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SHASHE PROJECT
(BOTSWANA)

World Bank Doc-
uments

International Bank for Reconstruction and Development

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R82-191

FROM: The President

June 14, 1982

BOTSWANA - (Loans 776-BT and 776-2-BT) Proposed Amendments to the Legal Documents for the Shashe Project to Allow a Third Financial Restructuring of the BCL, Ltd. Mining Component; Modification of the Matte Purchase Agreement.*

Summary

1. This memorandum seeks the approval of the Executive Directors to approve amending the legal documents relating to the Shashe Project to permit (i) a third financial restructuring of BCL, the nickel/copper mining venture,[1] and (ii) agreeing to a modification of the Matte Purchase Agreement, which regulates the price and terms by which BCL's matte is purchased by AMAX Nickel, a subsidiary of AMAX. These amendments would not jeopardize repayment of the Bank's outstanding loans to the Government of Botswana (776-BT and 776-2-BT) for infrastructure connected with the Shashe Project.

Background

2. The Executive Directors approved loans totalling US$37.5 million in June 1971 and May 1974 to the Republic of Botswana to finance water, power, transport, and housing infrastructure for the mining project. The works are completed, and the loans completely disbursed. As of May 30, 1982, US$32

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[1]The mine, which started production in 1974, is operated by BCL, Ltd., a company indirectly controlled by AMAX Inc. of the United States (AMAX) and the Anglo-American Corporation of South Africa, Ltd. (Anglo), with a 15 percent equity holding by the Government of the Republic of Botswana.

Distribution

Executive Directors and Alternates
Senior Vice Presidents
Senior Management Council
Vice Presidents, IFC
Directors and Department Heads, Bank & IFC

*Questions on this document may be referred to Mr. Polak (Ext. 74924) million was still outstanding, with a final maturity of May 15, 1996. Since Botswana was not deemed creditworthy for Bank funds when the loans were made, the Bank obtained full repayment guarantees from AMAX, Anglo, and several subsidiary companies of the AMAX and Anglo Groups, as well as from Metallgesellschaft (Federal Republic of Germany), the original principal purchaser of BCL's processed metal (nickel-copper matte). The project also includes (i) a Trust Deed under which all BCL sales revenues are channelled through a Trust; and (ii) a mortgage in favor of the Bank and the mining project's senior creditors, Kreditanstalt fuer Wiederaufbau (KfW) and the Industrial Development Corporation of South Africa (IDC), on BCL's title, rights and interest in the mining lease and certain immovable properties of BCL. In accordance with the Trust Deed, matte sales revenues are payable by AMAX Nickel, the current purchaser, to the Trustee which makes monthly allocations to the accounts of the lenders to service their loans, to the Government for royalties and township costs, and to the Botswana Power Corporation and the Water Utilities Corporation for water and power charges. Any balance is paid to BCL.

3. On beginning operations in 1974, BCL initially suffered major technical problems and a prolonged financial crisis, exacerbated by depressed world metal prices. As a result, the major shareholders had to inject much more money than expected into the project. After extensive discussions and negotiations, the Shashe parties agreed in March 1978 to a comprehensive financial restructuring providing for, inter-alia, increased royalties to the Government, further contributions by the major shareholders amounting to P 45 million (then about US$55 million)[2] in the form of a liquidity reserve, and the conversion of P 75 million subordinated loans into preference shares. The shareholders also reconfirmed their obligation to complete the second phase of the project and to carry out a pollution control program. The Executive Directors approved this restructuring on March 10, 1978 (R78-39).

4. Thereafter, plant production reached design capacity (40,000 metric tons of matte a year), the pollution control program was begun, and a good management team assembled. Due to low metal prices and increased capital requirements, however, BCL's financial position continued to deteriorate. The shareholders approached BCL's senior creditors, the Bank and the Government, in the spring of 1979 to discuss BCL's need for financial relief after the liquidity reserve was fully utilized, then expected sometime in 1980. Negotiations on these proposals took some time and, in August 1979, a strike at AMAX Nickel's refinery at Port Nickel, Louisiana, USA, led AMAX Nickel to declare force majeure, leaving BCL without sales proceeds. To prevent insolvency, negotiations on interim financing arrangements to bridge the strike period took priority over discussions about longer-term relief measures for BCL. The Executive Directors approved the amendments to the Trust Agreement required for the interim financing proposals in December 1979 (R79-306).

5. With interim financing in place, discussions on the second restructuring continued among the various parties - the major shareholders,

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[2] Pula = US$1.06.

the senior creditors, the Government, and the Bank - with the objective of providing BCL with longer-term relief. Agreement was reached on a restructuring approved by the Board on May 9, 1980 (R80-103).

6. On January 15, 1980, the strike was settled and shortly thereafter AMAX Nickel resumed purchases of BCL matte. During the strike period, the P 45 million liquidity reserve from the shareholders was fully depleted and about P 8.0 million in interim financing from the major shareholders and the Government was utilized. These advances were repaid from the sale of matte stockpiled during the strike.

7. The second restructuring provided that:

(a) BCL could elect to defer any principal repayments due on loans extended by KfW, IDC, the Chase Manhattan Bank, and the major shareholders during the period from December 31, 1979 to December 31, 1983 (the December 1979 payments had already been temporarily extended under the interim financing). During the same period, BCL could elect to defer royalty payments above a P 0.75 million annual minimum to Government. Deferrals were subject to a cash liquidity test and, any deferred amounts outstanding on January 1, 1984 were to be repaid in seven semi-annual installments beginning June 30, 1984.

(b) In order to save interest costs, BCL was permitted to prepay up to P 12 million to the major shareholders of the P 45 million liquidity reserve (no prepayment was permitted under the original arrangements). The major shareholders also agreed to extend their obligation to maintain this P 12 million in the liquidity reserve for two years, until December 31, 1983, during which time BCL could draw on this, if needed.

(c) The parties to the Deed of Deferral were permitted to make available to BCL, through June 1987, Emergency Funding of up to P 25 million provided certain "needs" tests were met. This funding would be on a demand basis, would be senior in priority to all existing loans, and would be repaid directly from matte proceeds without passing through the existing Trust Mechanism. The Bank and KfW reserved the right to object to the terms of this financing on a case-by-case basis.

The Present Situation

8. Based upon early 1980 nickel-copper price projections and an analysis of BCL's operations, it was felt that the second restructuring would enable BCL to avoid a major financial crisis over the next few years. However, the continuing international recession and its effect on metals prices led to new difficulties in the second half of 1981. Nickel prices fell by about 40 percent and copper prices dropped to their lowest levels in decades in real terms. As a result, the Shashe mine, although operating at peak capacity and regarded as one of the most efficient nickel-copper producers in the world, faced an extremely uncertain future.

9. In September 1981, AMAX, facing severe financial strains of its own and unable to sell refined nickel at satisfactory prices from its rapidly increasing stockpile, threatened to pull out of the project unless relieved of its obligation to purchase all BCL's matte output at world prices. With the agreement of all parties involved, new buyers were found for about 20 percent of BCL's production, and AMAX reconfirmed its intention to purchase the balance.

10. Meanwhile, the concerned parties began a series of meetings to devise a plan to relieve BCL's crushing debt-service burden and provide the firm sufficient working capital to ride out the metal slump. Discussions centered on ways to reduce debt service obligations by the conversion of a large part of existing debt to a junior basis to be serviced only if BCL's cash position permitted. One of the two shareholders, Anglo-American, and Government agreed to jointly provide additional Emergency Funding under the terms of Second Restructuring to permit BCL to operate while more permanent arrangements were being worked out. In addition, it was proposed that all senior debt due on December 31, 1981 be deferred - both principal and interest - pending agreement on new arrangements. All parties, including the Bank, agreed to this plan in late December.

11. Intensive negotiations since then have led to the development of a scheme for a third restructuring, the main features of which are outlined below:

(a) All existing senior debt of BCL (the Bank loan was made to the Government for onlending to the power and water corporations, and the Bank is not, therefore, a creditor of BCL), whether from shareholders, KfW, IDC, Chase, or Standard Bank would be split into two classes of loans - 30 percent remaining senior debt and 70 percent becoming a new subordinated debt (evidenced by issuance of new subordinated notes). The only exception to this is the Barclays pipeline financing which will remain 100 percent senior since it is essential for operations.

(b) There will be a four-year deferral period (1982 through 85) during which BCL can defer principal and interest on all debt unless BCL has Excess Cash (as defined) to make these payments.

(c) At the end of 1985, all deferred senior debt will be rescheduled to mature from 1986-95. There will be no change in existing security or guarantees, and unpaid deferred interest bears a 12 percent interest charge.

(d) The new subordinated notes will have no maturities and these loans (both principal and interest) will only be paid out of Excess Cash, if any. In view of this, the trust mechanism does not apply. All subordinated notes will be denominated in US dollars and bear interest at 12 percent.

(e) All existing subordinated loans will be converted to redeemable 12 percent cumulative preference shares, but no dividends can be paid until after all payments are made on the new senior debt and subordinated notes.

(f) Royalties payable to Government but previously deferred and royalties due in 1982/83 will be converted into the same classes of obligations as the existing senior debt, i.e., 30 percent senior debt payable over 12 years and 70 percent subordinated notes. BCL can defer royalty payments due in 1984-85 unless it has Excess Cash,and all deferred amounts will receive 12 percent interest and be payable from 1986-95. After 1985, current royalties will be paid, although an amount will be deducted equal to 70 percent of the debt-service portion of the water, power, and township charges for which subordinated notes will be issued. (See "g" below.) Subordinated notes for royalties will be accorded priority in payments from Excess Cash in respect to other subordinated notes.

(g) The Bank infrastructure loans, made directly to Government, will remain unchanged and will continue to be serviced through the trust mechanism. During 1982-85, BCL will provide 30 percent of the funds required and the Government will advance the remaining 70 percent through BCL in return for subordinated notes. Beginning in 1986, the trust will receive the amounts needed to service infrastructure loans either from matte sales proceeds or from BCL, and BCL will deduct from royalties payable to the Government an amount equivalent to 70 percent of the loan payments (see "f" above). This was done at the Government's request to facilitate its handling of these payments.

(h) BCL will be permitted to obtain up to P 50 million in Emergency Funding. This will be senior to all other debt of BCL, will be demand notes, bear interest at cost of borrowing plus 6 percent, and can be serviced directly from matte proceeds outside the trust mechanism.

(i) For the present, Anglo-American and the Government have agreed to provide Emergency Funding of up to P 25 million in 1982 on a 75-25 basis. This amount includes funds already provided under the temporary arrangements agreed late in 1981. It is expected that this Emergency Funding will provide most of BCL's cash requirement for 1982.

Effect of Proposed Restructuring on Bank Loan Agreements

12. The proposed restructuring would not require changes in the Bank's loan agreements. The restructuring would be set out in an Agreement and Plan of Reorganization; the Bank would not be a signatory to this Agreement, but would have to provide its consent. The Trust Deed, to which the Bank is a party, will need to be amended to permit continued use of Emergency Funding. Proposals for Emergency Funding would permit proceeds from matte sales to be used directly to satisfy Emergency Funding repayment claims before being passed to the Trust. It is, thus, likely that the Trust mechanism for

servicing the Bank's loans would be disrupted, although this was also possible under the Second Restructuring. It is in fact to ensure that funds are available for the Bank's debt service that the Government will provide the advances described in paragraph 11(g) above.

13. The proposed restructuring would not endanger repayment of the Bank's loans. The Government, to whom the loans were made, remains directly liable for their repayment. Botswana is creditworthy for Bank loans[3] and is fully capable of servicing the two loans directly from its own resources and of ensuring the viability of the power and water corporations that operate the Bank-financed facilities. Further, the Bank loans are directly guaranteed by AMAX, Anglo, their associated companies, and Metallgesellschaft, which would be obligated to make repayment if the Government failed to do so. These companies are large, soundly-financed entities and are quite capable of fulfilling their guarantees if required.

Modification of Matte Purchase Agreement

14. Discussions have been underway for several months between AMAX Nickel and BCL on changing the Matte Purchase Agreement to provide a more realistic basis for determining sales prices. The objective is a formula that would protect both AMAX Nickel, the purchaser, and BCL, the seller, during periods when posted world prices do not reflect actual selling conditions. A revised formula was recently agreed that appears to be fair to both parties. On the average, the new agreement would result in a slightly lower sale price (about five cents per pound of nickel, depending on future prices). Since AMAX had stipulated agreement on a revised Matte Purchase Agreement as a precondition to any financial restructuring, and since negotiations on this have only just been concluded, approval of the modification is necessary to the financial restructuring.

Conclusions

15. The proposed restructuring, which leaves the Bank's financial security undiminished, will greatly ease BCL's immediate debt burden; the emergency funding provisions should enable the firm to meet its projected cash requirements for operating expenses through most of 1982. While these measures appear to provide BCL with financial protection for the immediate future, they would be inadequate to cover any major unexpected cash requirements resulting from technical problems or continued adverse movements in world metals prices. While the Bank's most recent commodity price forecasts predict significant upturns in both nickel and copper prices beginning in 1983, these are predicated on improvements in the world economic situation. Unless metal prices do improve as expected, BCL's ability to survive in 1983 and beyond will depend on the willingness of the major shareholders and the Government to provide further financial support after the Emergency Funding now currently being provided is depleted.

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[3] At the end of 1981, Botswana's total external debt (including the Shashe loans) outstanding and disbursed amounted to US$154.8 million. Debt service payments during 1981 were US$9.8 million, giving a debt service ratio of 2.2 percent.

16. Without the proposed restructuring and, particularly, its provisions for P 25 million of Emergency Funding during 1982, however, there is a strong likelihood that BCL would have to declare some form of bankruptcy within a few months. As the mining complex generates, directly and indirectly, some 10,000 jobs and is the only major source of employment in Selibi Phikwe, whose 30,000 inhabitants make it the second largest town in Botswana, the proposed restructuring would seem the only viable alternative for Botswana and the mining company at this time.

Recommendation

17. In the absence of objection (to be communicated to the Vice President and Secretary, or Deputy Secretary, by close of business on June 21, 1982), I propose to approve the changes required in the Trust Deed and other documents related to Loans 776-BT and 776-2-BT to give effect to the proposed restructuring and to the modification of the Matte Purchase Agreement.

A.W. Clausen
President

International Bank for Reconstruction and Development

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R80-103

FROM: The President

May 1, 1980

BOTSWANA - Proposed Amendments to the Loan Documents for the Shashe Infrastructure Project (Loans 776-BT and 776-2-BT). Second Financial Restructuring of the BCL Ltd. Mining Component and Substitution of Guarantors. *

Summary

1. This memorandum seeks the approval of the Executive Directors to amend the loan documents for the Shashe Project (infrastructure financed with Bank assistance) to permit (i) a second financial restructuring of BCL, the associated copper/nickel mining venture (for which the Bank did not make a loan), 1/ and (ii) substituting the existing guarantee of the Bank's Loan Agreement by the Minerals and Resources Corporation Ltd. (Minorco), with equivalent guarantees from Anglo-American Corporation of South Africa Ltd. (Anglo) and De Beers Consolidated Mines Ltd. (De Beers).

Background

2. In June 1971 and May 1974, the Executive Directors approved loans in the aggregate of US$37.5 million equivalent to the Republic of Botswana to finance infrastructure (water, power, transport and housing facilities) for the mining project. The physical works of the infrastructure project are all completed, and, as of February 29, 1980, US$32.5 million of the loans were outstanding and disbursed with a final maturity on May 15, 1996. Since Botswana was not deemed creditworthy for Bank funds at the time the loans were made, the Bank sought and obtained full repayment guarantees from AMAX, Anglo and several subsidiary companies of the AMAX and Anglo Groups, as well as from Metallgesellschaft (Federal Republic of Germany), who originally was the principal purchaser from BCL of its processed metal. In addition the project includes (i) a Trust Deed under which all sales revenues of BCL are channelled

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1/ The mine, which started production in 1974, is operated by BCL Ltd., a company indirectly controlled by AMAX Inc. of the United States (AMAX) and the Anglo-American Corporation of South Africa Ltd. (Anglo), with a 15 percent equity holding by the Government of the Republic of Botswana.

Distribution:

Executive Directors and Alternates
Senior Vice President
President's Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

* Questions on this document may be referred to Mr. Sullivan (Ext. 74025)

through a Trust; and (ii) a mortgage in favor of the Bank and the project's senior creditors, Kreditanstalt fur Wiederaufbau (KfW) and the Industrial Development Corporation of South Africa (IDC), on BCL's title, rights and interest in the mining lease and certain immovable properties of BCL. In accordance with the Trust Deed, matte sales revenues are payable by AMAX Nickel (a subsidiary of AMAX), the current purchaser of BCL's matte 1/, to the Trustee who makes monthly allocations to the accounts of the lenders to service their loans, to the Government for royalties and township costs, and to the Botswana Power Corporation and the Water Utilities Corporation for water and power charges. The balance is paid to BCL.

3. From its initial operations in 1974, BCL has suffered major technical problems and a prolonged financial crisis, exacerbated by depressed world metal prices. The major shareholders had to inject much more money into the project than they had originally expected. After extended discussions and negotiations, the parties to the project agreed in March 1978, to a comprehensive financial restructuring providing, inter alia, for increased royalties to the Government, further contributions by the major shareholders amounting to P 45 million 2/ in the form of a liquidity reserve and the conversion of P 75 million of subordinated loans into preference shares. The shareholders also reconfirmed their obligation to complete the second phase of the project and to carry out a pollution control program. This restructuring was approved by the Board on March 10, 1978 (R78-39).

4. After the restructuring, plant production reached annual design capacity (40,000 metric tons of matte), expansion and pollution control programs were begun and a good management team was assembled. Due to low metal prices, as well as increased capital investment requirements, however, BCL's financial position continued to deteriorate so that financial difficulties were anticipated after the liquidity reserve was fully utilized. Since AMAX had decided not to increase its commitments to the project further and Anglo was unwilling to assume AMAX's portion of any possible future cash shortfalls, the shareholders approached BCL's senior creditors, the Bank and the Government in early 1979, to discuss a second financial restructuring. Last August, during negotiations on the proposals, a strike at AMAX Nickel's refinery in Port Nickel, Louisiana, USA (which purchases all of BCL's matte), led AMAX Nickel to declare force majeure, leaving BCL without sales proceeds. In order to prevent the company's insolvency, negotiations on interim financing arrangements to bridge the strike period took priority over discussions about longer-term relief measures for BCL. The Executive Directors approved proposals for interim financing, described in a paper circulated on December 14, 1979 (R79-306), and these became effective on December 31, 1979. 3/

1/ An intermediate copper/nickel compound requiring further refining.

2/ Pula (P) 1 = US$1.27.

3/ On January 15, 1980, the strike was settled and shortly thereafter AMAX Nickel lifted force majeure and resumed purchases of BCL matte. About P 8.0 million in interim financing was used; it has since been repaid.

5. With interim financing in place, discussions on the second restructuring continued among the interested parties -- BCL's principal shareholders, the senior creditors, the Government of Botswana and the Bank -- with the objective of providing BCL with longer-term debt relief, if needed, and readying additional financial sources for possible future cash shortfalls. Agreement has now been reached among all parties on the various proposals which constitute BCL's second financial restructuring. 1/ Barring unforeseen developments in metal prices or major technical difficulties, these measures should safeguard BCL's continued operations through 1983, by permitting the deferral of loan principal repayments and royalties. In subsequent years, expected improvements in BCL's financial situation should enable it to meet the additional financial burden represented by the deferrals.

BCL's Current Financial Situation

6. In order to meet operating and capital expenses, and make minimum royalty payments, BCL had, by January 31, 1980, (i) depleted the balance of the P 45 million liquidity reserve established as part of the first restructuring (para. 3), (ii) fully utilized its line of credit under the Barclays Credit Agreement (P 25 million) under which it can borrow against the value of matte in transit, and (iii) drawn down P 8.0 million from the interim financing facility. With resumption of sales in February 1980, following the removal of force majeure, BCL's cash position has improved. Smelting, however, was halted on March 14, 1980, for regular maintenance of the furnace and will not resume until May 10, 1980. Projections of its cash position indicate that, without financial relief, BCL will have deficits in 1980 and 1982, with a small cash surplus in 1981. From 1983, BCL is expected to have steadily improving cash surpluses.

Proposals for a Second Financial Restructuring

7. To enable BCL to meet cash shortfalls during 1980-83, the parties to the project have agreed on a comprehensive set of financial proposals. While the parties' interests have not always been compatible, they have accepted the proposals as a reasonable settlement of a complex problem.

8. The major proposals include:

a) Deferral of Loan Principal Repayments and Royalties.

During the period December 31, 1979 to December 31, 1983 (the deferral period), BCL could elect to defer all or portions of (i) principal repayments due on loans extended by KfW, IDC, the Chase Manhattan Bank

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1/ KFW has accepted these proposals in principle and submitted them for final approval to its guarantor, the Government of the Federal Republic of Germany, which is expected to agree before May 15, 1980. If the German Government fails to reach agreement, we would not proceed with the proposed arrangements and would notify the Board immediately.

and the major shareholders 1/ and (ii) royalty payments to the Government. 2/ These deferrals, however, would be available to BCL only in the event its net cash position as of the next loan maturity date (last day of June or December) was expected to be negative. In the event an independent auditor determines that BCL was not entitled to the deferral, BCL would have to repay the excess deferred amounts; this repayment would be guaranteed by the major shareholders. During the deferral period, deferred amounts become due and payable on the next loan maturity date. At this point BCL can either repay the outstanding balance, or, if necessary, can again defer it together with loan principal due on this maturity date. The balance of deferrals outstanding on January 1, 1984, would then be repayable in seven semi-annual installments with the last installment to be repaid on June 30, 1987. BCL would be required to prepay deferred amounts if it accumulates excess cash during the repayment period.

b) Liquidity Reserve

As part of BCL's first financial restructuring, the major shareholders established a P 45 million standby facility to cover cash shortages through 1981. Due to force majeure (para. 4), however, BCL drew down the entire reserve by the end of January 1980. Under the terms of the new proposals, BCL would be entitled to prepay from time to time up to P 12 million 3/ of this reserve (prepayment was not permitted under the original arrangements), thus saving interest charges on this amount. In the event of future cash shortfalls, BCL could then make calls on this reserve. The major shareholders have agreed to extend their obligation to maintain the liquidity reserve from the end of 1981, to the end of 1983, at which time they would advance BCL the then outstanding balance if deferred principal is outstanding.

1/ These creditors have deferred their repayments that were due on December 31, 1979 (about P 4.8 million) to May 15, 1980, in order to permit all parties to reach agreement on the second restructuring.

2/ Government's minimum royalty payment of P 750,000 annually would not be affected.

3/ An unused balance of P 12 million remained in the liquidity reserve at the time force majeure was invoked.

From January 1, 1984, repayment of the liquidity reserve would be on the same basis as deferred principal.

c) Emergency Funding

The Deed of Deferral would permit the parties thereto to agree to make available to BCL, through June 30, 1987, additional loans (known as emergency funding) of up to P 25 million in the event BCL (i) has exhausted available cash including the liquidity reserve; (ii) has deferred all loan principal amounts; (iii) has depleted all other credit facilities; and (iv) has determined that it is unable to meet any of its expected obligations due within the next 60 days. In order to attract lenders, emergency funding would be repayable on demand and in priority to any other debt directly from matte proceeds outside the established Trust mechanism. The Bank and KfW reserve the right for a 14 day review period in which they can object to any requests for Emergency Funding.1/

Effects of Proposals on Bank Loan Agreements

9. The proposed deferral of loan principal repayments and royalties, to be provided for in a Deed of Deferral, would apply only to the Government's royalty payments and repayments of loans from BCL's senior creditors. It would not affect the Government's obligation, as stipulated in the loan agreements, to pay the Bank, nor would the Bank be a signatory to the Deed, although it would have to provide its consent. The liquidity reserve also would have no impact on the repayments of the Bank's loans, although Section 2.08 of the Guarantee Agreement would have to be amended to permit the reserve to be reinstated to December 31, 1983. Proposals for emergency funding, however, would require amending the Trust Deed to permit matte sales to be used directly to satisfy repayment claims before being passed to the Trust. This creates the possibility that the Trust mechanism, currently used for servicing the Bank's loans, could be disrupted, and that a time could come when the Trust would have insufficient funds to make obligated payments to the various beneficiaries, including the Bank. In any event, the Government, as borrower, remains directly liable for repayment of the Bank loan. Botswana now is creditworthy for Bank loans 2/ and is capable of servicing the loans from its own resources as well as ensuring the viability of the power and

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1/ Based on current estimates of metal prices, the need for emergency funding is not expected during the deferral period, 1980-83. The amounts of principal and royalties available for deferral equal P 108 million; BCL is estimated to require about P 75 million.

2/ At the end of 1978, Botswana's total external debt (including the Shashe loans) outstanding and disbursed amounted to US$120.7 million. Debt service payments during 1978 were US$8.2 million, giving a debt service ratio of 3.4 percent.

water corporations, which operate the Bank-financed facilities. The Government, for its part, has confirmed its obligation to repay the loans and support the power and water corporations as required. In addition, the Bank's loans are guaranteed by Anglo, AMAX and their associated companies which are considered financially sound.

Guarantor Substitution

10. Unrelated to the proposed restructuring, Anglo has requested an amendment to the Bank's Guarantee Agreement to substitute guarantees from Anglo and De Beers for the existing guarantee of Minorco of Bermuda (a member company in the Anglo-De Beers Group). 1/ This request stems from a substantial reorganization of the Anglo-De Beers Group of companies, recently approved by their shareholders, in which Minorco's African investments were transferred to other companies in the Anglo-De Beers Group.

11. Under the complex arrangements of the Guarantee Agreement (described in the Annex), Minorco, together with other guarantors, at present guarantees a maximum of 50 percent of the Bank loan. The obligations of the remaining guarantors -- AMAX, Anglo, Charter Consolidated Limited (United Kingdom) and Metallgesellschaft -- remain and they, along with the Government of Botswana, have consented to the proposed substitution. 2/ In financial terms the change would enhance the Bank's guarantee since Anglo and De Beers are two of the largest companies in the Republic of South Africa with extensive assets worldwide. In 1978, Anglo's net earnings were US$150.0 million, and De Beers', US$920.0 million, compared with US$3.1 million for Minorco. The Government of South Africa currently controls foreign exchange transactions, but the South African Reserve Bank has agreed in principle that in the event the Guarantee were called, sufficient foreign exchange would be made available for Anglo and De Beers to meet their obligations. The South African Reserve Bank will provide assurances to this effect as part of the closing arrangements.

Conclusions

12. The proposed restructuring, which leaves the Bank's overall financial security undiminished, should enable BCL to meet its projected cash requirements for operating expenses and capital expenditures through 1983. While these measures appear to provide BCL with financial protection during the deferral period, they would be inadequate to cover any major unexpected cash requirements resulting from technical problems or adverse movement in world metal prices. Without the restructuring, however, BCL's financial viability and the livelihood of some 10,000 persons employed directly and indirectly would be in jeopardy.

1/ Anglo and De Beers are interlocking companies, each owning and controlling a substantial portion of the other's equity.

2/ Under the terms of a separate Lender's Agreement, the Bank, KfW, and IDC have agreed to consult each other on major changes in any of the Shashe agreements. This has been done with regard to the proposed guarantor substitution.

13. The proposed substitution of guarantors would meet the corporate needs of one of the project's principal sponsors, and would in no way impair or diminish the strength of the Bank's loan guarantee.

Recommendation

14. In the absence of objection (to be communicated to the Vice President and Secretary or Deputy Secretary by the close of business on May 9, 1980), I propose to amend the legal documents on Loans 776-BT and 776-2-BT to give effect to the restructuring and guarantor substitution as described above. The short period for review reflects the complexity of the restructuring arrangements, the numerous parties involved in the negotiations and the need to have approval in time to finalize arrangements before May 15, 1980, when the interim deferrals expire.

Robert S. McNamara
President

by E. Stern

May 1, 1980

BOTSWANA SHASHE PROJECT
Loans 776-BT and 776-2 BT

Summary of Arrangements Provided in the Existing Guarantee Agreement

In connection with the loans to the Republic of Botswana for the Shashe Infrastructure Project, the Bank obtained guarantees from BCL (the mining company), Metallgesellschaft (originally the principal purchaser from BCL of its processed metal), AMAX and Anglo (the mining project's major shareholders) and BRST, RST, Minorco and Charter (companies either controlled by, or closely affiliated with, AMAX and Anglo). 1/ Subject to extensive force majeure provisions, the mechanism of the Guarantee Agreement works as follows:

I. BCL - guarantees unconditionally 100 percent of the loans.

II. Metallgesellschaft - guarantees 40 percent of the loans up to US$12 million. This guarantee is valid only until March 1990.

AMAX - RST - BRST - guarantee 30 percent of the loans.

Anglo-Minorco-BRST - guarantee 22.5 percent of the loans.

Charter-Minorco-BRST - guarantee 7.5 percent of the loans.

III. To the extent Metallgesellschaft's guarantee liability is satisfied or terminated, the obligations of the remaining guarantors in II above become:

AMAX-RST-BRST - 50 percent

Anglo-Minorco-BRST - 37.5 percent

Charter-Minorco-BRST - 12.5 percent

Each group of guarantors is liable only for the specified percentage of its group; but within a group, each company is jointly and severally liable for the entire percentage applicable to that group.

1/ BRST stands for Botswana Roan Selection Trust Limited and is owned by AMAX (30 percent), Anglo (30 percent) and the public (40 percent); RST stands for Roan Selection Trust and is wholly owned by AMAX; Minorco stands for the Minerals and Resources Corporation of South Africa and is part of the Anglo-De Beers Group; and Charter, also a member of the Anglo-De Beers Group, stands for Charter Consolidated Limited.

International Bank for Reconstruction and Development

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R79-306

December 14, 1979

FROM: The President

BOTSWANA - Proposed Temporary Waiver of Trust Deed Provisions for the Shashe Infrastructure Project (Loans 776-BT and 776-2-BT)
BCL Ltd. Mining Component: Emergency Interim Financing during Force Majeure Period*

Summary

1. This memorandum seeks the consent of the Executive Directors to the temporary waiver of certain provisions of the Trust Deed for the Shashe Project (infrastructure financed with Bank assistance), which will permit emergency interim financing for the associated nickel/copper mining venture (for which the Bank did not make a loan). The mine, which started production in 1974, is operated by BCL Ltd., a company indirectly controlled by AMAX Inc. of the United States (AMAX) and the Anglo-American Corporation of South Africa (Anglo), with a 15 percent equity holding by the Government of the Republic of Botswana. The interim financing proposals submitted jointly by AMAX and Anglo and accepted in principle by the Government of Botswana, were sent to the parties to the project's Trust Deed on December 6, 1979 with the stipulation that they will lapse unless approved by the lenders--Kreditanstalt fur Wiederaufbau (KfW), Industrial Development Corporation of South Africa Limited (IDC), and the Bank--by December 19, 1979. This deadline was set since BCL is expected to exhaust all funds currently available to it by the end of this month.

Background

2. In June 1971 and May 1974, the Executive Directors approved loans in the aggregate of US$37.5 million equivalent to the Republic of Botswana to finance infrastructure (water, power, transport and housing facilities) for

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Executive Directors and Alternates
Senior Vice President
President's Council
Vice Presidents, IFC
Directors and Department Heads, Bank and IFC

* Questions on this document may be referred to Mr. Sullivan (Ext. 74025).

the mining project. The physical works of the infrastructure project are all completed, and, as of November 30, 1979, US$32.9 million remained outstanding with a final maturity on May 15, 1996. Since Botswana was not deemed creditworthy for Bank funds at the time the loans were made, the Bank sought and obtained full repayment guarantees from AMAX and Anglo as well as from Metallgesellschaft, in the Federal Republic of Germany, who originally was the principal purchaser of BCL's processed metal. In addition, the project was structured to include (i) arrangements under which all sales revenues of BCL are channelled through a Trust; and (ii) a mortgage in favor of KfW, IDC and the Bank on BCL's title, rights and interest in the mining lease and certain immovable properties of BCL. Under the Trust Deed, matte sales revenues are payable by AMAX Nickel (a subsidiary of AMAX) to the Trustee who makes monthly allocations to the accounts of the lenders (KfW, IDC and the Bank) to service their loans, to the Government for royalties and township costs, to the Botswana Power Corporation and the Water Utilities Corporation for water and power charges, with the balance being paid to BCL.

3. From its initial operations in 1974, BCL has been faced with major technical problems and a prolonged financial crisis, exacerbated by depressed world metal prices. This required the major shareholders to inject substantially more funds into the project than they had originally expected. After extended discussions and negotiations, the parties to the project agreed in March 1978 to a comprehensive financial restructuring providing, inter alia, for increased royalties to the Government and further contributions by the major shareholders amounting to Pula 45 million (about US$55 million)1/ in the form of a liquidity reserve. The shareholders also reconfirmed their obligation to complete the second phase of the project and to carry out a pollution control program. This restructuring was approved by the Board on March 10, 1978 (R78-39).

4. Since the restructuring, plant production has reached annual design capacity (40,000 metric tons of matte), expansion and pollution control programs are underway and a good management team has been assembled. Due to low metal prices, as well as increased capital investment requirements, however, BCL's financial position continued to deteriorate and some financial difficulties were anticipated after the liquidity reserve was fully utilized sometime in 1980, depending on the development of copper and nickel prices. Since AMAX had decided not to increase its commitments to the project any further and Anglo was unwilling to assume AMAX's portion of any possible future cash shortfalls, the shareholders approached BCL's senior creditors (KfW and IDC of South Africa), and the Government, in the Spring of 1979, for financial relief in the form of royalty and debt service deferrals and reductions in infrastructure costs. Negotiations on such a "second restructuring" have been going on since then. Progress has been made on reaching a consensus on the conditions under which BCL might be entitled to defer maturities of the KfW and IDC loans and the senior loans the major shareholders made to BCL. Nevertheless, a number of open questions remain and finalization of a second restructuring in the form of a draft amended Deed of Deferral and other legal documents is therefore not possible before year-end.

1/ Pula (P) 1 = US$1.22.

5. Recent events have, however, caused deep concern about BCL's future. At the end of August, AMAX Nickel, which is under contract to purchase all of BCL's matte, declared force majeure under that contract on the grounds that as a result of a strike against its Port Nickel, Louisiana (USA) refinery, where all of BCL's output is processed, it is prevented from accepting matte deliveries. Nevertheless, efforts to find alternative purchasers have been unsuccessful. The duration of the strike is uncertain; the union has demanded not only pay raises but also a four-day workweek. While the strike has been in effect since August 31, the first face-to-face negotiations took place only on December 4. Although AMAX Nickel states that it expects settlement around the end of this month, it is quite possible that the strike may continue much longer. Because of the strike, BCL's liquidity reserve has been drawn down much faster than had been anticipated, so that BCL faces insolvency unless interim financing arrangements are in place before December 31, 1979, when substantial debt service payments become due and all sources of funds will be exhausted.

Interim Financing Proposals

6. Following recent discussions, the project's major shareholders (AMAX and Anglo) have submitted interim financing proposals under which the project's major shareholders and the Government would make about P 14.1 million[1] available to BCL prior to December 31, 1979. In addition, Anglo & AMAX will defer the principal and interest due December 31, 1979 on their loans to BCL. The major shareholders have offered these funds on the following conditions:

(i) the funds provided under the interim financing will be due unconditionally on demand and their repayment will be on a senior-senior basis in priority to claims of Trust beneficiaries;

(ii) the principal payments due to BCL's senior lenders on December 31, 1979 will be deferred;

(iii) the existing matte purchase agreement between AMAX and BCL as to quantity, timing and pricing of matte deliveries will

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1/ P 6 million each from Anglo and AMAX, and P 2.1 million from the Government which is in proportion to its 15% share of the equity. Anglo's and AMAX's commitment will be reduced by the amounts of any guarantee liability in respect of a loan Barclays has made to BCL of P 25 million which is secured against the value of stockpiled matte. If the eligible value of this matte is less than the total loan outstanding, the major shareholders have agreed to guarantee the shortfall. The shareholders have indicated that the eligible value of matte accumulating and available for such security will, during the interim financing period, exceed the total loan outstanding and that therefore their guarantee will be zero.

be modified during the period after the force majeure to permit AMAX's refinery to absorb the stockpiled matte over a period to be agreed;

(iv) the Trust beneficiaries, including the Bank, will instruct the Trustee to authorize AMAX Nickel to repay interim financing from matte proceeds in accordance with the interim financiers' instructions, leaving any balance payable to the Trustee for distribution under existing Trust arrangements; and

(v) the proposals will be considered as a whole and have a deadline for their acceptance as of close of business New York time, December 19, 1979.

7. Of these conditions, the shareholders' requirement that repayment of their interim financing be on a demand basis means that they can, at their discretion, put BCL into bankruptcy at any time BCL's cash resources are insufficient to cover the demand notes. Although the shareholders intend that actual repayment of their interim funds would in practice be scheduled in a way to ensure sufficient cash is available to BCL to meet its other obligations and therefore assure its continued viability, they argue that the nature of such financing compels them to require that the new financing be repayable by BCL unconditionally on demand. Thus, until the interim financing is repaid in full out of the matte proceeds, there is a possibility that no funds from either the proceeds of the matte sales or other sources will be available to BCL to enable it to meet its other obligations.

8. These proposals have been accepted in principle by the Government. IDC and KfW (which has submitted these proposals to its guarantor, the Government of the Federal Republic of Germany) are expected to agree by December 19. If either of these parties fails to reach agreement, we would not proceed with the proposed arrangements and would notify the Board immediately.

9. To implement the interim financing proposals, the Trust Deed (para. 2) would be temporarily waived to permit sales proceeds of the matte, following the end of force majeure, to be paid by AMAX Nickel directly to the interim financiers with the balance, if any, to the Trustee. This arrangement would not affect the Bank's rights under the Loan Agreement, Guarantee Agreement and Mortgage Bonds; it would merely affect the mechanism (payment by the Trustee) through which the Bank's loans are currently serviced with the result that the Bank may have to seek loan service payments directly from its borrower, i.e. the Government, or the Guarantors, thereby temporarily departing from the enclave concept. However, Botswana is now creditworthy for Bank loans and would be capable of both servicing its obligations under the Loan Agreements from its own resources and ensuring the continued viability of the power and water corporations, the entities financed by the Bank loans.1/

1/ At the end of 1978, Botswana's total external debt (including the Shashe loans) outstanding and disbursed amounted to US$120.7 million. Debt service payments during 1978 were US$8.2 million, giving a debt service ratio of 3.4 percent.

Botswana has confirmed its intention to service the Bank loans and support the operations of its infrastructure parastatals, the power and water corporations. In addition, the guarantee of the Bank's loans by Anglo and AMAX, and their associated companies, is regarded as financially sound.

BCL's Future Financial Requirements

10. The interim financing arrangements would provide about P 14.1 million of liquid funds, which is expected to be enough to meet BCL's operational requirements for the first two months of 1980. If the strike at the Port Nickel refinery continues into February 1980, BCL will require additional funds or face the prospects of insolvency. Meanwhile discussions on proposals for a second financial restructuring of BCL will continue with the intention of reaching agreement in principle early in 1980. We would expect to return to the Board at that time to seek approval for BCL's second financial restructuring.1/

Conclusions

11. The interim financing proposals are primarily designed to provide emergency relief to BCL; they do not give assurance of continued operations beyond early 1980, nor are they adequate to cope with a prolonged strike beyond January unless further financing is found. Due to BCL's dire financial situation, with the possibility of mine closure, the interim financing proposals seem the only solution currently acceptable to both the shareholders and the Government to overcome the current force majeure problem. The proposals affect neither the Bank's ultimate loan security nor the long-term trust arrangements, but they would result in a temporary waiver of the trust mechanism until interim funds have been repaid. Moreover, the Government is creditworthy and capable of making up any shortfall in payments by the Trustee to the Bank and the power and water corporations.

Recommendation

12. In the absence of objections (to be communicated to the Vice President and Secretary or Deputy Secretary by the close of business on December 18, 1979), I propose, subject to agreement being reached by all parties concerned, to advise those parties of the Bank's acceptance of the proposals set out herein and to instruct the Trustee accordingly. The unusually short time is due to the complexity of the situation, the extended negotiations with the parties concerned and the need to agree on an interim solution to avoid insolvency of BCL by the end of the year.

Robert S. McNamara
President

by E. Stern

1/ At the same time, approval will be sought for a request the Bank has received from Anglo regarding substitution of guarantors to the Bank's Guarantee Agreement.

International Bank for Reconstruction and Development

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R78-39

FROM: The President

February 28, 1978

BOTSWANA - Proposed Amendments to the Loan Documents for the Shashe Infrastructure Project (Loans 776-BT, dated June 29, 1971, and 776-2BT, dated June 7, 1974)
BCL Mining Component: Financial and Commercial Restructuring*

A. Summary

1. This memorandum seeks the approval of the Executive Directors for amendments to the loan documents for the Shashe Project (an infrastructure project, financed with Bank assistance), which will permit the comprehensive financial and commercial restructuring of the associated nickel/copper mining venture (for which the Bank did not make a loan).

2. The mine, which started production in 1974, is operated by BCL Ltd. (formerly Bamangwato Concessions Ltd.), a company indirectly controlled, through BRST Ltd., by AMAX Inc. of the United States (AMAX) and the Anglo-American Corporation of South Africa (Anglo), with a 15 percent equity holding by the Government of the Republic of Botswana.

3. From the beginning, the mining venture has been beset by major technical and managerial problems, which have made it difficult to sustain high production levels of nickel/copper matte. Over the last 2-3 years these problems have been exacerbated by depressed world metal prices and by a consensus amongst observers of the industry that there will be no radical improvement in the nickel or copper markets before the early 1980s.

4. As a result of these difficulties, the Government's likely return from the mining venture (which was originally projected, in 1970 terms, to be about US$106 million from royalties, taxes and dividends over the mine's life) has been reduced to the annual minimum advance royalty of P 750,000 (US$900,000) and the private shareholders have been required to provide BCL with very substantial subordinated loans which BCL may not be capable of repaying over

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*Questions on this document may be referred to Mr Jordan (extension 74026).

the life of the mine.

5. Since late 1974, therefore, discussions have continued among the interested parties - Kreditanstalt für Wiederaufbau of the Federal Republic of Germany (KfW) and the Industrial Development Corporation of South Africa (IDC), who are BCL's senior creditors, the Government, the Bank and Anglo and AMAX - with a view to improving Botswana's return from the mining project while guarding against the possibility that BCL might be forced into bankruptcy.

6. The proposed restructuring, which is discussed below and in Annex 1, would be a major step towards achieving these goals. However, although it would reduce the likelihood that BCL might declare bankruptcy, it cannot provide any guarantee of BCL's future financial viability which, to a large extent, will remain dependent on whether the present levels of matte output can be sustained or improved and on international market developments for nickel and copper.

B. Background

7. In June 1971, the Executive Directors approved a loan of US$32.0 million equivalent (increased by a supplemental loan of US$5.5 million in May 1974) to the Republic of Botswana to help finance the power, water, transportation and township facilities which were to be provided as basic infrastructure for the BCL mining venture.[1] These loans were - and will remain - guaranteed by BCL, with additional several but not joint guarantees totalling 100 percent of the Bank loans from companies in the AMAX group, (including BRST, a company controlled equally by Anglo and AMAX, which owns 85 percent of BCL's equity), from companies in the Anglo group (including BRST), and from Metallgesellschaft (Federal Republic of Germany). These guarantees have been, and will continue to be, subject to a restrictive force majeure clause, which provides for suspension and termination only in the case of certain acts or omissions to act on the part of the Government of Botswana.

8. Although there were significant cost overruns, the infrastructure project was completed essentially on schedule and the Bank loan has been virtually fully disbursed. All facilities are operating normally and a Project Completion Report will be prepared in mid-1978.

9. The mining project (the Project), which was financed by long-term loans from KfW and IDC as well as by loans and equity from the private shareholders, experienced serious problems both before and after start-up.

1/ A full description of the Shashe Infrastructure and Mining Projects was given in the President's report of June 26th, 1971, No. P-969, and in the Appraisal Report, dated June 11th, 1971, No. PU-67(b). The two components were discussed further in a memorandum from the President to the Executive Directors, No. R 74-86, dated May 3rd, 1974.

At appraisal, the cost of the mine and beneficiation plant was expected to be about US$99 million. Recent estimates show that the actual capital cost will be at least US$164 million, primarily as a result of changes in the plant design. To this must be added increased working capital requirements and initial operating losses which, together, will bring the total project cost to over US$250 million. In spite of this, a major project component, which was designed to produce elemental sulphur and, hence, to reduce sulphur dioxide (SO_2) emissions, has never operated satisfactorily and, indeed, production of sulphur is no longer considered to be technically or economically justified.

10. It appears likely that the primary reason for the cost overrun and for the delay in implementation was that the ore actually being mined did not possess the uniform physical qualities which were originally assumed. The consequence was a plant design incompatible with the friable nature of the ore. This problem was compounded by the fact that the plant chosen was relatively sophisticated and perhaps not entirely appropriate for a project in such a remote location.

11. BCL's technical difficulties have been exacerbated by a rapid turnover of management personnel and by the absence of a clear demarcation of authority between Anglo and AMAX, who have had joint responsibility for project implementation and operations. These problems however, appear to have been solved and on-site management has improved considerably over the last 2 years.

12. On top of BCL's technical and managerial difficulties, there has been a sharp real decline in metal prices since the peaks of 1974-75. At the time of appraisal, the long-term nickel price assumed was about US$2.50/lb in 1978 terms. At present, BCL is only realizing between US$1.90 and US$2.10/lb for nickel. Similarly, at the time of appraisal, it was assumed that the copper price would fluctuate around US$0.90/lb in 1978 terms through to 1980. In fact, the current copper price is only about US$0.55-0.60/lb. Although some recovery from these exceptionally low prices is expected, no major real increase is anticipated before the early 1980s.

13. As a result of these problems, BCL has experienced increasing financial difficulties, of which the Bank was first informed in late 1974 and which were first conveyed to the Executive Directors in the semi-monthly report (R 74-200) of October 3rd, 1974. As of the end of November 1977, BRST - whose only significant investment is its holding in BCL - had an accumulated loss of approximately P 98 million (US$118 million), and subordinated completion loans, advanced by AMAX and Anglo to BCL through BRST, totalled P 165 million (US$198 million).

C. BCL's Future Prospects

14. BCL's future financial prospects largely depend upon: (i) management's ability finally to overcome continuing technical problems; and (ii) world market price trends for nickel and copper.

15. On the technical side, BCL has been able to run the plant at or about 80-85 percent of rated capacity since early 1977, although significant fluctuations in monthly matte production still occur. Nevertheless, problems remain with, inter alia, SO_2 emissions resulting from elimination of the sulphur train, the feed systems for the flash smelter, the electro-static precipitators and the flotation circuit. According to proposals submitted to the BCL Board in late 1977, additional capital investments of at least US$10-15 million will be necessary over the next 2-3 years if high production levels are to be sustained.

16. Adding to these uncertainties is the current disarray in the world nickel market, which has resulted from the decision by INCO (Canada) to discontinue its long-established practice of publishing floor prices, and the extremely high producer stocks of both nickel and copper.

17. It seems possible, therefore, that - based on estimates of production and revenues which have been derived independently by the Bank and the other lenders - BCL's cumulative cash deficit from 1978 to 1981, excluding additional capital investments and before making provision for interest on existing subordinated debt, might well be in the region of US$100-150 million, although Anglo and AMAX have themselves prepared more optimistic projections.

D. Proposed Restructuring

18. As a condition for their continued participation in the Project, Anglo and AMAX have insisted on a comprehensive financial and commercial restructuring of BCL.

19. The package which is here proposed has been discussed at considerable length and in great detail among the various parties, whose interests have not always been mutually compatible. While what has emerged is, therefore, inevitably a compromise, it is, under the circumstances, a reasonable settlement of an extremely complex problem.

20. The major proposals included in the restructuring, which are discussed in greater detail in Annex 1, are:

(a) Increased Government Royalty. It is proposed that the Government's royalty should be a flat 3 percent of the gross value of metal-in-matte, rather than the present 7-1/2 percent of BCL's hypothetical net profits.

(b) Matte Sales. Currently, BCL sells most of its refined nickel on a long-term contract with Metallgesellschaft in the Federal Republic of Germany at prices quoted in the German market, with the remainder being sold on an agency basis by AMAX. It is now proposed that AMAX would purchase BCL's entire matte production FOB Maputu, up to tonnages which are unlikely to be exceeded, at a price which will be approximately the same as under the present arrangement. The advantages to BCL of this are: (i) the transfer of the marketing risk to AMAX for BCL's total production; and (ii) accelerated receipt of sales proceeds. The advantage to AMAX is that, in return, it will be allowed to increase the deduction it takes from the price paid to BCL to reflect a larger part of the increase in the cost of refining the matte which has occurred since the original contract was signed in 1972.

(c) Project Completion. It is proposed that BCL should be deemed to have "completed" Phase I of the project (which will relieve AMAX and Anglo of the obligation to continue to provide subordinated completion loans for this initial phase of the Project) without having produced elemental sulphur (as was originally required in the Project Description) and without having installed the anti-pollution equipment, designed mainly to eliminate SO_2 emissions, which will be required once the Government has established mandatory pollution standards. As indicated in (h) below, however, this exception will not limit significantly BCL's future obligation to operate the plant in conformity with relevant anti-pollution legislation.

Notwithstanding the redefinition of "Completion" for Phase I, Anglo and AMAX's obligation to provide subordinated completion loans for Phase II (primarily the opening up of the Selebi mine, which will be required to keep up production levels as the present open pit at Pikwe is depleted) will remain unchanged.

(d) Future BCL Financing. It is proposed that AMAX and Anglo would jointly make available to BCL up to P 45 million (US$54 million) in unsubordinated but unsecured debt for cash flow shortages through to the end of 1981. In addition to this, they would also undertake to provide up to P 10 million (US$12.0 million) for necessary anti-pollution expenditures (see (h), below) and will continue to provide additional funds for the opening up of the Selebi mine. Should BCL require further funds, however, Anglo and AMAX would not be obliged to provide them and BCL would, presumably, have to go into the open market. Even under these circumstances, the Bank, KfW and IDC would, nevertheless, maintain some control over future borrowings since the maximum terms and conditions of debt that BCL could incur without the lenders' approval would be specified.

(e) Prepayments to KfW and IDC. As a condition for their approval of the restructuring, it is proposed that KfW and IDC would receive partial payments of their outstanding loans of DM 47.4 million (US$23.7 million) and R 2.24 million (US$2.6 million) respectively. These prepayments - which are about 23 percent of the outstanding balances - would be financed by a 7-year loan from the Chase Manhattan Bank, the terms and conditions of which will be approximately equal to those of the KfW loan but somewhat more onerous than those of IDC.

The Bank - which does not have an automatic right to a parallel prepayment - chose not to insist on a similar payment in view of the facts that: (i) our loan is to the Government, whose position is materially improved by the restructuring; and (ii) the ultimate guarantee of our loan is unaffected by the restructuring.

(f) Subordinated Debt. It is proposed that P 75 million (US$90 million) of outstanding subordinated shareholder debt would be converted into 10 percent cumulative redeemable preference shares. The remaining shareholder debt (approximately P 90 million) would be serviceable under more or less the same terms as at present until the end of 1981 and under somewhat less restrictive terms thereafter.

Although this conversion will improve BCL's debt:equity ratio, the terms for payment of dividends on, and redemption of, the preferred shares would not be significantly different from the terms for service of the subordinated debt which they replace.

(g) Revolving Credit Facility. At present, the existing legal documents allow BCL only to incur borrowings of up to P 3 million (US$3.6 million) against the value of matte in transit to purchasers. However, the lenders have so far specifically permitted BCL to increase borrowings secured by matte up to a total of P 17 million (US$20.4 million). One effect of the restructuring will be to reduce the period between production and sale of matte, and, hence, the value of matte in transit. It is now, therefore, proposed that BCL will be allowed to borrow against the entire value of matte in transit and a P 25 million (US$30 million) revolving credit facility would be established with Barclays Bank to replace both the borrowings presently secured by matte and an unsecured P 5 million (US$ 6 million) bridging loan.

(h) Pollution. Since it has not proved feasible for BCL to produce elemental sulphur as originally envisaged, SO_2 pollution levels in and around the plant are substantially higher than had been anticipated. In the absence of applicable government standards which BCL would be required to meet, it is, therefore, proposed that BCL would provide the Bank with an undertaking that it will carry out a program, which has been agreed upon with the Bank, which should substantially reduce low-level pollution if the plant is operated correctly. As indicated in (d) above, Anglo and AMAX will provide up to P 10 million (US$12 million) to finance this program.

In the opinion of the Bank, the proposed solution would not significantly limit BCL's obligation to operate the plant in conformity with thatever environmental legislation Botswana will finally enact.

21. While the proposed restructuring would result in some dilution of the Bank's security, for example by enabling BCL to encumber 100 percent of the reduced value of matte in transit (which might otherwise be available to the lenders in the event of a default) to secure other borrowings, it should be understood that the ultimate guarantee of the Bank's loan is in no way affected (see para. 7, above).

E. Government Revenues

22. Under the present legal arrangements, and in the light of current expectations of the Project's future profitability, it is unlikely that Botswana's annual revenues from BCL would ever exceed the minimum advance royalty of P 750,000 (US$900,000). Assuming a project life of 20 years, this would give gross receipts, from 1977, of only P 15 million (US$18.0 million), which, using a discount rate of 10 percent, would have a net present value (NPV) of only P 6.38 million (US$7.7 million).

23. The royalty proposed under the restructuring would give Botswana gross revenues over the same period of approximately P 112 million (US$134.4 million), assuming that there are no unexpected new technical problems and that sales revenues increase in line with general inflation. Using a 10 percent discount rate, these revenues would have a NPV of about P 39.5 million (US$47.4 million).

F. Conclusion

24. Although it is felt that the proposed restructuring, which leaves the Bank's ultimate security undiminished, is probably the best arrangement that could be obtained in the present circumstances, it should be understood that it is not a solution to all of BCL's problems. While it makes provision for the financing of capital expenditures necessary to sustain high production levels, it cannot provide any assurance that attempts to maintain increased production will not result in further technical problems or higher unit operating costs. Nor can the restructuring in any way affect the world market

trends on which BCL's cash flow ultimately depends, although it is designed to provide some assurance that BCL will be able to sell its total output at a reasonable price during what is expected, at least until the early 1980s, to be a period of continuing over-supply.

25. Finally, it must be stressed that the increased government royalty - which is, in many ways, the most attractive feature of the restructuring - is, itself, dependent on BCL's financial viability, which requires the continued participation of AMAX and Anglo. While the restructuring may make this more likely, it can obviously in no way assure it.

G. Recommendation

26. In the absence of objection (to be communicated to the Vice President and Secretary or Deputy Secretary by the close of business on March 10, 1978), I propose to amend the legal documents on Loans 776-BT and 776-2BT to give effect to the restructuring as described above.

Robert S. McNamara
President

Attachment

by J. Burke Knapp

February 24, 1978

BCL Ltd.: Summary of Proposed Financial and Commercial Restructuring

1. The proposed restructuring is designed: (i) to ensure the continued participation of the sponsors, AMAX Inc. of the United States (AMAX) and the Anglo-American Corporation of South Africa (Anglo) in the Project; and (ii) to increase its likely return to the Government. To accomplish these goals, a number of concessions have had to be made both to AMAX and Anglo - in terms of the conditions for completion of the Project, for provision of additional unsubordinated loan financing and for servicing of existing subordinated debt - and to the other lenders, KfW (Federal Republic of Germany) and IDC (South Africa) - who have insisted on partial prepayment of their outstanding loans.

2. The main points of the restructuring as agreed upon among the sponsors, the lenders and the Government, and as will be reflected in the amended Bank Loan and Guarantee Agreements 1/, are as shown below:

(a) Royalty: Para 12(B) of the amended Mining Lease will impose a cash royalty on BCL of 3 percent of the gross value of the metal content of the matte, retroactive to January 1, 1977.2/ The price of nickel is to be determined as the weighted average monthly price for electrolytic nickel, CIF Duisburg, for major non-socialist bloc producers selling in the Federal Republic of Germany. That for copper is to be the average daily LME wirebar cash price in the month prior to shipment, and the price for cobalt will be the average "Metals Weeks" price for 250 Kg. shot/cathode containers. There will be metal deductions of 2 percent each for nickel and copper and 30 percent for cobalt.

1/ Documents entitled:
(i) "Agreement Providing for Third Amendment and for Restatement of Loan Agreement."
(ii) "Agreement Providing for Second Amendment and for Restatement of Guarantee Agreement."
Copies of these agreements are available on request from Mr. Christian Walser (x74233).

2/ Previously, the royalty had been 7-1/2 percent of net profits, with a minimum advance of P750,000 per annum which would be offset against royalties in future years. Under most recent projections, the Government would have received no more than the minimum annual advance over the entire life of the Project.

In an agreement referring to the amended Mining Lease, AMAX and Anglo will undertake jointly to provide a full guarantee of any notes which BCL, owing to its own cash flow deficiency, is obliged to provide to the Government in lieu of royalties. This guarantee will run to the end of 1979 and, during this period, the Government will have the right immediately to sell such notes at their full par value to AMAX and Anglo, who will be obliged to purchase them.

Subsequent to the end of 1979, Section 3.02 (i) of the amended and re-stated Trust Deed will provide that the Trustee will resume channelling funds from sales proceeds into the Government Royalty Account at the rate of one-sixth of the semi-annual advance payment (P375,000) monthly. Should a cash flow deficiency exist at the time that the royalty payment actually falls due, the amended Mining Lease will provide that BCL may offer notes in lieu of the full payment but the Government will not be obliged to accept them unless they are fully and unconditionally guaranteed by AMAX and Anglo. Anglo and AMAX, however, will not be obligated to provide such a guarantee.

In our opinion, the proposed royalty agreement is fair and goes a long way towards settling the Government's legitimate grievance over its reduced revenues.

(b) Matte Sales Agreement: The proposed restructuring foresees the termination of the following agreements1/:

(i) the Refining Agreement between BCL and AMAX Nickel;
(ii) the Metallgesellschaft (MG) Sales Agreement;
(iii) the Metal Sales Agency Agreement;
(iv) the Nickel Sales Agreement between MG and AMAX; and
(v) the Matte Sales Agreement between BCL and BCL Sales.

These agreements will be replaced by a single Matte Purchase Agreement between BCL and AMAX Nickel, with separate sales agency agreements between AMAX and MG for refined nickel, copper and cobalt.

Elimination of the MG Sales Agreement is particularly important, since the commissions earned by MG on sales of BCL nickel and copper in the Federal Republic of Germany have been felt by the other parties involved to have been excessive.

Under the terms of the new Matte Purchase Agreement, AMAX Nickel will be obligated to purchase BCL's entire matte production up to a maximum of 45,500 tons in any one year, commencing with 1977. For

1/ Whereby BCL had originally contracted with AMAX to toll-refine its nickel and had established a subsidiary, BCL Sales Ltd., to sell a proportion of the refined nickel to Metallgesellschaft, with the rest being sold under an agency agreement by AMAX in the Federal Republic of Germany.

tonnages between 45,500 and 54,000 tons in any one year, AMAX Nickel will also be obliged to purchase the matte, provided BCL gives due notice in the preceding year. AMAX Nickel will, however, not be required to purchase quantities over 54,000 tons, although it will have the option to do so.

If BCL fails to produce at an average rate of 75 percent of projected capacity over a 4-year period[1] or at 70 percent of projected capacity in any one year[2], Para 5(d) of the Matte Purchase Agreement specifies that BCL will be liable for 83 percent of the weighted average treatment charges on the difference. The 83 percent has been arrived at as an estimate of the fixed component in AMAX Nickel's cost of refining.

The purchase price for matte will be determined by:

(i) the weighted average monthly price of "free world" producers, CIF Duisburg, for electrolytic nickel or nickel which is metallurgically equivalent, for all purposes except electroplating, to INCO's electrolytic nickel;

(ii) the monthly average LME wirebar cash price for copper in the month succeeding shipment from southern African port; and

(iii) the "Metals Week" 250 Kg. shot/cathode container price for cobalt.

From this price, however, a number of deductions will be made, which are detailed in Para. 7 of the Matte Purchase Agreement:

(i) metal loss deductions of 2 percent for nickel and copper and 30 percent for cobalt;

(ii) an additional 3 percent for nickel and cobalt and 2 percent for copper;

(iii) a deduction which is approximately equivalent to the interest savings which accrue to BCL from the substantially shorter pipeline;[3]

[1] This figure will be reduced for the 1978-1981 period, though the exact number has not yet been specified.

[2] With the exception of 1978, for which a specific tonnage will be inserted based on budget estimates for the year.

[3] The term "pipeline" is used to denote the value of nickel/copper matte in transit to the purchaser. The value of matte-in-transit will be diminished under the proposed arrangements since AMAX will now purchase the product ... Maputu.

(iv) a refining deduction, which - while based on the existing toll-refining agreement - allows AMAX Nickel to charge BCL for a higher percentage of cost inflation between 1970 and 1981 and for 100 percent thereafter;

(v) a deduction to cover actual shipping costs from southern Africa to the refinery and from the refinery to Duisburg, plus a deduction for loading and packaging; and

(vi) a further deduction of 0.25 percent of the net amount.

The Matte Purchase Agreement, as proposed, will terminate in 1990 unless extended by mutual agreement. Either party could, however, cancel it unilaterally from 1984 onwards except that, under Section 5.09 of the amended Bank Guarantee Agreement, such cancellation would require the prior approval of the Bank.

The new Matte Purchase Agreement is critical to the success of the restructuring, particularly since there is no guarantee that, under the present agreements, BCL could sell its entire output in what is expected to continue to be a depressed metals market. However, the Bank is aware that the price for an assured off-take is considerable. Nevertheless, we feel that the proposed arrangement - which is itself the product of lengthy negotiations between AMAX Nickel and Anglo (representing BCL) - is, on balance, advantageous and will benefit BCL both directly, by assuring it of a steady cash flow, and indirectly, by relieving it of the onerous marketing function.

(c) Completion of Phase I of the Project: Under the proposed restructuring, there will be two major changes to the description of Phase I of the Project (which, for the purpose of provision of subordinated completion loans, determines the moment when Anglo and AMAX may be said to have completed Phase I) and, hence to the conditions under which AMAX and Anglo will be relieved of their obligation to provide subordinated loans to BCL to meet cash flow deficiencies[1/]:

1/ At present, the shareholders must provide equity or loan funds (on favorable terms) to BCL, as and when required for operating or capital expenditures, until Phase I is completed. Phase I includes the open-pit and underground mines at Pikwe and most of the processing facilities. Phase II is, primarily, opening up of the underground mine at Selebi and construction of transportation facilities between Pikwe and Selebi. These subordinated loans currently total about P165 million and, under the existing legal provisions, are unlikely to be fully repaid during the life of the Project.

(i) the facilities for manufacture of elemental sulphur will be eliminated from the Project Description in the amended Bank, KfW and IDC Loan Agreements; and

(ii) the requirement that the Phase I facilities shall be constructed "according to design specifications" will be dropped.

On the first point, the plant has never produced sulphur satisfactorily and the sulphur train has been shut down since 1974. It is accepted that to reopen the sulphur train would have a serious adverse effect on matte production. Concurrently with the restructuring, an outstanding claim by Triomf Fertilizer (South Africa) for non-delivery of sulphur is being settled for R 3.366 million (US$3.9 million).

On the second point, the phrase "according to design specifications" is not considered to be very meaningful any more, since the specifications were never very clearly defined and have changed substantially over time. Its elimination, therefore, poses no problem.

BCL will, in addition, be relieved of its obligation to have already installed the anti-pollution equipment which is listed as part of the Project Description, since the Government of Botswana has not yet enacted legislation on pollution standards. In so far as BCL was previously obligated to install this equipment had the Government imposed standards, such an obligation will, however, remain when the standards are finally promulgated.

The importance of completion is, as already indicated, that, until the "Completion" of Phase I, AMAX and Anglo are obligated to provide capital and operating funds for BCL on a subordinated loan or equity basis. Thereafter - aside from a similar obligation to finance Phase II of the Project - the shareholders are, at present, not required to backstop BCL's financial viability. A redefinition of "Completion" to permit the sponsors to complete Phase I of the Project at the latest in early 1978 is, therefore, one of the principal demands of Anglo and AMAX.

In return for this, Anglo and AMAX have made an additional - though limited - commitment to the Project by undertaking to provide a P45 million supplemental financing facility to BCL.

(d) P 45 Million Facility. From February 28th, 1978 or the date at which Phase I is deemed to have been completed, whichever is later, until the end of 1981, AMAX and Anglo will undertake to provide up to P 45 million (US$54 million), as and when required, to meet all BCL cash shortages, except those incurred for:

(i) Phase II of the Project (which will be financed by subordinated loans and additional equity as in the present legal documents);

(ii) pollution control, up to a maximum of P10 million (see para. 2(i));

(iii) guarantees of BCL royalty notes up to 1979 (see para. 2(a)); and

(iv) prepayment of existing debt.

It is agreed that the P45 million may, however, be reduced by inter alia:

(i) the difference between the amount of the proposed Barclay's credit drawn down at the time of closing (see para. 2(h)) and the sum of the pipeline and bridging finance which it replaces, up to a maximum of P3 million;

(ii) the settlement with Triomf (see para. 2(c) above) and a further P 1.5 million settlement with AMAX Nickel for extra charges associated with non-delivery of matte to its Louisiana refinery;

(iii) any excess funds provided by the proposed Chase Manhattan loan over and above those required for partial prepayment of the KfW and IDC loans (see para. 2(f)); and

(iv) additional capital investments (which may total in excess of P10 million) which are necessary to sustain production levels at or near the capacity figures which have recently been achieved.

The significance of the February 28th date, referred to above, is that it represents a compromise between the original proposal of AMAX and Anglo, which might have allowed "Completion" to have occurred well before closing, and the lenders' insistence that "Completion" not occur prior to closing. Anglo and AMAX had originally suggested that "Completion" of Phase I be deemed to have occurred on the date that both the production and audit tests (as modified under the restructuring) were satisfactorily concluded. Since this would have left open the possibility that funds put into BCL by the sponsors on a subordinated basis might be refinanced out of the P45 million, it was unacceptable to the lenders.

Since February 28 is the target date for closing, the restructuring will now be deemed to have been carried out as of that date even if - as seems likely - the actual signing of documents slips into mid-March. This will clearly leave open the possibility of a limited refinancing of subordinated debt - but only for that amount put into BCL between the end of February and the middle of March. Should signing slip significantly beyond mid-March, this approach would, of course, have to be reviewed.

(e) Terms of Future Debt: Under the terms of the existing legal documents, BCL's borrowings - even after completion of Phase I - would be severely circumscribed. Under Section 4.03(g) of the existing Trust Deed, BCL's new borrowings, except as the Bank, KfW and IDC should otherwise agree, may only include:

(i) subordinated shareholder debt, on the same terms as prior to completion of Phase I;

(ii) current liabilities or liabilities under supply contracts over one year, "excluding monies borrowed"1/;

(iii) bank overdrafts, not exceeding R 100,000 (US$115,000); and

(iv) R 3 million (US$3.45 million) of borrowings secured against the pipeline.

In Section 4.03(g) (H) of the amended and restated Trust Deed, these restrictions would be replaced by an undertaking from BCL that any funds it borrows in the future, other than those specified at the time of the restructuring (which include the Chase Manhattan loan, the Barclays credit and borrowings under 2(e) (ii) and (iii) above) and other than for Phase II of the project, will be at an effective interest rate of not more than LIBOR plus 2 percent (or the equivalent in New York, Johannesburg or Botswana) and that such funds will have a term of not less than three years, with no repayments falling due before the end of 1981.

These terms are fairly advantageous to BCL and there is no disagreement on this point. However, it should be understood that - if the nickel market does not improve drastically - BCL may be unable to borrow commercially on any terms without the full guarantee of AMAX and/or Anglo and that the shareholders will not be obliged to provide such a guarantee.

(f) Prepayments to KfW and IDC: As part of the price for their agreement to the proposed restructuring, KfW and IDC will receive prepayments of approximately DM 47.4 million (US$23.7 million) and R 2.24 million (US$2.6 million) respectively, being about 23 percent of each of their loans to BCL.

1/ The significance of this phrase is not clear and it leaves open the possibility that BCL could incur unlimited supplier credits if such credits were not defined to be "monies borrowed". To eliminate this possibility, it has been agreed that supplier credits for capital investment items will be specifically excluded from this clause.

These prepayments are being financed by a US$25 million term loan from Chase Manhattan at an interest rate which, according to para. 2.4 of the draft Chase Manhattan Loan Agreement, will be 1-1/4 percent above the prime commercial rate, plus a commitment fee of 0.5 percent on the undisbursed balance and lump-sum facility and arrangement fees. The term of the loan is seven years, with semi-annual repayments beginning in June 1978.

The Bank recognizes that the interest rate on the proposed Chase loan is somewhat more onerous than that of the IDC loan which it replaces, although it is approximately the same as that of KfW, and that this condition of the restructuring has no significant advantages either for BCL or for the Government1/. However, these partial prepayments are a condition of KfW and IDC's approval without which the restructuring might not be accomplished. The Bank has, therefore, accepted this proposal, and has chosen not to insist on a parallel prepayment of its loan.

(g) Preference Shares: Originally, one of the major goals of the restructuring was to relieve BCL of its enormous overhang of subordinated debt (which is now about US$198 million). It was, therefore, proposed that either part or all of the subordinated debt be converted into straight equity. As the prospects of BCL continued to deteriorate, however, the original proposal was modified.

It is now proposed that BCL will increase its authorized capital from P 47 million to P 120 million, as part of the restructuring, by the allocation of P 75 million (US$ 90 million) in cumulative, redeemable preference shares which will be issued in equal amounts to AMAX and Anglo through BRST and against which P 75 million of existing subordinated debt will be retired. These notes will carry a fixed 10 percent dividend which will be payable:

(i) prior to completion of Phase I, only with the approval of KfW, IDC and the Bank; and

(ii) after completion of Phase I, on substantially the same terms under which the subordinated debt which they replaced would have been payable.

Although dividends on these preference shares will not compound, they will accumulate and must be paid off before the shares themselves can be redeemed.

1/ The interest rate on the IDC loan, as indicated in Para. 2.01 of the original IDC Loan Agreement, is a fixed 6-1/2 percent. That on the KfW loan (KfW Loan Agreement, Para. 3.02) is 8-3/4 percent on the first tranche and 9-1/2 percent on the second tranche.

Redemption of the shares is to be in annual installments of no more than P10 million, commencing at the end of 1983, out of funds available for dividends, provided that no accumulated preference dividends remain outstanding.

Although the preference shares are normally non-voting, shareholders will be entitled to vote under certain circumstances and Anglo and AMAX will, therefore, give a permanent and irrevocable proxy to the Government for 15 percent of the preference shares so as not to dilute the Government's holding in BCL.

Conversion of subordinated debt into preferred shares is an arrangement which does not significantly affect the financial position of BCL and there seems, therefore, no reason to oppose the proposal. Nevertheless, since we had originally hoped for the conversion of debt into straight equity, this represents a somewhat more negative conclusion than we would have wished.

(h) Barclay's Credit: The shareholders have arranged a P 25 million (US$29 million) Revolving Credit Agreement with Barclays Bank to replace both the existing P 5 million (US$6 million) bridging loan and the pipeline borrowings of up to P 17 million (US$20.4 million) which have been incurred by BCL. The credit would be secured: (i) by the value of the shortened BCL pipeline; and (ii) for amounts above the value of the pipeline, by the proportional guarantees of AMAX and Anglo.

Although, as the proposal was originally drafted, Anglo and AMAX were not obliged to guarantee drawdowns above the value of the pipeline, agreement has now been reached in general terms, that Anglo and AMAX will undertake not to remove their guarantee until 540 days after the restructuring.

The credit will terminate, and all amounts outstanding will become due and payable, on December 31, 1982. The interest rate will be 1/2 percent above LIBOR or 1/2 percent above the Botswana prime rate, depending on whether the drawdowns are denominated in US dollars or Pula.

The general principle of this credit has been accepted and the Bank has agreed to the proposal that the full value of the remaining pipeline may be encumbered. This is, it should be noted, a restriction of the immediate security which the Bank, KfW and IDC previously enjoyed under Section 4.03(d) of the existing Trust Deed, although it in no way affects the ultimate security of the Bank loan under the guarantee provided by AMAX, Anglo and MG.

(i) Pollution: Since excessive SO_2 emissions, associated with non-production of elemental sulphur, first became a serious issue, there has been a considerable divergence in the positions of Anglo and AMAX, on the one hand, and the Government (generally supported by the Bank) on the other.

In late 1977, Anglo and AMAX submitted a program of pollution-related works which BCL would undertake to carry out. These would have, as a goal, a reduction in internal plant SO_2 emission levels to 13,000 μgrams/NM^3 as a time-weighted concentration over a 40-hour week. This program would, however, have been contingent on:

(i) the Government not imposing any pollution standards until the proposed program had been carried out and corroborative monitoring completed, i.e. before the end of 1981;

(ii) agreement that any external pollution standards finally imposed would not be more onerous than SO_2 "target" figures of 80 μgrams/NM^3 as a daily average over a 12-month period and 365 μgrams/NM^3 as a maximum in any 24 hours;

(iii) agreement that, if the targets in (ii) above were achieved, BCL's obligations outside the plant would have been terminated and that, if they were not achieved, BCL's additional liabilities would not have exceeded the cost of increasing the stack height by 50 percent; and

(iv) an undertaking that all of BCL's obligations to make investments for pollution control - both inside and outside the plant - would have terminated immediately that BCL's pollution-related expenditures exceeded P 10 million.

The limitations of this program and the restrictions on BCL's obligations, and on the Government's rights under Clause 19 of the Master Agreement/1, made it clearly unacceptable, not only to the Bank but also to the Government and to the other lenders.

After prolonged discussions, it has now been agreed that the proposed pollution program will be covered in a letter agreement from BCL to the Bank (with AMAX and Anglo's financial obligations cross-referenced through Clause 2.08 of the Bank Guarantee Agreement).

This letter will state that, in consideration of the Bank's agreeing to the restructuring, BCL will undertake to carry out a specific

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/1 Which entitles the Government to impose reasonable environmental standards (taking account, inter alia, of their economic impact on BCL) to protect the health and safety of its citizens.

list of works which has been agreed upon with the Bank and of which the cost attributable to pollution is expected to be approximately P 7.5 million (US$9 million). Clause 2.08 of the Guarantee Agreement will obligate the sponsors to provide up to P 10 million (US$12 million) of unsecured debt (in addition to the P 45 million facility referred to in para. 4(d) above) for these expenditures or for other anti-pollution investments required under the Master Agreement. No reference will be made in the letter to standards or to the likelihood that the program will achieve any particular levels of pollution control.

In addition, the Bank will provide KfW (and, possibly, IDC) with a supplemental letter which will confirm that the program referred to above was discussed with the Bank and that, in the opinion of the Bank, it represents a reasonable response at this time to the serious low-level pollution problem, although there can be no guarantee that it will reduce SO_2 emissions to a satisfactory level.

At the insistence of Anglo and AMAX (supported by IDC) the Government may also provide BCL with a letter stating that it concurs with the Bank's opinion that the program is a reasonable response at this time and that, although there will be no restriction on BCL's future obligations, the commitment of Anglo and AMAX will be limited to P 10 million. The Government may also provide an assurance that, when it establishes pollution standards, it will pay due regard to the likely results of the proposed pollution program.

In order to expedite the implementation of the program of works which has been identified, the Bank has agreed to allow expenditures on that program, which were made subsequent to December 31, 1977, to count against the P 10 million commitment in Clause 2.08 of the Guarantee Agreement. This limited retroactivity is justified since, otherwise, there would be an incentive for AMAX and Anglo to defer necessary expenditures until after closing in order to avoid having to finance them on a subordinated basis. Expenditures made in 1977 for pollution control, which were financed by Anglo and AMAX, will, however, remain subordinated.

(j) <u>Service of Remaining Subordinated Debt</u>: Under the original documents, service of subordinated debt was governed by the most restrictive set of legal provisions; <u>i.e</u>. those of IDC, which said that such debt may only be serviced out of funds available for dividends. These were defined in Para. 10 of the IDC Agreement as consolidated net profit after tax, less:

(i) the current portion of long-term debt;

(ii) preference share dividends and redemptions due and payable in the following 12 months; and

(iii) authorized capital expenditures for the next year.

There are two important points here. One is that there is a "double-counting" of interest, since shareholder interest is only payable out of net profit after tax, which would normally be interpreted to mean after provision for interest charges. The other is that only IDC, among the lenders, requires the deduction for capital expenditures in the following year.

Under Para. 2.02(a) (iii) and (iv) of the original Bank Guarantee Agreement, principal and interest on subordinated debt were payable out of consolidated net income, provided, inter alia, that after such payments BCL maintained a 1.5:1 current ratio. This test was not included in IDC's documents.

The original proposal of Anglo and AMAX, made as part of the restructuring, was that service of these loans after "Completion" of Phase I would be on the following terms:

(i) Interest: would be paid out of net income after taxes, after interest on all other loans and after making allowance for principal repayments due on the KfW, IDC and Bank loans, but before depreciation and amortization. "Double-counting" of interest on subordinated loans would be specifically excluded, but, after payment of shareholder interest, BCL would still have to maintain a 1.5:1 current ratio.

(ii) Principal: would be repaid out of net income after tax, after interest payments, after repayment of other senior debt but before depreciation and amortization, provided that BCL maintains a 1.5:1 current ratio after such repayments. The other terms for repayment of principal would be unchanged.

IDC and the Bank have objected to the lifting of the "double-counting" provision and have insisted that they retain the present wordings of their respective legal documents until the end of 1981, except that the Bank will change its relevant provisions in such a way as specifically to include IDC's wording on the "double-counting" of interest and that IDC will adopt the Bank's current ratio test. From 1982 onwards, the shareholders' proposal, as indicated above, will be adopted.

HASSAN

DOCUMENT OF

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

NOT FOR PUBLIC USE

776-BT

SecM75-123

February 20, 1975

FROM: The President

BOTSWANA - SHASHE INFRASTRUCTURE PROJECT (Loan 776-BT)

1. The following memorandum has been prepared for the information of the Executive Directors to keep them informed regarding the financial and operational problems which have been encountered by the mining project which the above-cited infrastructure project was designed to support.

Background

2. The Shashe Infrastructure Project was designed to provide supporting facilities for the copper-nickel mining project at Selebi-Pikwe. The Bank made a loan (776-BT) of US$37.5 million equivalent (US$32.0 million on June 30, 1971, increased by US$5.5 million on May 14, 1974) to the Republic of Botswana to help finance the project. This loan is guaranteed by companies in the American Metal Climax group (AMAX), including American Metal Climax, Inc. and companies in the Anglo-American group (ANGLO) including Anglo-American Company of South Africa, Metallgesellschaft AG of Germany, and Bamangwato Concessions Limited (BCL) of Botswana. The guarantors, other than Metallgesellschaft, are the principal investors in the mining complex.

Currency Equivalents: Since 1971 the value of the Rand has fluctuated between US$1.33 and US$1.49; in early February 1975, the Rand was quoted at US$1.47.

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Infrastructure Project

3. The Infrastructure Project consists of providing road and rail access, water supply and power facilities and the development of a township at Selebi-Pikwe. The project has been financed primarily by loans from IBRD (US$37.5 million), the Canadian International Development Agency - CIDA (US$30.0 million equivalent) and the United States Agency for International Development - USAID (US$5.5 million). All important facilities became operational almost on schedule and the project is now virtually completed. The only major item still to be completed is the bituminization of the Seruli-Pikwe road. However, the power station, financed by CIDA, is running mainly on imported coal as the boilers require modification to allow them to burn local (Morupule) coal; remedial work is underway but it is doubtful that the station will be able to operate entirely on local coal. The executing agency, the Shashe Project Management Unit (SPMU), has almost been phased out and the specialized agencies (Botswana Power Corporation, Water Utilities Corporation, Selebi-Pikwe Town Council) and the Ministry of Works are now operating the facilities. Bank loan disbursements amounted to US$31.6 million as of December 31, 1974.

Mining Project

4. The mining project (in which the Bank is not directly involved) consists of constructing and installing mining and processing facilities at Selebi-Pikwe to produce about 43,000 tons of matte (impure mixture of copper and nickel) annually over an estimated 23 years. The mining project has been developed and is operated by BCL. The major shareholders of BCL are AMAX and ANGLO, through the Botswana Roan Selection Trust Ltd. (BRST). The Government of Botswana owns 15% of BCL shares. The cost of the mining project has increased from the June 1971 estimate of R86.5 million to about R130 million. The development of the first stage of the mining operation and the installation of the surface treatment plant have proceeded according to schedule. The production of matte which started in December 1973 has, however, been much lower than projected and in September 1974 BCL announced that it had encountered serious problems in the milling and smelting plants.

Mining Project's Problems

5. The surface plant at Selebi-Pikwe has faced numerous problems. While some of the problems were of the usual "start up" type, it appears that the major problem arises primarily from the fact that the ore being mined does not possess the physical qualities that were assumed in the designing of the plant. BCL, assisted by a team of AMAX specialists, is attempting to modify the surface plant. The result of these technical problems is that the total matte production during 1974 and that estimated for 1975 will amount to about one-third of the June 1971 estimates for the two-year period, and is not expected to reach full-rated production (45,600 tons) before 1977.

Financial Implications of Problems

6. The loss of matte production during 1974 resulted in BCL operating at a loss of R44 million and the loss of production during 1975 is estimated to required an additional R40 million to meet the operating expenses not covered by sales revenue. These losses (which BCL wants to capitalize) would bring total project costs (including capitalized losses) into the region of R215 million. BCL has proposed that the resultant cost overrun be financed principally by fixed interest shareholder loans at commercial rates.

7. The large increase in the total capital costs of the mining project would result in a substantial reduction in the benefits (royalty, tax revenue and dividends) projected to be received by the Government of Botswana. Should BCL finance the cost overrun solely by debt, as it has proposed, the Government's total income from the project would be drastically reduced. The Government is disturbed at this possibility and is seeking ways to safeguard the benefits the project was expected to provide.

Actions Underway and Possible Solutions

8. Bank staff have been studying various financial and technical possibilities for improving the financial prospects of the project and have been assisting the parties to arrive at an understanding. One possible means of improving the financial prospects would be an expansion of the surface plant capacity to allow an increased throughput. As much of the plant has been overdesigned, a considerable increase in annual production may be possible by 1978 without much additional capital expenditure and with a resultant increase in benefits for all parties.

9. A series of meetings have been held at the initiative of BCL and Bank staff between September and December 1974 for the purpose of clarifying the technical and financial problems confronting the BCL mining project, discussing possible remedies and devising solutions that would have general agreement. At these meetings BCL has argued for financial concessions from Kreditanstalt für Wiederaufbau (KfW) and Industrial Development Corporation of South Africa (IDC), the principal lenders on the mining project, and relaxation of various technical and financial undertakings of BCL to give it flexibility of action. The Government of Botswana has proposed that BCL shareholders inject equity to finance the cost overruns and increase the level of minimum royalty payments. No general agreement has yet been arrived at on resolving the problems, but further meetings between the Government, BCL, AMAX and ANGLO are envisaged.

10. The Executive Directors will be kept advised of further important developments regarding the BCL mining project. Any questions may be addressed to Mr. Deane N. Jordan, extension 3629.

Robert S. McNamara

DOCUMENT OF

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

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FOR EXECUTIVE DIRECTORS' MEETING

For consideration on May 14, 1974

R74-86

May 3, 1974

FROM: The President

see also R 74-86/1

Subject: BOTSWANA - Proposed Amendment to Loan for Shashe Infrastructure Project (776-BT, dated June 29, 1971)

1. On June 30, 1971, the Bank made a loan of US$32.0 million equivalent (776-BT) to the Republic of Botswana (with repayment initially over 29 years, but amended to 25 years in March 1972, including four years of grace at an interest rate of 7-1/4%) to help finance the Shashe Infrastructure project. I now propose that the amount of the loan be increased from US$32.0 million to US$37.5 million, to help finance cost increases on the project. There would be no change in the repayment period, the grace period or the interest rate on the increased loan.

2. A full description of the Shashe Infrastructure and mining projects was given in my report of June 26, 1971 (P-969) and the Appraisal Report (PU-67b, dated June 11, 1971) attached to it. In my memorandum of February 17, 1972 (R72-37), I informed the Executive Directors of the developments that had taken place subsequent to the initial approval of the loan and the signing of the original Loan Agreement (June 30, 1971), and the consequent need to amend the Loan Agreement and to revise the draft Guarantee Agreement originally circulated to the Executive Directors. The loan finally became effective on March 7, 1972.

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Executive Vice President and Vice President, IFC
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3. The loan was made to finance part of the infrastructure required to support the development of a copper-nickel mining complex at Selebi-Pikwe. The infrastructure being financed by the Bank loan comprised the road and rail facilities, the township, part of the water facilities, engineering and administration and interest during construction. Other parts of the infrastructure project are being financed by loans to the Republic of Botswana from the Canadian International Development Agency (CIDA) (for power) and the United States Agency for International Development (USAID) (for the water pipeline). In addition, some temporary water facilities and a small proportion of administration and training costs have been financed by the Government and by grants and loans from the United Kingdom (UK), Canada, and the United Nations Development Program (UNDP). The Bank loan was to finance approximately half the total originally estimated cost (US$64.5 million) of the infrastructure facilities. The loan is guaranteed by companies in the American Metal Climax group, including American Metal Climax, Inc., and companies in the Anglo-American group, including Anglo-American Company of South Africa; Metallgesellschaft AG, and Bamangwato Concessions Limited. The guarantors, other than Metallgesellschaft, are the principle investors in the mining complex.

4. The mining complex located at Selebi-Pikwe has facilities for producing 42,600 metric tons (annual average over the life of the mine) of copper and nickel matte (impure mixture) with sulphur and cobalt as by-products. The mining project has been developed and will be operated by Bamangwato Concessions Limited (BCL). Current estimates show the total cost of the mining complex to be about US$193 million excluding the cost (R7 million) of completing Selebi underground mining by 1979.

5. The physical progress of both the mining and infrastructure projects has been satisfactory; BCL commenced commercial mining operations in November 1973 and the infrastructure project is now nearly complete. However both projects have experienced changes and cost overruns since the Bank loan was made. An updated description of both projects is contained in Annex I. Current estimates of the infrastructure project cost compared with the original cost are shown in Annex II and a revised summary of the loan and infrastructure project is provided in Annex III. Despite the cost increases, the overall financial rate of return on the mining and infrastructure projects when considered jointly and on the infrastructure project alone have improved over the estimates given in the Appraisal Report.

THE INFRASTRUCTURE PROJECT

6. The main aspects ofthe infrastructure project are nearing completion; power and water have been available to the mine since September 1973 and power and water delivery dates were declared effective from November 14, 1973, enabling the Mining Company to go into commercial operation. Some work remains to complete the Pikwe-Serule road (para 9) and there are finishing works still outstanding on the township roads and services and the power and water facilities. Construction of the health

center is in progress. Completion of all work with the exception of the Pikwe-Serule road is expected by mid-1974. The road surfacing contract for this road is expected to be let by late 1974 and completed by mid-1975.

Cost Increases

7. The original estimated cost of the infrastructure project (shown in the Appraisal Report) was US$64.5 million and the latest estimate of costs is US$75.4 million, giving a net cost overrun of about US$10.9 million. Of this amount, the estimated cost overrun on the Bank-financed component is US$5.5 million despite the cost savings referred to in paragraph 10.

8. The increase in total costs of US$10.9 million has been due in the first instance to a combination of the following factors, affecting all elements of the project:

(a) Exchange rate realignments: The successive devaluation of the US Dollar and revaluation of the Rand are estimated to account for some US$3.0 million increase in costs expressed in US Dollars.

(b) Inflation: The Rand Currency Area experienced an unanticipated inflationary spurt during 1971-73, averaging about 8% per annum, as compared to about 3% per annum in the preceding two years.

(c) Delays in project: The project was appraised during November/December 1969 and approved by the Bank in June 1971. Delays in concluding the various financial arrangements caused a delay of about eight months in the awarding of contracts. In the case of the largest Bank-financed contract (Shashe Dam), the delay necessitated re-tendering as the validity date for placing of contracts on the first tender had expired before contracts could be finalized. This resulted in a cost increase of US$0.84 million above the earlier lowest bid.

(d) Procurement difficulties: First, lack of interest by South African contractors in small contracts in Botswana at a time of increased construction activity in South Africa resulted in a very poor response and high tendered prices. Second, the Canadian International Development Agency's (CIDA) financing of the power facilities entailed restricted tendering. Only two Canadian firms entered bids for the construction and erection contract (about 30% of the total cost of power facilities). The tenders were considered excessive and reductions in the amounts quoted had to be effected by negotiation with the bidders. In spite of this, however, the total costs of the power facilities still increased by about US$5 million equivalent over the engineers' estimate. It may be noted, however, that CIDA increased the amount of its loan by Can$10 million to Can$30 million, and that the loan is on very concessionary terms (no interest, repayment over 40 years after ten years' grace).

9. In addition to the general reasons for increases in costs explained above, there were others: (a) Township Costs: increased costs are partly due to additions to the scope of work after contracts were placed; (b) Transportation: increased costs are primarily because of deterioration of the Pikwe-Serule road - due mainly to heavy mine construction traffic - since it was handed over by the contractor. The revised cost includes US$1.9 million to improve and surface this road with a bituminous wearing course; (c) Administration and Training: increased costs are the result of the longer construction period, higher pre-staffing and other costs relative to the Power and Water Corporations, and the inclusion of maintenance equipment and transport for the Power and Water Corporations and the Township Authority; (d) Engineering Costs: increased costs reflect the longer construction period and the additional costs consequent upon changes in the infrastructure project.

Cost Savings

10. As it became apparent that the Bank loan of US$32 million could not finance the Project as originally envisaged, savings were effected on the following items (reflected in the Amending Loan Agreement of March 1972):

(a) Upgrading of the Serule/Francistown road was deleted from the Project in view of the Government's subsequent long-term plans for paving the main North/South road (which includes this section), resulting in a saving of US$780,000.

(b) Water supply to the Morupule coal mine has been financed by the Anglo-American Company, and has resulted in a reduction of about US$400,000.

(c) The installation of the water pipeline, estimated to cost about US$2.5 million, was accepted for financing by USAID (which was also financing the supply of pipe). These contracts have now been completed at an overall cost of US$6.4 million, within the USAID loan amount of US$6.5 million.

(d) Interest during construction: the original estimate included a generous allowance at US$5.6 million. Recalculation has resulted in the reduced amount of US$3.6 million.

In addition, under the new (post-March 1972) arrangements, the Health Center equipment, originally to have been financed by the Bank loan, has been financed by a Danish Government loan. This has resulted in a reduction of about US$500,000.

Revised Cost Estimates and Financing Plan

11. A summary comparison of the revised cost estimates and the appraisal cost estimates together with the original and revised financing plans and explanatory notes is shown below; details are given in Annex II.

	US$ millions				
Original Financing Plan	Estimate of Costs	CIDA	USAID	BANK	OTHERS
Power Facilities (Incl.Contingencies)	23.44	23.44			
Water Facilities (Incl.Temp.Water)	14.52		7.6	5.94	0.98
Transportation Facilities	3.66			3.66	
Township Facilities	6.45			6.45	
Engineering and Administration	4.41			3.93	0.48
Contingencies and Escalation	6.42			6.42	
Interest during Construction	5.6			5.6	
Total	64.50	23.44	7.6	32.0	1.46
Present Financing Plan*					
Power Facilities	30.0	30.0			
Water Facilities (Incl.Temp.Water)	17.53		6.5	10.05	0.98
Transportation Facilities	6.55			6.55	
Township Facilities	8.89			8.89	
Engineering and Administration	6.71			6.30	0.41
Contingencies and Claims	2.08			2.08	
Interest during Construction	3.60			3.60	
Total	75.36	30.0	6.5	37.47	1.39

12. The above comparison demonstrates that Botswana needs additional finance of US$5.5 million for the items of the infrastructure project being financed by the Bank. It also demonstrates that increasing the Bank Loan by US$5.5 million will maintain the Bank's share in the financing of the total cost of the infrastructure project at about the original 50 percent. The whole of this additional finance is required to complete contracts and other items being financed from the Bank Loan, all of which have already been awarded or committed, with the exception of the road surfacing contract.

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* The breakdown corresponds to award of contracts and therefore does not correspond with the Loan Agreement allocation of proceeds table which follows the original Loan Agreement breakdown.

13. As explained in paragraph 8(d) and demonstrated in the comparison of financing plans shown in paragraph 11, the CIDA loan was increased to US$30 million equivalent to meet the revised costs of the power facilities. Further small cost increases in the construction contract together with the cost of necessary modifications to the power station boilers (explained in Annex I) will necessitate additional finance for the completion of the power facilities. When assessment if these additional costs is completed, the Government intends to ask CIDA for the necessary supplementary finance.

Disbursements

14. The Bank loan presently finances the total costs (both foreign and local) of those aspects of the infrastructure, administration and training to which it is to be applied, and also all of the engineering costs. This would continue until completion of the infrastructure project and any unused balance of the loan would be cancelled.

Benefits

15. The justification of the infrastructure project is inextricably linked to the mining project and the benefits it will bring to Botswana, which were described in detail in the Appraisal Report. The justification has been re-examined in the light of BCL's revised mining plan, the increased costs of the infrastructure and mining projects and the increased revenues which can be expected as a result of nickel and copper price increases since the appraisal.1/ A mine life of 23 years has been taken and, bearing in mind the possibility of continued mining in the region after the end of this period and other development needs, the revenue earning elements of the infrastructure have been depreciated over 25 years (except the dam which is depreciated over 50 years) - the normal period for most of the assets within their respective categories.

16. Using BCL's revised projections of mine costs and revenues, the internal financial rate of return on the mine and infrastructure combined is now 15.1%, compared with 10.2% shown in the Appraisal Report. A separate calculation of the financial rate of return to the Government on the infrastructure project alone, using the revised capital and operating costs, gave a result of 12.8% compared with the appraisal estimate of 12.3%. The lack of significant improvement is because the higher than forecast revenues from the infrastructure facilities, royalties, taxes and dividends are largely offset by the higher capital and operating costs. The estimated R18 million additional customs revenue accruing to the Government during 1972-75 because of imports relating to the Shashe project, has not been considered in this calculation. The rate of return on the mining project has improved, because of nickel and copper price increases, in spite of large capital cost overruns since the appraisal. The rate of return for the mining project alone is now 18.3% compared with 11.6% shown in the Appraisal Report.

1/ Nickel and copper prices used in the appraisal were $1.20 per lb and $0.43 per lb; now projected at $1.53 and $0.67, respectively, over the life of the project.

17. As a result of the higher trend now projected for metal prices, the Botswana Government's direct income from the mining project (royalty, tax and share of dividend) for 23 years of operation is now estimated at R235 million compared with R89 million shown in the Appraisal Report. The increase of net income to the BCL foreign shareholders is also substantial. This is estimated at R235 million compared with the appraisal figure of R88 million. A larger proportion of the total benefits of the early years of operation will accrue to the foreign shareholders rather than the Government because of the capital depreciation allowances permitted by the tax agreement. For this reason, the Government and BCL have agreed upon a maximum matte production limit for a period of five years.

18. The total employment resulting from the Shashe project is estimated at about 3,500 (including 400 jobs held by expatriates) and it is expected to increase to 5,200 by 1980. The mining company directly employs about 2,200 workers (of whom about 300 are expatriates). The total wage income expected to be generated by this employment is estimated at about R8.0 million per annum. Almost half of this income will initially be earned by the expatriate staff but the proportion will gradually decline until almost complete localization, projected for 1990, is achieved. The incomes generated by the Shashe project are expected to result in an average Government revenue (from personal income taxes and other levies) of a half million rand a year.

LEGAL INSTRUMENTS

19. A draft Second Loan Amendment Agreement and Guarantee Amendment Agreement, the Report of the Committee provided for under Article III, Section 4 (iii) of the Articles of Agreement of the Bank concerning the proposed increase in the amount of the Loan, and the text of the draft Resolution approving the proposed increase are attached.

The Second Loan Amendment Agreement

20. The attached Second Loan Amendment Agreement increases the amount of the Bank Loan to Botswana provided under Loan 776-BT, from thirty-two million United States Dollars ($32,000,000) to thirty-seven million five hundred thousand United States Dollars ($37,500,000) - the Amortization Table in the Loan Agreement being revised accordingly (Sections 3.01 and 4.02).

21. The Amendment Agreement also makes certain incidental changes to the infrastructure project described in the Loan Agreement (Section 4.03) and provides a new Allocation Table for the apportionment of the additional amount of the Loan among the water, power and other facilities financed by the Bank (Section 4.01). These changes are reflected in the changes to the Power and Water Subsidiary Loan Agreements which are also provided for in the Amendment Agreement (Article V).

22. In addition, the Amendment Agreement revises the description of the mining project contained in the Loan Agreement, to include an open cast mine at Pikwe (Section 4.04).

23. It is envisaged that certain consequential amendments to the other Shashe project documents will be required and the making of arrangements satisfactory to the Bank for these amendments is a condition of effectiveness (Section 6.01).

The Guarantee Amendment Agreement

24. The guarantee contained in the original Guarantee Agreement dated March 1, 1972, is extended to cover the amount of the Bank Loan, as now increased to $37.5 million (Section 2.01).

25. A new provision is inserted in the Guarantee Agreement under which certain of the parties to the Guarantee Agreement agree to provide financial and technical assistance to BCL to maintain production capability at 2 million metric tons of ore per year, if capability would otherwise fall below this figure as a result of the introduction of open cast mining at Pikwe (Section 2.02).

26. The financing plan for the mining project set out in the Guarantee Agreement is amended to reflect the increased value in Rand terms of the KFW loan and the additional amount of completion loans to be provided by certain of the guarantors to meet the balance of the estimated additional costs of the mining project.

27. I am satisfied that the increase in the amount of the Loan and the amendments referred to above would comply with the Articles of Agreement of the Bank.

RECOMMENDATION

28. I recommend that the Executive Directors approve the proposed increase in the amount of Loan No. 776 BT, to assist the Republic of Botswana in the financing of the additional costs expected to be incurred in the carrying out of the Infrastructure Project, together with the other amendments referred to above, substantially in the form of the draft legal documents attached hereto.

Robert S. McNamara
President

Attachment
May 2, 1974

BOTSWANA

THE MINING AND INFRASTRUCTURE PROJECTS

1. Those sections of the President's Report (P-969) of June 16, 1971 (and the updating memo of February 17, 1972) on the Bank loan to Botswana for the Shashe Infrastructure Project, which describe the infrastructure and mining projects, methods of financing in each case, and security arrangements, have been updated to reflect the changes subsequent to February 1972. The updated version is reproduced below.

The Mining Project

2. The mining project consists of the construction and installation of mining and processing facilities at Selebi-Pikwe. The facilities are designed to produce a matte (impure mixture) of copper and nickel from the Selebi and Pikwe ores at an average annual rate over the life of the mine, presently estimated at 23 years from the start of full production, of 42,600 metric tons (45,600 tons until 1979) and, as by-products, 127,500 metric tons of sulphur and 126 metric tons of cobalt. The matte will be refined in a refinery in the U.S.A. owned and operated by American Metal Climax, Inc. (Amax). The entire expected production of refined copper and cobalt and two-thirds of the expected nickel output will be shipped to Germany and sold to Metallgesellschaft AG (MG), with which Bamangwato Concessions Limited (BCL) has signed a 15-year sales contract. Revised arrangements subsequently negotiated require Amax to purchase part of the nickel from MG. The remaining one-third of the nickel will be sold by BCL on its own account in Germany or elsewhere, depending on where the price is more favorable. Most of the sulphur will be sold to Triomf Fertilizer (Pty) Limited of South Africa under a 10-year sales contract.

3. The mining project has been constructed and will be operated by BCL, of which the largest shareholder is another Botswana company, Botswana RST Limited (BRST). Under a reorganization of these two companies the Botswana Government, with its 15 percent shareholding (which it obtained pursuant to the concession agreement) and BRST (85 percent) became the only shareholders of BCL. With the reorganization, BRST is now owned 29.4 percent by companies in the Amax group (Amax and RST International), 29.4 percent by companies in the Anglo-American group (Anglo, Charter and Zamanglo), 5.4 percent by other companies, and 35.8 percent by public stockholders.

4. Subsequent to the appraisal report of June 1971, there was a detailed re-evaluation of the mining project by an expert group from the Anglo-American Co. Under the original mining plan (described in the June 1971 Appraisal Report) ore was to be mined for 25 years from two mines (Selebi and Pikwe) and both mines were to be opened at the same time in 1973; the cost of the mining project on this basis was US$123 million equivalent. When BCL became aware that significant cost overruns faced the company, an

intensive technical review of the mining plan and installation was carried out. This review resulted in measures designed to minimize the impact of the overruns and defer part of the capital expenditure required. First, the commencement of mining of the Selebi ore body has been delayed until 1979 but the richer Pikwe ore body will be mined at a higher rate to maintain production at the level previously planned (i.e. 2,000,000 tons per year) and thus partially offset the increased costs. Secondly, the surface facilities have been modified to treat a wider range of ore grades, so that BCL can increase its production of nickel and copper in any given year by processing higher grade ore. The average mining rate has been increased with a corresponding reduction in the estimated mine life from twenty-five to twenty-three years. As a result of these changes, the production of nickel and copper during the first 4 years of operation would be 16,950 and 15,450 tons respectively, compared with originally planned production levels of 14,800 and 16,600 tons. These changes were incorporated in the Amending Loan Agreements of March 1, 1972.

5. In September 1972, BCL completed a study of open cast mining of a portion of the ore body in the southern part of Pikwe. The study was designed to solve the difficulty of producing the planned 2,000,000 tons per year from a single underground mine and to increase nickel and copper production during early years of operation with the exploitation of the richest parts of the ore body. This study showed that it was possible to produce about 18,000 tons of nickel and 17,000 tons of copper annually during the first four years of full operations. BCL accepted the results of the study and has developed the open cast mining. According to the latest estimates, the open cast mine which will run concurrently with underground mining, will have 4-5 years of operation after which all extraction will be from underground mining at both Pikwe and Selebi.

6. To maintain total production from the mining project at the planned ore production level of 2 million metric tons per annum, BCL plans the timely development of underground mining capability (at Selebi and Pikwe) to replace the expected decline of production from the open cast mine at Pikwe. A safeguard that total ore production will not be allowed to fall substantially below this level, as a result of the further revision to the mining project description, has been provided by way of an undertaking (in the proposed Guarantee Amendment Agreement) from Amax-RST-BRST, Anglo-Zamanglo-BRST and Charter-Zamanglo-BRST, to provide the necessary financial and technical assistance to BCL, if and when required, to enable the mining project to have a capability of producing 2,000,000 metric tons of ore per year.

Financing of Mining Project

7. The capital cost of the BCL mining project, including pre-operation and working capital, is now estimated at R 135.8 million (US$193 million equivalent) (excluding R7 million required to complete the Selebi underground mine by 1979), of which 59.6 percent will be financed from loans (including pipeline finance and suppliers' credits) and 40.4 percent from equity and

shareholders' subordinated loans. The costs of the mining project, at the time of appraisal and at September 1973, together with the financing plan, are summarized in the following table:

	Estimate used in Appraisal Report June 1971	Estimate by BCL September 1973 /1	Change
	R million		
A. Cost Item			
Fixed Plant	69.0	99.8	30.8 /2
Preproduction Expense	1.3	1.7	0.4
Interest during Construction	7.5	10.7	3.2
Working Capital	8.7	23.6	14.9
Total	86.5	135.8	49.3
B. Financing Plan			
Equity	30.0	32.8	2.8
KfW Loan	43.0	54.5	11.5
Industrial Development Corporation of South Africa (IDC) Loan	13.5	13.5	-
Shareholders Subordinated Loan	-	22.0	22.0
Suppliers Credits and Pipeline Financing	-	13.0	13.0
Total	86.5	135.8	49.3

/1 This does not include an estimated R 7 million required to complete the Selebi underground mine by 1979.

/2 More than R 20 million of this increase is attributed to the smelter.

8. Those shareholders of BRST which are guaranteeing the Bank loan have also undertaken, in the event of a cost overrun on the mining project, to make available to BCL the necessary additional financing, including working capital, required.

The Infrastructure Project

9. The infrastructure project consists of the power and water supply systems, road and rail links and a township at Selebi-Pikwe.

(1) The water facilities include a dam on the Shashe River, pumping station, pipeline, treatment plant and distribution system to serve the mining complex, power station and township. The facilities are to be owned and operated by the newly established national water authority, the Water Utilities Corporation (WUC).

(2) The power facilities include a 60-MW conventional steam power station, a transmission line to Francistown, the main city in northern Botswana, and an electric distribution system in the mining township. The facilities are to be owned and operated by the newly established Botswana Power Corporation (BPC), which will take over the responsibilities for operating and expanding all public power facilities in Botswana. The coal for the power plant will be supplied from a new coal field located at Morupule. Appropriate remedial action is being taken to deal with a problem in firing Morupule coal in the boilers and meanwhile Southern Rhodesia (Wankie) coal is being used. The liabilities for this problem have yet to be determined and the assessment of the cost of the remedial works has not been completed. When these matters have been resolved, the Government intends to apply to CIDA for a supplementary loan to meet any cost increase it must bear.

(3) Two railroad branch lines have been built to connect with the Rhodesia Railways main line through Botswana, a 10-mile spur to the coal field, and a 40-mile spur to the mine, smelter and power plant. The Government will own the railbed, but will hire the tracks and other recoverable items and equipment from Rhodesia Railways. A gravel access road (Pikwe-Serule) to the project area has also been provided. This road is to be upgraded with a bituminous wearing course, and the consultants are preparing technical specifications and contract documents.

(4) The township facilities include housing for Government, Government corporations and railway employees, roads, sewerage and other services, schools, administration, health service and other Government facilities. Upon completion of construction, the facilities are being taken over by a Township Authority.

10. To ensure coordination among all elements of the infrastructure project, the Government established a central Management Unit which has been responsible for construction. This Management Unit, in turn, works closely with BCL to ensure coordination of the construction of the infrastructure and mining facilities.

Financing of the Infrastructure Project

11. The total construction cost of the infrastructure project is now estimated at just under US$72.0 million compared with the appraisal estimate of US$58.9 million and total financing including interest during construction is US$75.4 million (appraisal estimate, US$64.5 million). These estimates are based on actual contracts placed, administrative and engineering costs incurred to date and claims which have been notified. Costs have increased by about US$10.9 million over the estimate made at the time of the appraisal.

Operating costs have also increased but these are more than offset by increases in revenues and the net effect of the various changes is a slight increase in the estimated financial rate of return on the infrastructure project (now 12.8% compared with the appraisal estimate of 12.3%).

12. The loans from the Canadian International Development Agency (CIDA), the United States Agency for International Development (USAID) and the Bank have financed virtually the whole of the infrastructure costs. The government is the borrower in each case. The CIDA loan financed the power facilities, except for the distribution system in the township. The amount of the loan as negotiated was Can$20 million and has since been increased to Can$30 million. The loan will be repaid over 40 years, after 10 years of grace. No interest will be charged. USAID granted a loan of up to US$6.5 million for the water trunk main, repayable over 30 years after a 10-year grace period, with 2 percent interest (which will be capitalized) during the grace period and 3 percent thereafter. About US$1.2 million required for temporary water facilities, training and administration was provided through grants and loans from the UK, Canada and UNDP and from the Government budget (about US$180,000).

13. The Government has also financed some other costs associated with the project amounting to about US$1.2 million equivalent which are not included in the project estimates. These are principally customs duties on equipment imported by the contractors on the USAID and CIDA contracts, local expenditure on temporary water supplies, railways supervision fee and the financing charges on bridging finance provided by BCL to cover costs incurred prior to effectiveness of the Bank loan.

14. The remaining parts of the infrastructure facilities for which no other aid was available on concessionary terms - the Shashe dam and water supply facilities (other than the water trunk main), the roads, rail spurs and the township - have been financed by the Bank loan, which, including the proposed Supplementary Loan of US$5.5 million, will amount to US$37.5 million. The loan also refinanced an amount of $0.9 million from Credit No. 172-BT in respect of the engineering services directly related to those facilities. Procurement for all items financed by the Bank loan has been in accordance with the Guidelines for Procurement under World Bank Loans and IDA Credits.

15. The Government has relent all of the proceeds of the CIDA and USAID loans and part of the proceeds of the Bank loan to the BPC and WUC on terms similar to those of the original Bank loan; that is, repayment over 25 years, at an interest rate of 7-1/4% following 4 years of grace. The arrangements for the relending are set forth in subsidiary loan agreements between the Government and the Corporations. The balance of the Bank loan has been applied to the cost of equipment and construction items for which government departments are directly responsible. The cost of construction and of services provided by the infrastructure facilities will primarily be recovered by charges to BCL. The respective obligations of BCL and the infrastructure operating entities are set out in 25-year contracts covering power, water, railway and township facilities.

Security Arrangements

16. The reappraisal of the mining project, as subsequently revised, concluded that BCL will be profitable and will be able to generate the revenues from which, directly or indirectly, the loans to BCL and to the Government will be serviced. However, there are risks inherent in most mining projects and Botswana was not at the time of reappraisal able to repay, or assure repayment of, loans on conventional terms. Accordingly, special arrangements were worked out to minimize the risks to the Bank, the creditors of BCL, MG and the principal shareholders in BRST. In addition to these guarantees, the Bank shares equally with KfW and IDC in the security arrangements they have with BCL (including the security they have taken on BCL's mining lease and housing properties) in order to prevent a dilution of the Bank's own security with BCL.

17. The power and water contracts further provide for minimum charges whether or not power and water are consumed, sufficient to cover the annual debt service payable by the BPC and WUC to the Government under the respective subsidiary loan agreements. These amounts exceed the amounts due by Botswana under the CIDA, USAID and proposed Bank loans.

18. The proceeds of all sales by BCL are to be paid in the first instance to a trust in the United Kingdom, from which the trustee will pay all amounts due by BCL to KfW and IDC and, in addition, payments due to BPC, WUC, and Botswana, before the balance is transferred to BCL. In turn, out of the payments due to Botswana, the trustee will also pay, on behalf of Botswana, payments due to the Bank under the proposed Bank loan.

BOTSWANA

INFRASTRUCTURE PROJECT

REVISED SUMMARY OF COSTS

US$1,000s

	Estimate of Costs shown in Appraisal Report	Revised Estimate of Costs: Contract	Revised Estimate of Costs: Description	Revised Estimate of Costs: Amount
Power Facilities				
Building + other Civil Works	2,506	B1 to B14	Equipment Contracts	17,026
Delivery and Erection	3,220	B21	Erection	12,974 1/
Mechanical Equipment	5,444			
Electrical Equipment	8,106			
Station Diesel Sets	308			
Transmission System	1,316			
Sub Total	21,000		Sub Total	30,000
Contingencies	1,411			-
Escalation	1,022			
Total	23,433		Total	30,000
Water Facilities				
Shashe Dam Works + Damsite Houses	5,040	C1 + C2	Shashe Dam + Fencing	5,457
Shashe-Pikwe Trunk Pipeline	7,546	D2	Plant + Pumps	1,484
Pikwe Treatment Plant, Second Service		D1 + D4	Pipe Manufacture + Laying	6,500 2/
Reservoir + Pump Station	529	D3	Civil Works (Water)	2,804
Morupule Water Supply 3/	420	F4B	Shashe Housing	238
		F4C	WUC Workshop	63
Sub Total	13,535		Sub Total	16,546
Contingencies + Claims (Excluding trunk pipeline)	2,030		Contingencies + Claims	544
Escalation	1,476			
Total	17,041		Total	17,090
Road and Railway				
Seruli-Pikwe Road	1,198	E1 & E1(a)	Pikwe Road + Railway	5,800
Seruli-Pikwe Railway	1,394	E2	Morupule Rail Spur	658
Seruli-Francistown Road upgrading 4/	780	F4A	Railway Housing	94
Palapye Morupule Branch Railway Line	286			
Sub Total	3,658		Sub Total	6,552
Contingencies + Claims	546		Contingencies + Claims	474
Escalation	420			
Total	4,624		Total	7,026
Township				
Water Distribution System	630	F1	Roads + Services (Incl. Maint. Equip.)	3,241
Power Distribution System	378	F2	Government Housing	3,257
Road + Other Services	1,525	F3	Government Buildings + Furniture	2,397
Government + Corporation Houses (Incl. furniture)	2,209		Temporary Water	980
Railway Houses	357			
Other Government Buildings (Incl. furniture and equipment) 5/	1,352			
Sub Total	6,451		Sub Total	9,875
Contingencies + Claims	966		Contingencies + Claims	562
Escalation	484			
Temporary Water	980			
Total	8,881		Total	10,437
Engineering and Administration				
Administration, Training and Other Additional Costs	980			1,760
Engineering and Design (Refinanced)	910			910
Other Engineering Costs	2,520			4,036
Contingencies on Engineering	504			-
Total	4,914			6,706
Currency Contingency 6/	-			500
Interest during Construction	5,600			3,600
Grand Total	64,493			75,359

1/ Final costs of B21 (Erection Contract) which are still under discussion are likely to exceed the figure shown by about Can$200,000. The Government is hoping to negotiate a supplementary loan from CIDA to cover this overrun plus the cost of boiler remedial works when the extent of Government responsibility for these costs have been determined.

2/ Final costs of the trunk pipeline are within the US$6.5 million available in the USAID loan.

3/ Morupule Water Supply has been dropped from the Project as this is now being financed by the Anglo American Company.

4/ The Seruli/Francistown Road upgrading has been dropped from the Project at the Government's request.

5/ Equipment for Health Center is excluded as Government has obtained finance from other sources for this equipment.

6/ A currency contingency of US$500,000 has been included in revised estimates to provide for possible future currency changes.

March 1974

EXPLANATORY NOTES

	Original Financing Plan	Estimate of Costs	CIDA	USAID	BANK	OTHERS
			US$ millions			
1/	Power Facilities (Incl.Contingencies)	23.44	23.44			
2/	Water Facilities (Incl.Temp.Water)	14.52		7.6	5.94	0.98
3/	Transportation Facilities	3.66			3.66	
	Township Facilities	6.45			6.45	
4/	Engineering and Administration	4.41			3.93	0.48
5/	Contingencies and Escalation	6.42			6.42	
	Interest during Construction	5.6			5.6	
	Total	64.50	23.44	7.6	32.0	1.46

	Present Financing Plan	Estimate of Costs	CIDA	USAID	BANK	OTHERS
1/	Power Facilities	30.0	30.0			
2/	Water Facilities (Incl.Temp.Water)	17.53		6.5	10.05	0.98
3/	Transportation Facilities	6.55			6.55	
	Township Facilities	8.89			8.89	
4/	Engineering and Administration	6.71			6.30	0.41
5/	Contingencies and Claims	2.08			2.08	
	Interest during Construction	3.60			3.60	
	Total	75.36	30.0	6.5	37.47	1.39

1/ The CIDA loan was increased to US$30.0 million to meet the revised estimate. This loan has now been fully committed and CIDA will be asked to provide supplementary finance in the required amount as soon as the cost overrun on Contract B21 and the costs of boiler remedial works have been established.

2/ Original estimated cost of the water pipeline was US$7.6 million and USAID undertook to meet the extra cost if the actual contract amount exceeded the approved loan of US$6.5 million. In the event, the aggregate cost of the supply and installation of the pipeline was within the USAID loan amount of US$6.5 million. Other finance covers the cost of the township temporary water supply at an estimated cost of US$0.98 million which was provided through a UK grant-in-aid.

3/ Revised estimate includes US$1.6 million for the proposed road hard surfacing contract.

4/ Other finance for Engineering and Administration originally included a Canadian Technical Assistance Grant of US$300,000 equivalent for staff training, the salary and expenses of the Project Coordinator at US$80,000 financed through the balance of the UNDP Special Fund which financed the feasibility study and the cost of Government seconded staff at US$100,000 financed by the Botswana Government. The present financing plan estimates the Government's contribution for seconded staff at US$180,000, direct project expenditures from the Canadian Technical Assistance Grant at US$150,000 and the UNDP Contribution remains at US$80,000.

5/ Revised estimates are based on contracts as let and subsequently adjusted for variations and the allowance for contingencies is principally to cover claims which are pending, plus a 20% contingency on the proposed road hard surfacing contract.

Note: For the purpose of the Cost Estimates it has been assumed that the Canadian dollar is equivalent to the US dollar.

REPUBLIC OF BOTSWANA

LOAN AND INFRASTRUCTURE PROJECT SUMMARY

Borrower:	Republic of Botswana
Guarantors:	Companies in the American Metal Climax groups, including American Metal Climax Inc.; companies in the Anglo-American group, including Anglo-American Corp. of South Africa: Metallgesellschaft, AG; and Bamangwato Concessions Limited.
Project:	Shashe infrastructure project for copper/nickel mine.
Cost of Project:	US$75.4 million.

Financing of Project:

CIDA	US$30.0 million
USAID	6.5
Other non-Bank Sources	1.4
IBRD loan	37.5
Total	US$75.4 million

Amount and Terms of Bank Loan:	US$5.5 million to bring Bank assistance to US$37.5 million equivalent; 7-1/4% interest; repayable 1975-1996.
Amount and Terms of CIDA Loan:	US$30 million. 50 years, including 10 years grace, no interest charged.
Amount and Terms of USAID Loan:	US$6.5 million; 2% interest during grace period and 3% thereafter. 40 years including 10 years of grace.

Relending Terms:

The Republic of Botswana will relend part of the proceeds of the (existing and proposed) Bank Loan and the CIDA and USAID Loans to the Botswana Power Corporation and the Water Utilities Corporation on terms of 29 years, including a 4-year period of grace at 7-1/4% interest.

Procurement:

(a) International competitive bidding for the Bank-financed part of the facilities;

(b) 75% procurement in Canada and 25% available for local costs for the facilities financed by the CIDA Loan;

(c) Procurement in the U.S. and selected countries, including Botswana, for the USAID Loan.

Construction Period:

1971-1975

Disbursement Schedule:
(IBRD Fiscal Year)

	FY72	FY73	FY74	FY75
Estimated Disbursements	7.3	11.5	13.7	5.0

Consulting Services:

Main Consultants: Sir Alexander Gibb & Partners (UK)

Sub-Consultants: Merz & McLellan (UK)
Shawinigan Engineering (Canada)

Internal Financial
Rate of Return:

(a) Mine plus Infrastructure - 15.1%

(b) Infrastructure alone - 12.8%

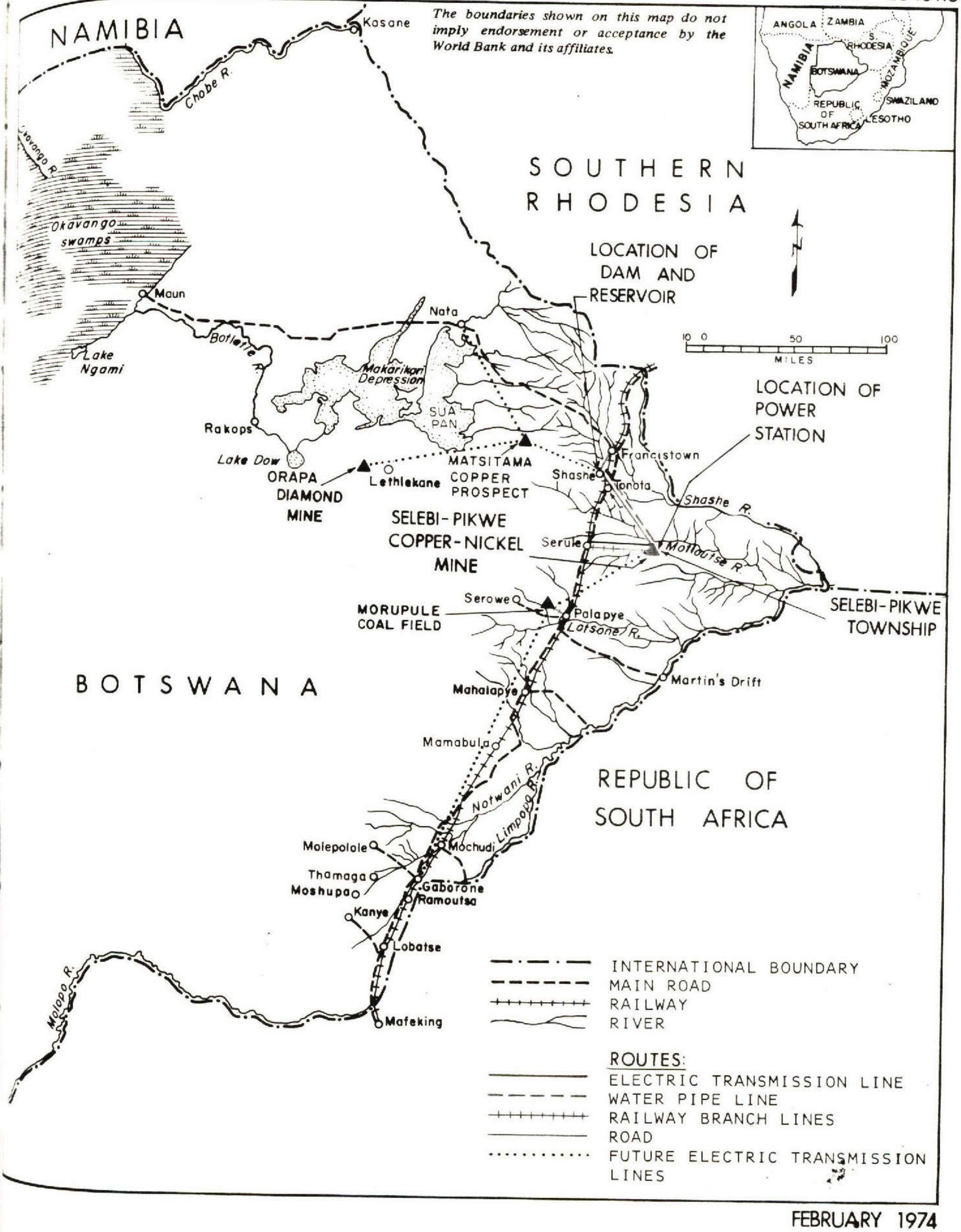
(c) Mine alone - 18.3%

Appraisal Report:

Report No. PU-67b dated June 11, 1971.

BOTSWANA
SHASHE INFRASTRUCTURE PROJECT

IBRD 2843R3



FEBRUARY 1974

INTERNATIONAL BANK FOR RECONSTRUCTION AND DEVELOPMENT

CONFIDENTIAL

FOR EXECUTIVE DIRECTORS' MEETING

For consideration on February 29, 1972

R72-37

February 17, 1972

FROM: The President

BOTSWANA: Modification of the Loan and Guarantee Agreements for Loan No. 776BT (Shashe Project)

1. I wish to call your attention to developments which have taken place since you approved, on June 29, 1971, the US$32 million loan to Botswana for infrastructure needed in connection with development of a nickel/copper mine in Northeastern Botswana and to propose for your approval consequential changes in the Loan and Guarantee Agreements. This loan is to provide finance for the Shashe dam and water distribution system, a township, roads, rail spurs, engineering, training and project administration. Parallel loans were made by Canada for electric power and by USAID for a water pipeline. Details of the infrastructure project (and the related mining project) are contained in the President's Report and Recommendation (P-969) dated June 16, 1971, and in the Appraisal Report (PU-67b) dated June 11, 1971. The loan agreement was signed on June 30, 1971 but we have been unable, for the reasons outlined below, to proceed with the signature of the Guarantee Agreement and to declare the loan effective.

2. The parties to the Guarantee Agreement as negotiated were, inter alia, Bamangwato Concessions Limited (the Botswana mining company that will construct and operate the mining project - hereinafter referred to as "BCL"), Botswana RST Limited (a Botswana holding company - hereinafter referred to as "BRST"), American Metal Climax and Anglo American Corporation of South Africa Limited (the principal shareholders of BRST - hereinafter respectively referred to as "Amax" and "Anglo"), Charter Consolidated Limited and Metallgesellschaft AG (the principal purchaser of the output of the mine - hereinafter referred to as "MG").

3. As you were informed on August 11, 1971 (R-71-206), MG declared, subsequent to the loan signing, that it was no longer willing to enter into the purchase agreement and to guarantee its 40 percent part of the Bank loan. This decision by MG also made it impossible for Kreditanstalt für Wiederaufbau (KfW), the principal lender for the mining investment, to proceed with its loan to BCL. Shortly thereafter it became apparent that there would be substantial cost overruns, both on the mining project and

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Executive Vice President, IFC
Vice President, IFC
Department Heads, Bank and IFC

on the supporting infrastructure due in part to cost inflation in Southern Africa. In order to ensure continued progress on the mine and infrastructure while the marketing, guarantee and financing problems were being resolved, BCL and its major shareholders arranged interim financing for key contracts including those for the Shashe dam and the power station. The problems referred to have now been resolved and a closing has been scheduled in Botswana on March 7, 1972 when all of the loan and other agreements would become effective.

4. Under the mining plan described in the June 1971 Appraisal Report, ore was to be mined for 25 years from two mines (Selebi and Pikwe) and both mines were to be opened at the same time in 1973. BCL estimated that the cost of the mining project on this basis would be US$121 million equivalent. When BCL became aware that major overrun costs faced the company, the major shareholders carried out an intensive technical review of the mining plan and installation. This review resulted in measures designed to minimize the impact of the overruns and defer part of the capital expenditure required. First, the commencement of mining of the Selebi ore body will be delayed until 1979 but the richer Pikwe ore body will be mined at a higher rate to maintain production at the level previously planned (i.e. 2,000,000 tons per year) and at least partially to offset the increased costs. Secondly, the surface facilities will be modified to treat a wider range of ore grades, so that BCL can increase its production of nickel and copper in any given year by processing higher grade ore. The average mining rate will also be increased with a corresponding reduction in the estimated mine life from twenty-five to twenty-three years.

5. The cost of the mining project as revised is now estimated at $149 million. Of the $28 million increase, $20 million will be required by 1973 and $8 million between 1973 and 1979. The $20 million will be provided to BCL in accordance with procedures for financing overruns originally agreed by the guarantor-shareholders with the Bank and the principal lenders to BCL - i.e., $4 million will be provided by way of new equity and the rest by way of subordinated shareholders' loans. The remaining $8 million needed by 1979 to open the Selebi mine will be provided in the form of new equity investment in BCL.

6. In June 1971, it was expected that MG would purchase two-thirds of the nickel and all of the copper produced by the mining project under a 15-year sales agreement and would guarantee 40 percent of the Bank's loan to Botswana. Since then, BCL and MG have renegotiated the sales arrangements. MG will, as before, guarantee 40 percent of the Bank's loan and purchase the quantities of nickel and copper covered by the original agreement, but the revised arrangements now require Amax to purchase part of the nickel from MG. In addition, Amax, BRST and BCL will indemnify MG with respect to its guarantee liabilities to the extent MG is not otherwise indemnified by the Federal Republic of Germany. Following the renegotiation of these arrangements, KfW has now signed its loan agreement with BCL.

7. The Bank has evaluated the changes in BCL's plans and cost estimates. Risks to the profitability of the mining project remain, due to the possibility of delays in the completion of construction, and to further increases in capital and operating costs due to the persistent inflation in Southern Africa. These risks are to some

degree mitigated by the increased flexibility in the mining project which enables BCL to increase metal production and, hence, sales revenue. On BCL's assumptions as to the date at which production will start, increases in capital and operating costs, and the future level of copper and nickel prices, the revised mining plan will give a financial return little lower than their earlier projections. On more conservative assumptions made by the Bank staff, BCL might face an acute cash shortage in the early years of its operation. The guarantee agreement provides some protection to the company against this possibility; the guarantor-shareholders, in order to satisfy their commitment to complete the project[1] are obliged to provide funds as necessary to enable BCL to meet a 1.5 current ratio test. In addition, no dividend payments may be made at any time during the life of the guarantee agreement unless, after the payment, the same current ratio test can be met.

8. Even if the profitability of the mining project were significantly reduced, the Botswana government (and the Power and Water Corporations) is financially protected by the contracts for the provision of utility services to BCL, which provide for minimum payments sufficient to service the infrastructure loans, and by the minimum royalty payable to the government irrespective of the company's revenues. The Bank itself is protected not only by these minimum payments and the trust arrangements through which they are to be paid, but also by the guarantee of three large financially sound mining companies and a large international metal trading company.

9. The changes in the mining project have not significantly affected the water and power demands, the amount of ore to be processed, the amount of matte to be transported, and the general size of BCL's operations at the mining site. This means that changes in the mining project have had no material effect on the size or nature of the infrastructure project. However, a substantial increase in the estimated cost of the power facilities in the light of the bids received, and the general escalation in construction costs in Southern Africa have resulted in an overall increase of about 13% in the infrastructure cost estimates. These are now approximately $75.6 million as compared with $67.3 million when the project was presented to you in June.

1/ Completion of the mining project is defined in terms of completion of construction in accordance with design specifications followed by a minimum of six months' continuous operation of not less than 80 percent of design capacity.

10. The additional cost of the power facilities, which are being financed by the Canadian International Development Association (CIDA), will be covered by an increase in the CIDA loan from the Can$20 million originally authorized to Can$30 million. As regards the facilities which were to be financed by the Bank loan, it is expected that the overruns can be met by the elimination, without great detriment to the project, of improvements to the Serule-Francistown road (about $1.4 million) and by other parties taking over some of their financing. USAID, which had authorized a loan of $6.5 million to finance the cost of the pipe required for the water supply main, has agreed to the savings under that loan being used to finance the cost of installation of the pipe (about $2.6 million). The Botswana government is negotiating with Denmark to use part of a loan already granted to finance the cost of the medical equipment required for the township health center (about $500,000). The water supply to the coal mine and the rail spur to the coalfield (estimated to cost about $900,000) will be financed by the coal company itself. A revised Loan and Project Summary incorporating these various changes in the infrastructure project and its financing is attached.

11. On the basis of the revised cost estimates, using the Bank's conservative assumptions referred to in paragraph 7, the financial rate of return to the infrastructure investment is now estimated to be 9.5% as compared with the 12.3% shown in the Appraisal Report, dated June 11, 1971. Considering that there will be additional indirect benefits to the Botswana economy, these rates of return are still acceptable.

12. A corporate reorganization, approved by a shareholders' meeting in January 1972, will result in the mining company, BCL, being owned 15% by the Botswana government and 85% by BRST, which is quoted on the London, Johannesburg, Scottish and Paris stock exchanges and traded over the counter in the United States. The present shareholders of BCL will exchange their shares for shares in BRST. BRST will then make a rights issue, which if fully subscribed, will result in Amax and Anglo each having approximately 30% of the equity of BRST, the public having approximately 35% and other corporate shareholders about 5%.

13. On January 13, 1972 a BRST shareholder filed a class action on behalf of the public shareholders of BRST in the U.S. District Court for the Eastern District of Pennsylvania against Amax, BRST, and certain BRST directors alleging, inter alia, that the proposed BRST/BCL reorganization and the proposed BRST rights offering (a) are a part of a fraudulent conspiracy among Amax, BRST, certain BRST directors and others and (b) are unfair to BRST public shareholders and dilute their interests in BRST for a grossly inadequate consideration. The Legal Department has studied the complaint and I am advised that there is no reason why the

Bank should decline to continue to participate in this project because the law suit is pending. However, a clause has been added to the Guarantee Agreement which ensures that no court order concerning the corporate reorganization shall relieve any of the guarantors from its obligations under the agreement.

Changes in Bank Loan Agreement and Guarantee Agreement

14. To take account of the developments described above, changes need to be made in the Loan Agreement signed on June 30, 1971 and the Guarantee Agreement as approved by the Executive Directors. (Copies of the draft Agreement Amending the Loan Agreement and the revised draft Guarantee Agreement are being distributed separately.)

15. The principal changes are summarized as follows:

(a) The Description of the Mining Project is revised to reflect the fact that the Selebi and Pikwe mines are to be opened at different times and that there have been changes in the surface facilities. (Schedule 4 to the Loan Agreement)

(b) The Description of the Project has been revised to eliminate the upgrading of the Serule-Francistown road and the Morupule (coal mine) water supply and to make minor modifications to the description of the water facilities. (Schedule 3 to the Loan Agreement)

(c) The allocation of the proceeds of the loan has been revised to reflect new cost estimates and the elimination of certain portions of the project. (Schedule 1 to the Loan Agreement)

(d) The final maturity of the Bank loan has been shortened from 2000 to 1996 so that the final maturity date corresponds with the estimated life of the mining operations. (Schedule 2 to the Loan Agreement)

(e) The completion test set forth in the draft Guarantee Agreement has been altered to take account of the fact that the two mines are to be opened at different times. (Sections 2.02 (c) and (d) of the draft Guarantee Agreement)

(f) The draft Guarantee Agreement has been altered to reflect the revised financing plan for the mining project and to ensure that sufficient funds are provided to BCL in the form of equity to complete the Selebi mine in 1979. (Section 2.02 (e) and Schedule 1 to the draft Guarantee Agreement)

(g) In order to limit the possible flow of funds out of BCL in the early years of the mining operations, the subordinated shareholder loans for the completion of the mining project will be repayable over not less than five years (instead of three years as previously agreed) from amounts otherwise available for dividends, subject to the 1.5 current ratio test being satisfied. If the company shall have paid out in any year dividends equal to 20 percent of the principal amount of the subordinated loans, up to one-third of the principal amount of such loans may be repaid in that year, subject always to the 1.5 current ratio test. (Section 2.02 (b) of the draft Guarantee Agreement).

(h) A new provision has been included in the Guarantee Agreement to ensure that the obligations of the guarantors will not be affected by the litigation involving the corporate reorganization of BCL and BRST. (Section 5.03 (b) of the draft Guarantee Agreement)

Recommendation

16. I recommend that the Bank agree to the changes proposed, substantially in the form set forth in the documents distributed as report R72-37-L.

Robert S. McNamara

Attachments

Questions on this document should be referred to Mr. Dean (extension 3565).

REPUBLIC OF BOTSWANA

REVISED LOAN AND INFRASTRUCTURE PROJECT SUMMARY

Borrower: Republic of Botswana

Guarantors: Companies in the American Metal Climax group, including American Metal Climax Inc.; companies in the Anglo-American group, including Anglo-American Co. of South Africa; Metallgesellschaft AG; and Bamangwato Concessions Limited.

Project: Shashe infrastructure project for copper/nickel mine.

Amount and Terms of IDA Credit (172-BT):
US$1.59 million (the credit was originally $2.5 million but $0.91 is being refinanced as a part of the Bank loan).
3/4 of 1% per annum service charge
50 years, including 10 years grace.

Amount and Terms of Bank Loan:
US$32 million equivalent; 7-1/4%
25 years, including 4 years grace.

Amount and Terms of CIDA Loan:
Can.$30 million; no interest;
50 years, including 10 years grace.

Amount and Terms of USAID Loan:
US$6.5 million; 2% during grace period and 3% thereafter;
40 years, including 10 years grace.

Relending Terms: The Republic of Botswana will relend part of the proceeds of the Bank loan and the CIDA loan to the Botswana Power Corporation and part of the Bank loan and USAID loan to the Water Utilities Corporation on terms of 29 years, including a 4-year period of grace at 7-1/4% interest.

Procurement:
(a) International competitive bidding for the Bank-financed part of the facilities;
(b) 75% procurement in Canada and 25% available for local cost for the facilities financed by the CIDA loan;
(c) Procurement in the U.S. and selected countries, including Botswana, for the USAID loan.

Construction Period: 1971-1973

Disbursement Schedule:

	FY72	FY73	FY74	FY75
Estimated disbursements	11.8	13.7	4.5	2.0

Consulting Services: Consulting engineers for design and supervision of construction.

Cost Estimates and Sources of Financing

A. Estimated Costs	US$ Million As in June 16, 1971 President's Report & Recommendation		Revised Estimates
Engineering Studies & Preliminary Works	2.49		2.49
Construction Costs			
Power Station & Transmission	21.00		27.94
Water Supply	13.53		15.47
Transportation	3.66		5.84
Township	6.45		8.36
Temporary Water Supply	0.98		0.98
Contingencies	8.86		4.17
Sub-total	54.48		62.76
Administration & Training	0.98		2.02
Engineering (including US$0.9 million refinanced from Credit 172BT)	3.43		4.43
Total Construction Costs	58.89		69.21
Interest during Construction			
On Bank Loan	5.62		3.60
On USAID Loan	0.35		0.35
Total Interest during Construction	5.97		3.95
Total Project Costs	67.35		75.65
Less elimination from the Project of			
(a) Water supply to coalfield		.46	
(b) Rail spur to coalfield		.46	
(c) Serule-Francistown road upgrading		1.36	
		2.28	
Total Financing Required			73.37
B. Sources of Financing			
Government of Botswana Counterpart expenditures on feasibility studies	0.62		0.62
Expenditures for interest on USAID Loan and project management	0.45		0.45
UNDP Grant for feasibility studies and project management	0.29		0.29
UK Grants and Credits for feasibility studies and temporary water service	1.05		1.05
IDA Design Credit (172BT)	1.59		1.59
Canadian International Development Agency Loan	*23.83		29.83
Canadian Technical Assistance Grant	0.31		0.60
USAID Loan	* 7.60		6.50
Bank Loan	32.00		32.00
Danish Aid (under discussion)	-		0.50
Total Sources	*67.35		73.43
Internal Financial Rate of Return	12%		9.5%

*These amounts were based on the appraisal estimates, prepared in March 1971, of the financing that would be required from these two sources.