing sales are falling, new development is falling flat, and the industrial juggernaut that used to consume 43% of global copper supplies is showing signs of fatigue.

This is a double-edged sword for First Quantum as its second highest-producing copper region is China, which generated \$860 million in revenues in 2013. The third issue is that half of the copper being consumed by China is from scrap, mainly from the collapse of the American manufacturing sector, further diluting potential earnings for First Quantum.

These are all troubling factors to consider when looking to invest or remain invested in First Quantum Minerals as the company will remain at the mercy of this foreign government. The stock closed Tuesday at \$19.80, with a 52-week range of \$16.47 to \$27.29 and an average price target of \$26.60.

CATEGORY

1. Investing
2. Metals and Mining Stocks

TICKERS GLOBAL

1. TSX:FM (First Quantum Minerals Ltd.)

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