With mining stocks lagging the world share indices and bank financing still difficult to achieve, conventional funding routes for mining companies are closed or problematic. For now. We look at trends in alternative financing and what to expect from the due diligence process.

3 things you need to know about alternative financing in the mining industry

pwc

www.pwc.co.uk/mining

130709-141848-NM-OS

Contents

3 things you need to know about alternative financing in mining

With mining stocks lagging the world share indices and bank financing still difficult to achieve, conventional funding routes for mining companies are closed or problematic for now. Because of this, the current high levels of interest from the global mining community in sources of alternative funding is no surprise, but what are the options and risks, the opportunities and experiences of those seeking alternative funding?

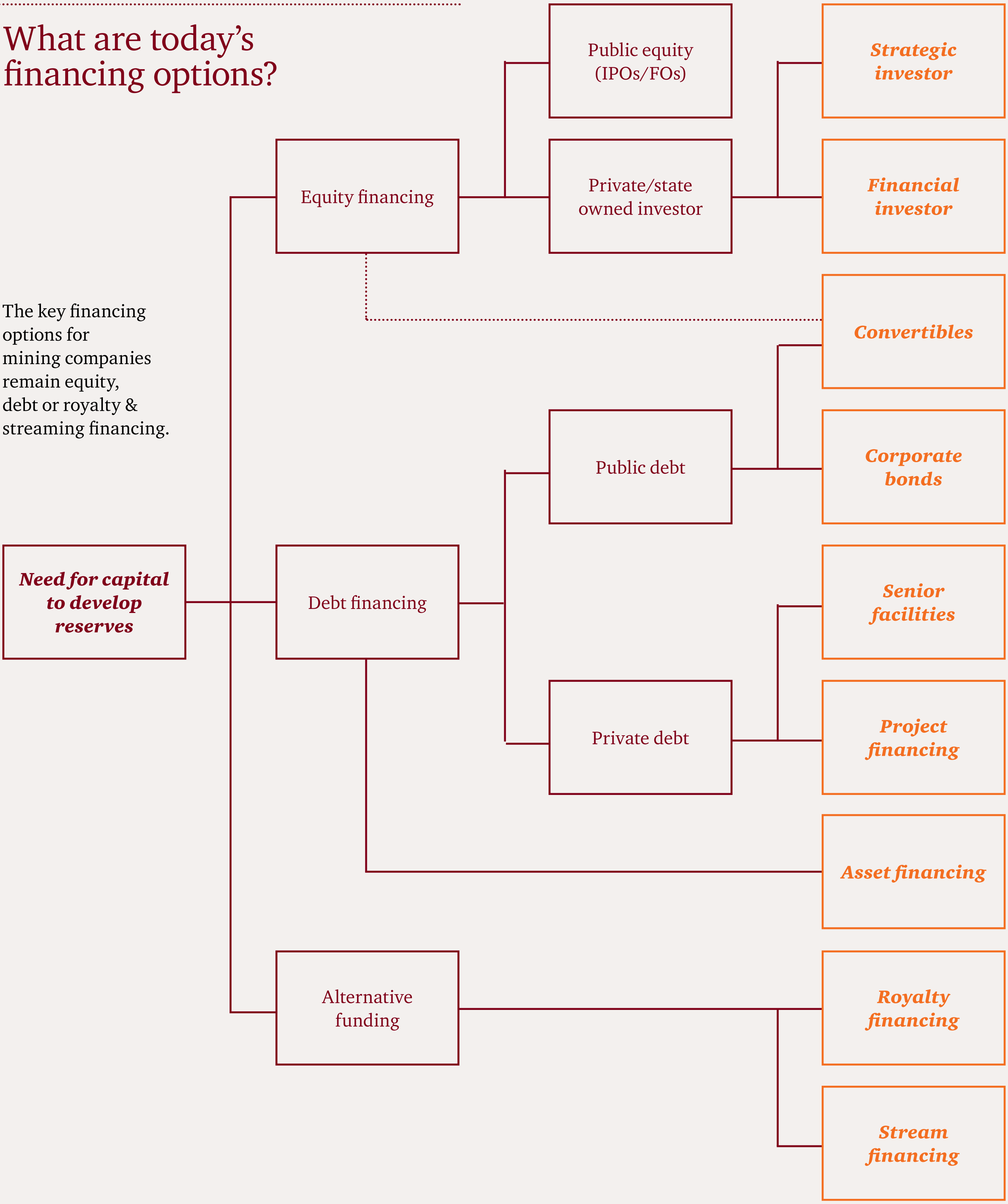
From our findings and experience we have identified:

1. The rise of South Korea as a source of investment
2. The likelihood of convertible bonds becoming mainstream in the UK in the near term
3. The relative importance royalty & streaming has to raising finance today

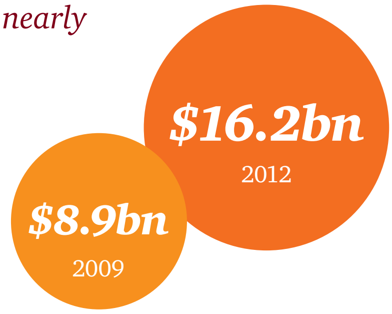
The due diligence requirements for alternative finance sources differ from those of a pure equity raise. We examine the information requirements of major alternative finance sources and the level of intrusion on management.

What are today's financing options?

The key financing options for mining companies remain equity, debt or royalty & streaming financing.



Total state-backed investment nearly doubled from 2009 to 2012. State-backed investors have the cash reserves and the investment time horizon to invest at low points in the cycle.



1. Strategic and financial investors – the rise of South Korea

Strategic and financial investors range from corporates looking for supply security to state-backed enterprises, such as sovereign wealth funds, looking to develop mining skills and expertise.

In 2012 alone, South Korean state backed consortia completed seven transactions taking an average shareholding of 23% per transaction.

Typical strategic corporate investment has come from Asia. For example in 2010 MMX, the listed iron ore producer in Brazil, issued new equity worth 14% of the company to SK Networks (a South Korean conglomerate) also with an off-take agreement. A further example would be Shangdong Iron and Steel Group's US$1.5bn investment into 25% of African Minerals Ltd's Tonkolili iron ore project.

Significant strategic investment has not been seen from these corporates in the exploration or development areas of the mining lifecycle, suggesting that seeking corporate investment is a means of monetising an existing mine, either for further expansion or development of new properties.

In contrast, state-backed entities are primarily investing in development stage projects. The initial price may not be high but when investment to finance future development is taken into account the costs are very significant. For example, Chinalco acquired the Toromocho project in Peru in 2008 for US $791m and total development costs are now expected to exceed US $4,800m when the mines starts producing at the end of 2013.

Over the last 4 years, where transaction value has been disclosed, investment from state-backed enterprises (defined as "government owned involvement" by Thomson One) has increased from US $8.9bn to US $16.2bn. The number of transactions, again where value has been disclosed, has increased from 33 to 46, although it should be noted that the total number of transactions has only increased from 51 to 55.

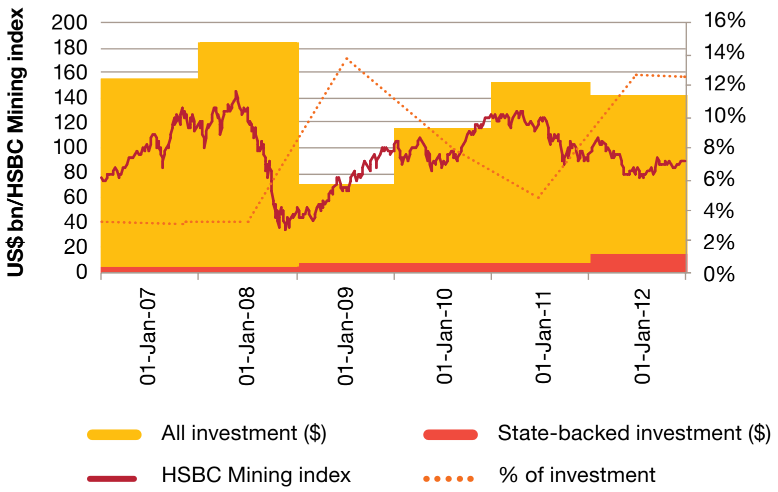
State-backed enterprise transactions range from acquisition of existing shares at the top-listed company level to a subscription for new shares at a subsidiary or even project level. The table below includes both acquisitions and finance injections but does not include intra-Chinese transactions.

There is a clear inverse correlation between global mining equity prices and state-backed investment. State-backed investors have the access to cash and the investment time horizon to invest at low points in the cycle.

On a global basis, state-backed investment activity focused on Australasia, with 33% of all investment ($13.7bn) being into parent companies based in the region. Unsurprisingly, both North America ($6.5bn) and Europe ($5.8bn) have received more investment than Africa and Central Asia ($5.2bn). These are traditional centres for raising finance and where most mature mining companies are headquartered. This suggests that state-backed investment is generally looking for more established projects with lower development risk. The attractiveness of the transparency and reporting regulations of these markets is also reflected. This is echoed by the significant investment in Central and Latin America ($7.6bn) over the period.

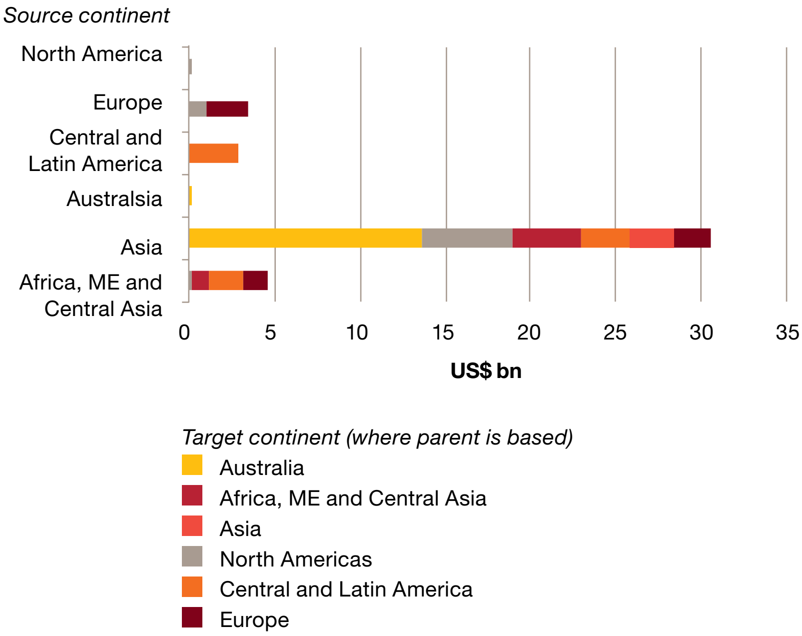
When looking at state-backed investment by continent where the principle asset is located, Australasia remains dominant with 34% of all investment. Mines in Africa and Central Asia received 23% of all investment ($9.5bn) with Central and Latin America receiving 20% ($8.3bn).

% of state-backed investment compared to all investment



Source: Thomson One, PwC Analysis

US$ value of state-backed investment grouped by continent (ex intra-China) into target contingent (2007 – 2012)



The rise in state-backed investment is predominantly flowing from Asia with 74% of total state-backed acquisition and investment coming from the region

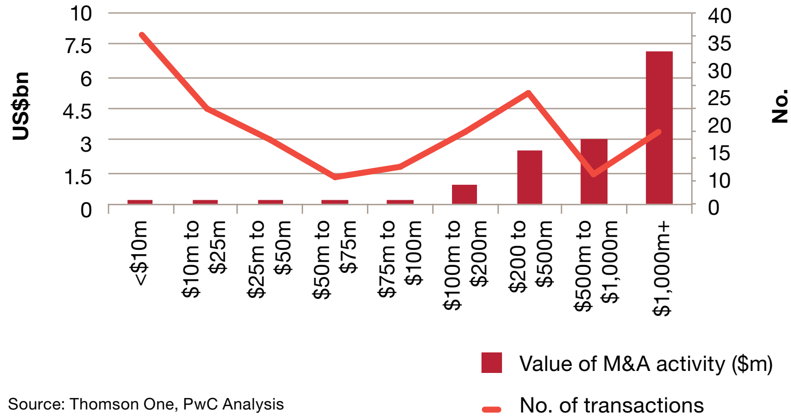
The rise in state-backed investment is predominantly flowing from Asia with 74% of all state-backed acquisition and investment coming from the region. Of this, 45% of acquisition by value is flowing into Australasia ($13.7bn) with more flowing into North America (17%, $5.2bn) than Africa and Central Asia combined (13%, $4.1bn).

Over the period there were 144 investments from state-backed entities that had a disclosed value, with 58% of these transactions coming from China at an average investment of $308m each.

State-backed investment is not just limited to large "statement" transactions. Between 2009 and 2012 there were 69 transactions of less than $50m, worth $1.3bn to the sector.

It comes as no surprise that China has the most state-backed investment into the sector with investment focused on the companies based in the traditional mining economic centres of Australia, Canada, South Africa and the UK.

Size of activity



Source: Thomson One, PwC Analysis

Nation	No. of transactions	Size of transactions (US$m)	Average value (US$m)
China	84	25,850	308
Chile	2	2,900	1,450
South Korea	16	2,188	137
Utd Arab Em	1	2,000	2,000
Russian Fed	5	1,788	358
Kazakhstan	2	1,347	674
Thailand	4	1,305	326
France	2	1,035	517
Singapore	3	643	214
Czech Republic	1	514	514

Source: Thomson One, PwC Analysis

The surprise is that South Korea has completed the second highest number of state-backed investments during our review period. The South Korean investment strategy revolves around investment through a consortium that has some form of state backing.

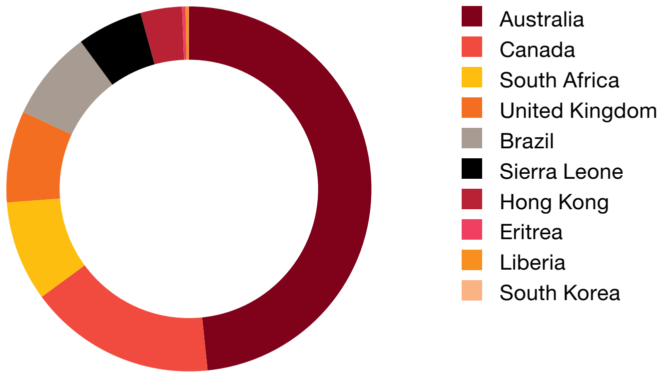
A consortium backed by Korea Resources Corporation, a majority owned unit of South Korea state, LG Corporation, Japan-Korea Joint Smelting Co Ltd, SK Networks Co Ltd and Iljin Mater has repeatedly invested into Baja Mining's Boleo Copper Project as the project faced significant capital expenditure over-runs. The average state-backed investment is smaller than other nations, at $137m.

South Korean backed investment activity appears on the increase with 7 transactions occurring in 2012 compared to 4 in 2009 and 3 in 2010. This contrasts with the fairly steady number of Chinese transactions, around 35 per year between 2009 and 2012.

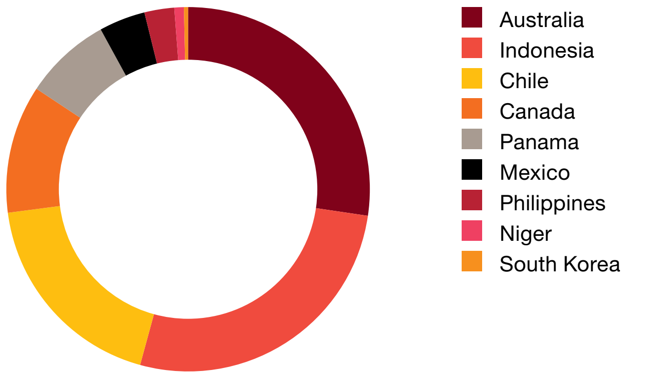
South Korean state-backed investment activity involves a strategy of seeking small equity positions and securing off-take agreements alongside the equity position. The off-takes secure natural resource supply, whilst the equity stake provides a financial hedge should commodity price rises.

Whilst not state-backed, Japanese trading houses are resuming to look at similar strategies to those of the South Korean consortiums following the considerable loosening of monetary policy in 2013.

China state-backed activity by target country 2009-2012, total $25.9bn



South Korean state-backed activity by target country 2009-2012, total $2.2bn



Source: Thomson One, PwC Analysis

The role of private equity

Whether there is a role for private equity in mining is still uncertain. Since Goldcorp championed a hedge free policy in the late 1990's and with Barrick Gold unwinding their hedge book in 2009, investors have wanted miners to give them direct exposure to commodity price changes. Hedging production would however give a PE house the more stable cash generation it requires.

Whilst the disconnect between commodity prices and miners share prices may have created an advantageous environment for financial investors, we have seen little transaction evidence that PE houses without existing mining expertise are looking to move into the sector. It seems very unlikely that traditional PE houses would ever look to invest before the production stage due to the high resource risk as well as the high likely capital expenditure required. We expect this to remain the domain of specialist funds.

Much of the recent specialist fund raising has centered around natural resources rather than exclusively mining funds. However, some funds are forming around former execs from industry. There was PE interest in BHP's Ekati asset, a diamond mine with a short remaining mine life. The attraction was to develop a 'buffer zone' for expansion but the mine ultimately was sold to a trade player, Dominion Diamond Corporation (formerly Harry Winston). In addition there has been PE interest in Rio Tinto's iron ore assets in Canada although the business plan is likely to rely on expanding the port and rail infrastructure and therefore require significant capital outlay.

Should the disconnect between project value and share price continue, private equity might take a closer look at mines that do not require significant capital investment.

In our experience to date, traditional private equity is more interested in gaining investment to the commodity cycle through investment in supporting industries, in particular, mining services companies.

What to expect from due diligence by strategic and financial investors

It is fundamental to distinguish the intentions of the many different strategic and financial investors. Take sovereign wealth funds (SWF). These can have very different purposes. Qatar Investment Authority is set up to get a financial return from any investment it makes (as witnessed by its active role in the Xstrata/Glencore merger). Its sister company Qatar Mining, is set up to secure supply of certain commodities for the country and to become a diversified mining company in its own right. Therefore it is looking to acquire significant stakes in projects.

The type of return an investor is looking for will have a significant impact on the part of the mining value chain a strategic or financial investor is willing to invest in. Strategic corporate investors are typically looking for security of supply and therefore tend to look at companies in production or at the latter stages of development.

In our experience strategic and financial investors have very high information demands during the due diligence process to help them understand risks.

In our experience strategic and financial investors have very high information demands during the due diligence process to help them understand risks.

The whole process can take a significant amount of time as internal approval has to be made, typically by management who are less familiar with the particular issues facing miners. This often involves an education process, a role frequently filled by advisors. We have seen that SWF transactions can be very lengthy to complete and it is important to appreciate that the key sign off may be by an individual who has had very little involvement in the underlying transaction process.

Not all strategic investments are made entirely for financial injection. Hummingbird Resources ("Hummingbird") recently agreed a $5m capital injection from the IFC. Tom Hill, Finance Director, believes that the rigour with which the IFC conducted their due diligence on the Company's social and environmental footprint will be a differentiator for the company in
future with respect to their ability to raise capital.

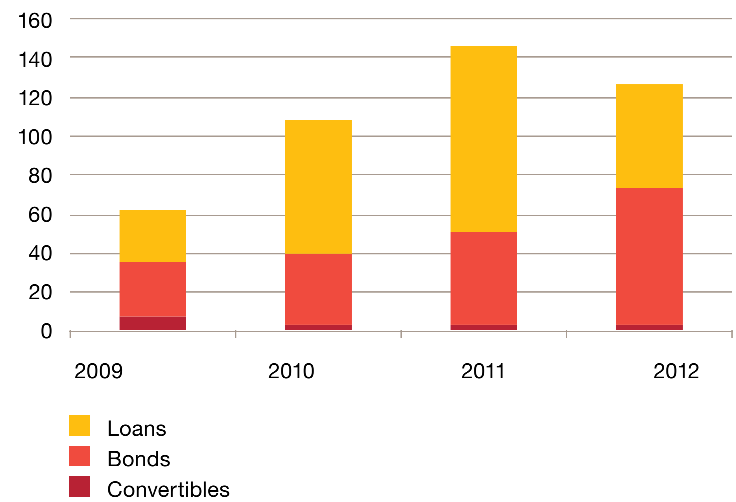
A key focus for the IFC was on understanding the history and legal nature of the project, the shareholders and where they got their shareholdings from, the mining licenses and the links they had with key suppliers. The process itself took the best part of 6 months and the different focus to traditional due diligence meant that a significant part of senior management time was taken up. We are also seeing an increase in reputational and anti-bribery due diligence, influenced by the anti-bribery act brought into the UK in 2010.

2. Convertible bonds – coming to the UK

Lending to the global mining industry has declined slightly since 2011, but remains more than twice the level seen in 2009. This suggests that lenders have not changed their appetite to global mining risk. Indeed, we have seen global miners raising bonds at record low yields. For example, in 2012 Rio Tinto raised $3.0bn of bonds in the US marketplace due in 2017 at a coupon of 1.625%.

The global debt market has seen a similar trend for smaller miners looking to raise less than US$250m. The decrease in lending for less than <$250m in Canada, Australia, UK and US was only 11% in 2012 to 2011, compared to 14% in all lending. We have looked at lending in Canada, Australia, UK and US because they make up the most significant borrowers, excluding the investment grade corporate lending to Chinese companies.

Global mining – debt raised (US$bn)



Source: Thomson One, PwC Analysis

There has been a noticeable shift in the type of lending occurring in the in these countries:

There has been sizeable decrease in loans under US$250m being borrowed which has not been compensated for by other forms of borrowing, although financing raised through convertible bonds has increased by $700m in 2012 compared to 2011.

While an expensive form of financing, the attractiveness of issuing convertible bonds increases when equity is scarce.

The convertible bond market has been dominated by raises by Australian and Canadian headquartered companies. The average global amount raised per bond in 2012 dropped to US$15m from US$22m in 2011 and US$27m in 2010 with little geographical variation.

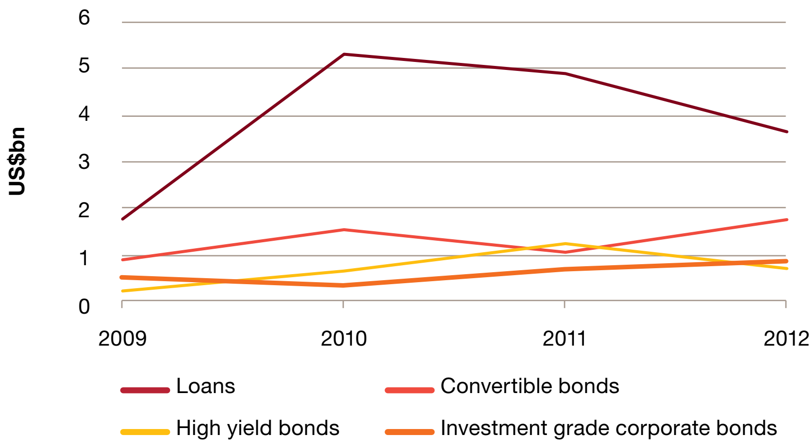
A convertible bond may have an impact on a company's ability to raise equity in the future. Careful consideration should be made of the impact on the shareholder register.

We expect to see an increase in the use of convertible bonds as a form of financing within the UK in the near term as traditional equity financing remains scarce.

What to expect from due diligence in issuing a convertible bonds?

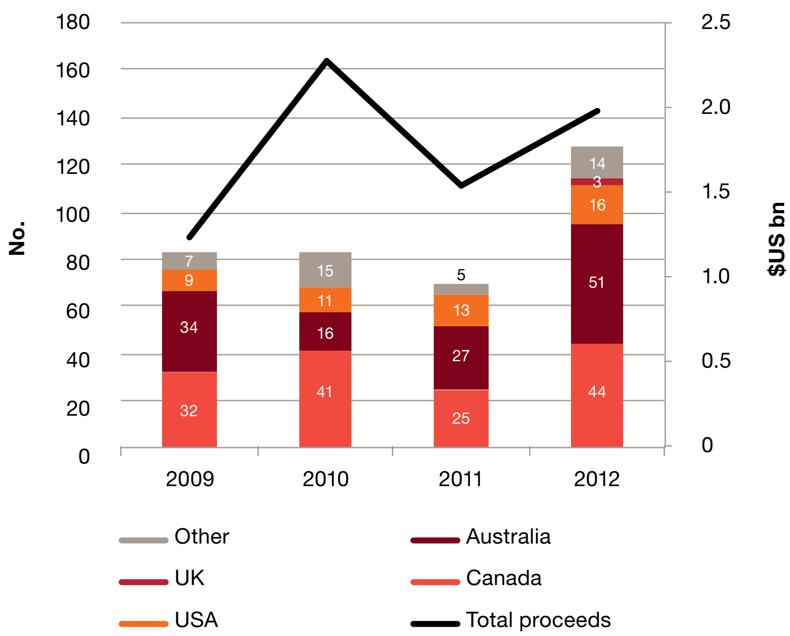
In issuing a convertible bond to the public market, the amount of due diligence for a listed company is minimal, from all of the technical, legal, tax and financial angles. Where a convertible bond is being issued to a strategic investor, such as Glencore's convertible bond issued in 2009, companies should expect due diligence more inline with that of traditional M&A.

Debt raised where proceeds <$250m, Canada, Australia, US and UK



Source: Thomson One, PwC Analysis

No. of convertible bonds raised, <$250m



Source: Thomson One, PwC Analysis

3. Royalty and streaming finance

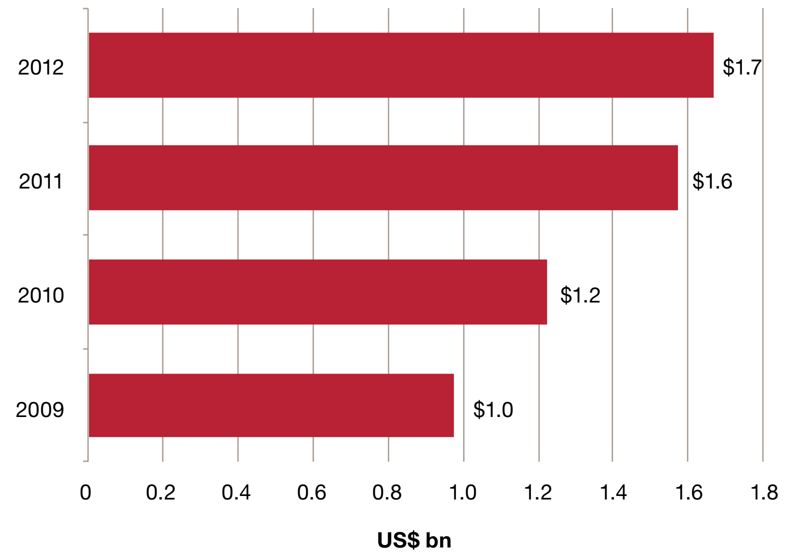
John Theobald, CEO of Anglo Pacific Group is firmly of the belief that junior and mid-tier alternative financing is becoming mainstream. He likens mining financing requirements to a three legged stool – with legs representing equity, debt and alternative financing. The moment you get an imbalance between the 3, the whole stability of the footstool is undermined.

There has been considerable industry attention on the growth of royalty and streaming finance available to mining companies over the last year. Significant transactions in the last year include the entry into the market by the giant Blackrock World Mining Trust following their $110m investment for a 2% royalty deal with London Mining's Sierra Leone Marapa Mine, the continued rise of Sandstorm Gold Ltd who completed a greater number of streaming transactions than the rest of the sector put together and Anglo Pacific Group's $15m royalty investment into Hummingbird's pre-feasibility stage Dugbe 1 project.

North American streaming companies are the leaders in mega streaming deals, which can reduce the amount of funding needed from equity dramatically. In 2013 Silver Wheaton announced a $1.9bn deal for 25% of the gold production of Vale's Salobo mine and 70% of Sudbury gold production.

Despite increasing industry attention and a significant rise in the $ value of royalty & streaming investment into mining companies, as a proportion of overall investment into mining royalty and streaming remains very small. In 2012 only 1.1% of all money raised was from royalty & streaming. This includes the $1bn Franco-Nevada precious metal stream agreed with Inmet Mining Corporation (before their acquisition by First Quantum). This was a significant % increase compared to 2011 where it made up 0.8% of all fund raising and an even smaller % in 2010 and 2009.

Cash invested by streaming/royalty companies



Source: Review of annual financial statements of Silver Wheaton Corp, Sandstorm Gold Ltd, Sandstorm Metals Ltd, Blackrock World Mining Trust plc, Premier Royalty inc, Callinan Royalties, Abitibi Royalties, Bullion Monarch Mining, Virigina Mines, Franco-Nevada, Anglo Pacific Group, Royal Gold, Gold Wheaton

With traditional equity financing drying up, more companies have been turning to royalty and streaming deals to secure investment that offers less dilution to the overall company than raising equity at depressed prices. Royalty and streaming investment has gained traction recently due to the disconnect between the NPV of projects and the market capitalisation of companies. Consequently, Erfan Kazemi, CFO of Sandstorm Gold Ltd explains, streaming and royalty deals currently offer companies better value based on just the NPV of the project, rather than the pricing implied by the equity markets.

What to expect from due diligence by royalty and streaming investors?

Erfan Kazemi estimates that the average streaming deal takes 4 to 6 weeks to complete and he has seen deals complete as quickly as two and a half weeks. From a due diligence perspective, Sandstorm perform much of their work from publically available information using their in-house expertise. When requesting access to management, they require the company's life of mine models and geological mapping as well as a site visit.

The timescale compares very favourable to debt financing, although it should be noted that streaming and royalty financing is more akin to equity than debt because a key part of any transaction is to enable the streaming or royalty company to benefit from the upside of increased commodity price, increased reserves and resources or increased production capacity.

In December 2012 Hummingbird agreed a $15m royalty from Anglo Pacific Group. This deal was unusual because it comes at an earlier stage in the lifecycle than has been seen in many other royalty or streaming deals. Indeed, Hummingbird only announced completion of their scoping study in April 2013. John Theobald says that the ability to stage gate payments based on specific milestones to be achieved by Hummingbird was vital in the context of the deal because it enabled APG to help mitigate the risk of investing in an exploration stage project.

Tom Hill, Finance Director of Hummingbird, noted that it is fundamental to consider the impact that a royalty or streaming deal in the future would have on your ability to raise debt. An agreement should not limit a mining companies ability to raise debt financing and the company should also consider what creditor preference is given to the royalty or streaming company and the impact that might have on your ability to raise finance in the future.

A royalty or stream investment will not be made simply to keep the lights running in a company for a few more months. The investor will be assessing management's ability to arrange the complete financing required for the project and this will almost always involve additional debt and equity investment if the mine is at a pre-construction stage.

Conclusion

Alternative financing in its various guises remains a small part of the total money invested into mining today. That being said, the absolute US$ value is increasing. From the transactions we have seen, alternative financing for exploration stage companies is largely limited to the convertible bonds market. There have been some signs of strategic and royalty & streamlining investment at exploration stage but these exceptions and certainly not the rule.

Strategic and financial investors have an important role to play in providing mid-tier producers with cash for expansion activities. They will also help majors de-risking projects as well as provide acquirers for the non-core asset disposal programmes.

The major financing rule remains to plan your financing needs earlier than you imagine you should and evaluate all options for as long as possible.

The major financing rule remains to plan your financing needs earlier than you imagine you should and evaluate all options for as long as possible.

Contact us

Visit our website:

www.pwc.co.uk/mining

PwC firms help organisations and individuals create the value they're looking for. We're a network of firms in 158 countries with close to 180,000 people who are committed to delivering quality in assurance, tax and advisory services.

PwC is a leading adviser to the global mining industry, working with a wide variety of explorers, producers and related service providers to ensure we meet the challenges of the global mining industry into the future.

Our strength in serving the global mining industry comes from our skills, our experience, and our seamless global network of dedicated professionals who focus their time on understanding the industry and working on solutions to mining industry issues.

For more information on this publication or how PwC can assist you in managing value and reporting, please speak to your current PwC contact or telephone/e-mail the individuals below who will put you in contact with the right person.

Author
Jonathan Lee
Deals
Telephone: +44 (0) 207 212 2468
Email: jonathan.m.lee@uk.pwc.com

Contacts
Jason Burkitt - UK mining leader
Telephone: +44 20 7213 2515
E-mail: jason.e.burkitt@uk.pwc.com

Mark Binney - UK deals
Telephone: +44 20 7804 0855
E-mail: mark.binney@uk.pwc.com

Nicola Corp - UK tax deals
Telephone: +44 20 7804 4732
E-mail: nicola.corp@uk.pwc.com

Alison Baker - UK assurance
Telephone: +44 20 7804 3314
E-mail: alison.c.baker@uk.pwc.com

Global mining contacts

John Gravelle
Canada
Global Mining Leader, Partner
T: +1 416 869 8727
E: john.gravelle@ca.pwc.com

Jose Almodovar
Mexico
Partner
T: +52 (55) 5263 6000 ext 7082
E: jose.almodovar@mx.pwc.com

Colin Becker
Chile
Partner
T: +56 (2) 940 0016
E: colin.becker@cl.pwc.com

Mark Binney
UK
Partner, Deals
T.+44 (0)20 7804 0855
E: mark.binney@uk.pwc.com

Hein Boegman
South Africa
Partner
T: +27 11 797 4335
E: hein.boegman@za.pwc.com

Jason Burkitt
UK
Partner
T: +44 (20) 7213 2515
E: jason.e.burkitt@uk.pwc.com

John Campbell
Ukraine
Partner
T: +380 (44) 490 6777
E: john.c.campbell@ua.pwc.com

Carlos Miguel Chaparro
Colombia
Partner
T: +57 (1) 634 05 55 ext 216
E: carlos. chaparro@co.pwc.com

Fernando Gaveglio
Peru
Partner
T: +51 (1) 211 6500 ext 7046
E: fernando.gaveglio@pe.pwc.com

Michael Goenawan
Indonesia
Partner, Deals
T: +62 21 5289 0340
E: michael.goenawan@id.pwc.com

Tim Goldsmith
Australia
Partner
T: +61 3 8603 2016
E: tim.goldsmith@au.pwc.com

John Nyholt
Canada
Partner, Deals
T: +1 416 815 5086
E: john.nyholt@ca.pwc.com

Jock O'Callaghan
Australia
Partner
T: +61 (3) 8603 6137
E: jock.ocallaghan@au.pwc.com

Steve Ralbovsky
U.S.A.
Partner
T: +1 (602) 364 8193
E: steve.ralbovsky@us.pwc.com

Kameswara Rao
India
Partner
T: +91 40 6624 6688
E: kameswara.rao@in.pwc.com

Ken Su
China
Partner
T: +86 (10) 6533 7290
E: ken.x.su@cn.pwc.com

Ronaldo Valino
Brazil
Partner
T: +55 (21) 3232 6015
E: ronaldo.valino@br.pwc.com

Simon Venables
South Africa
Partner, Deals
T: +27 11 797 5660
E: simon.venables@za.pwc.com

Leonardo Viglione
Argentina
Partner
T: +54 (11) 48504690
E: leonardo.viglione@ar.pwc.com

Sacha Winzenried
Indonesia
Partner
T: +62 21 5289 0968
E: sacha.winzenried@id.pwc.com

www.pwc.co.uk/mining

130709-141848-NM-OS