RESPONSE FROM LONMIN TO AMABHUNGANE

Preamble:

Craig McKune is a journalist with amaBhungane - a non-profit centre for investigative journalism – articles are published primarily in the Mail & Guardian. They are researching the issue of base erosion and profit shifting in a South African context and are examining a number of companies here, including Lonmin.

The Alternative Information & Development Centre (AIDC) recently published data to support its allegation that Lonmin was "systematically" under-pricing the metal it sells (http://www.aidc.org.za/media-room/news-articles/65-press-conference-2-june-2014-why-have-amplats-impala-and-lonmin-been-systematically-selling-their-pgm-metals-below-market-prices.html).

**Questions and Answers:**

Q: Please can you explain why there is a disparity between Lonmin's trading prices and market prices?

A: We have not been privy to the detailed analysis that the AIDC has done. However, it would appear as if their analysis was overly simplistic – their calculations were based on arithmetic means rather than weighted means.

There is a lot of seasonality in Lonmin's production and metal prices are very volatile. All of this needs to be taken into account when performing an analysis of this nature. Comparing straight line average prices (which is what AIDC appears to have done) to fluctuating prices where volumes also fluctuating significantly from month to month will give you a wrong answer. In reality our discounts have reduced over the past 5 years and are now well below 1% of market prices and never exceeded more than 2%.

The fact is that all of Lonmin's metal is sold directly by Lonmin's operating subsidiary (WPL) direct to third parties at prices which are market prices. As such there is no transfer pricing or "value shifting" as none of these sales are taking place through tax haven subsidiaries. There is also no logic to Lonmin selling metals to third parties with whom it is not related through shareholdings or otherwise at anything less than the best possible price it can achieve. Our strategy has largely been to keep our marketing structure small and incentivise customers to develop the market rather than direct involvement.

Simply put the industry traditionally offers relationship customers a discount in return for their long term business. Value does extend to the customer (who is an unrelated party), but in return we get market intelligence, access to their R&D activities and also a guaranteed buyer for some of the OPMs.

Q: In its reporting, Lonmin refers to its "two principal customers for PGMs, both global corporations

(BASF and Mitsubishi). Six customers for base metals". Are any of these customers related parties, and can you please identify them?

A: No. None of these customers are related parties.

Q:

a. I understand that Furuya Metals is one of these customers and is part owned by Lonmin. Is there any reason this customer should not be considered as a related party?
b. To what extent do sales to Furuya Metals account for the discount, if at all?

Q: In respect of the alleged "systematic under-pricing" by Lonmin and two other companies, the AIDC stated: "We suspect, but still have to investigate further, that we are dealing with misinvoicing and transfer pricing where surpluses are transferred to tax havens by these multinational companies." (http://www.aidc.org.za/programmes/political-economy/wage-and-profits/58-aidc-back-to-the-negotiating-table-now-stop-wage-evasion.html)

i.) Please comment on this allegation.

A: There is no logic in, or benefit to be gained for anyone from,  misinvoicing or underinvoicing. None of our customers are related parties, so it is not as if any loss in profit that we make in Lonmin as a result of under invoicing would be gained somewhere else. Also, as mentioned, our sales are direct from WPL to our customers. None of our sales are routed through off-shore companies. So as a result there is no opportunity for transfer pricing.

ii.) Is Lonmin misinvoicing and/or using transfer pricing to transfer pre-tax profits offshore?

A: No. See above.

2. Lonmin has reported that over the past five years, it paid US$90m in tax. Over the same period, the company reported a total underlying pre-tax profit of US$656m. That amounts to tax of only 13.7% of profits, less than half of South Africa's 28% corporate tax. How has Lonmin achieved such a low tax bill?

A: We assume that the five year period applied commences from 2009 financial year and ended during the 2013 financial year.  This five year period commenced with the world economic recession and various other factors which influenced commodity prices, our profitability and taxable income. Whilst capital expenditure is depreciated over certain periods for accounting purposes, in terms of the South African tax law mining capital expenditure is fully deductible against mining income limited to taxable income.  The Income Tax Act further provides for unused capital expenditure to be carried forward against future taxable profits.  The foregoing has the effect of reducing  effective tax rate during the years of intensive capital investment despite the low margin environment.  It should be borne in mind that mining is a self-destructive industry wherein capital investment applied gets depleted immediately upon shafts being mined out, further mining capital development would continuously be required to retain production levels.   Lonmin is no different and since it wished to retain or even improve our production capacity during the period under review, Lonmin continues to invest in capital expenditure despite the low margin environment. This had the effect that as a result of deductible capital expenditure in terms mining tax law, taxable income simply proved to be lower than accounting income.

Under IFRS we can treat costs arising in certain one-off scenarios as "special items". The headline accounts less those special items, are the underlying numbers – we use these to help investors see the picture of our trading with distortions removed.

However, you can't compare headline tax payments to underlying profits. Under normal tax accounting, we include the special costs in our tax computations as they genuinely reduce our taxable (headline) profits.

In addition to the above, we wish to advise that Lonmin's largest operations are in South Africa, and the major taxation costs would be paid over to the revenue authorities based on the rand tax profits. As a result we report for income tax purposes on income converted at spot rate for SARS purposes. For purposes of reporting to other stakeholders other than SARS, listed companies are required by the International Financial Reporting Standard (IFRS) report in US dollars. The translation from rands to US dollars has the effect of providing variances between net profit in rands and USD annual financial statements respectively. The variance is created mainly by the exchange differences emanating from dollar denominated monetary assets and liabilities converted at year-end using spot rates. Major movements in the exchange rates therefore also impacted the income statement profits as the dollar values of Rand transactions varied as exchange rates changed.

3. In 2011, ActionAid, an NGO, accessed a list of Lonmin subsidiaries, which it published online (http://www.actionaid.org.uk/tax-justice/ftse-100-tax-haven-tracker).
a.) Please can you provide a full, updated list of Lonmin's subsidiaries and, if possible, an explanation of the corporate structure?

A: Many of the companies in the Lonmin structure though are a historical legacy either from the Lonhro days when Lonhro operated in multiple jurisdictions in multiple industries or are as a result of acquisitions made at various points in time. Many of these subsidiaries are dormant.

b.) Lonmin reports that it employs about 28 000 people in South Africa and eight in the UK. This seems to suggest that Lonmin does not employ staff at its subsidiaries in other countries. Please can you confirm and explain?

A: This is correct. See explanation above. As you know our accounts are audited.

4. The subsidiary list published by ActionAid includes the following companies registered in tax haven jurisdictions (for example see http://www.financialsecrecyindex.com): AfriOre International (Barbados) Ltd; Kwagga Gold (Barbados) Ltd; TWF Holdings (Barbados) Ltd; AfriOre Ltd (British Virgin Islands); AfriOre Precious Metals Holdings Inc (BVI); Metals Technology Inc (BVI). These companies appear to be linked to Lonmin's 2007 acquisition of AfriOre Ltd. Please can you explain this "AfriOre" structure, including:
a.) What assets do these companies hold?

A: AfriOre was acquired when Lonmin acquired the Akanani exploration project. This project is not currently generating any revenue.

b.) What revenues, if any, do they generate for Lonmin?

A: Nil.

c.) How and where are they taxed?

A: In their own relevant tax jurisdiction. Currently, only the Akanani exploration project is of any significance and as this is still in an exploration stage and is not generating revenue. Should it at some point in time in the future generate revenue it will be taxed in South Africa in accordance with South Africa mining tax legislation, as is the case for all other mining companies operating in South Africa. The location of the holding company won't make any difference to this.

d.) Do they employ staff in their relevant locations? How many employees? What services do they perform for the company?

A: No. There are none.

e.) What is the commercial rationale for this seemingly complicated offshore structure, and why are these companies not located in the countries where they own assets and operate?

A: It was inherited when Lonmin purchased the Akanani exploration asset as explained above.

7. With respect to Southern Platinum (Cayman Islands) Corp:
a.) What assets does it hold?

A: We acquired this company, along with numerous others, when we acquired the Limpopo asset as part of the Southern Platinum acquisition in July 2005. SPCI does not produce annual accounts as there is no statutory requirement for it to do so; nor is there any internal governance reasons to produce accounts as SPCI is essentially a non-trading company.

b.) What revenues, if any, does it generate for Lonmin?

A: Nil.

c.) How and where is it taxed?
d.) Does it employ staff in Cayman Islands? How many employees? What services do they perform for the company?

A: Nil

e.) What is the commercial rationale for this company's offshore registration?

A: Inherited when we acquire the Limpopo asset.

8. With respect to Western Platinum (Pty) Ltd and Eastern Platinum (Pty) Ltd: Lonmin reports that it holds these companies through LSA (UK) Ltd. Are there any further subsidiaries in this corporate structure, and can you please explain?

A: Yes.

Q: Sorry if my question was not clear. Please can you explain the holding structure of each of WPL and EPL? Please include the names of their respective holding companies, if there are any other than LSA (UK) Ltd.

9. With respect to Lonmin Insurance Ltd:
a.) What service does this company provide for Lonmin, or what role does it play in Lonmin's corporate structure?

A: Lonmin as a mining company faces significant risks. Where we can, we try and insure against these risks. For this purpose we have an insurance captive called Lonmin Insurance Limited, which then allows us to access the big international re-insurance markets. Otherwise we would be forced to deal through third parties and our cost of insurance would be higher.

b.) I understand that it was registered in Bermuda until recently being continued in Guernsey. Is this correct?

A: Yes. It was re-domiciled in Guernsey in 2013.

c.) When and why was it transferred to Guernsey? And what is the commercial rationale for using this jurisdiction?

A: Guernsey is in the same time zone as Lonmin's other operating businesses and is closer to London. Since for governance purposes it is important to have regular Board meetings, it is more practical to have LIL located in Guernsey so that these Board meetings can be held at the same time as the relevant Lonmin executives responsible for LIL are travelling to London on other Lonmin business.

d.) Does it employ staff in Guernsey? If so, how many, and what work do they do?

A: No. LIL does not have any staff in Guernsey. It has however, appointed Willis as its captive manager and Willis manages the day to day affairs of LIL. The Board of LIL consists of 2 Lonmin employees and 2 independent directors, and the Chairman of the Board is one of the independents. So governance of the entity is very strict.

e.) How and where are related party transactions between Lonmin and this subsidiary taxed?

A: Yes. WPL, EPL and Lonmin buy most of their insurance through LIL. As explained above this allows the group to access a bigger market of reinsurance companies and as such results in the group obtaining more competitive insurance premiums.

10. With respect to Western Metal Sales Ltd:
a.) I understand that the company was formerly registered in Brussels, but was later moved to Bermuda. Is this correct? When was it moved?

A: This company has long been dormant and is no longer in use.

Q:

a. During what years was Western Metal Sales in use?
b. Did it employ staff, and how many?
c. Did it keep an office, and what was its address?
d. What functions did it perform?
e. In performing this function, what risks did it assume and what assets did it employ?

b.) Please explain the commercial rationale for the choice of jurisdiction?
c.) Descriptions by Lonmin and various authorities regarding Western Metal Sales state that the subsidiary markets and sells the metals that Lonmin produces. But to the best of my knowledge, Lonmin's marketing function is run from its South African office, overseen by the relevant executives here. What, then, is the commercial purpose of the Bermuda-registered subsidiary?

A: Dormant. A historical legacy.

c.) Does Western Metal Sales employ staff? How many and what do they do?

A: Nil. Dormant.

d.) Does this subsidiary buy the metals from the company and on-sell to end clients, or is it paid a service commission? Otherwise please explain the nature of the service it provides and how it transacts with Lonmin?

A: Dormant. All metal is sold direct by WPL to customers.

e.) How are these rates negotiated, and where are they taxed?

A: WPL negotiates prices with customers as all commercial entities do – both parties negotiate as hard as possible to obtain the best possible price. All our pricing is market related.

11. Previously, Lonrho Management Services provided management services to Lonrho. More recently, Lonmin reported that "A branch of Lonmin Plc operates in South Africa, trading as Lonmin Management Services or 'LMS'."
a.) Does this latter LMS charge Lonmin for management services?

A: Yes. Certain employees of the Group are employed by LMS and in turn LMS charges group companies for the services that these employees perform.

b.) If so, how are the rates calculated, and on the basis of what service, exactly?

A: The rates charged are market-related and commensurate with the services that are performed. In a large organisation it is commercially sensible that certain services are centralised rather than duplicated across the group structure. This is why these services sit in LMS and LMS then on charges the relevant group companies such as WPL and EPL for these services.

c.) How and where are these management fees taxed?

A: LMS, although it is a branch of Lonmin Plc, is registered for tax in South Africa and therefore pays tax in South Africa, and in fact is one of the reasons why Lonmin's group tax bill is actually higher than it could be, since even if WPL and EPL do not generate any taxable income (due to the capital expenditure deductions explained above) it is still possible that LMS might generate some margin on its services, which would then still be taxable (as South Africa does not have a system of group taxation).

12. Lonmin has reported that since 2009 it paid US$158m in "management and marketing services".

A:

a.) Do fees paid to Western Metal Sales and Lonmin Management Services account for this cost?

A: As Western Metal Sales is dormant nothing would have gone through this entity.

b.) If so, how much was paid to the two subsidiaries respectively?

A: N/a

c.) Otherwise, please explain this "management and marketing services" cost, to who is it paid, on what basis, and where and how are the fees taxed?

A: As above, LMS is taxed in South Africa.

Q:

a. Do I understand correctly then that these "management and marketing services" (for ease of reference, they are reported on p 174 of Lonmin 2013 AR) are paid to LMS?

ENDS

Additional information:

Please note: you might also want to read the piece below by Allan Seccombe:

http://www.bdlive.co.za/business/mining/2014/06/09/metals-not-undersold-says-platinum-miner