

# ClientAlert

## Global Mining and Metals Industry Group

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### Patchwork options

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#### More difficult project funding environment brings innovative financiers to the fore

A combination of factors since the global financial crisis has made it increasingly difficult for companies other than the majors to develop new projects, with limited exceptions for only the very best projects in select commodities and geographies.

These include the lack of equity available to juniors and midcaps, a withdrawal of commercial banks from the project-finance market, increased sovereign risk arising from resource nationalism, and investor aversion to growth.

To make matters worse, after a decade-long commodities boom, in 2013 the floor fell out on coal, gold, nickel, iron ore and other commodities. Miners wanting to secure financing to progress projects have been forced to look beyond traditional finance sources to a more complex mix of financing tools over the life of a project.

The Hudbay Minerals financing of the Constancia copper project in Peru illustrates how a mining house has had to piece together a patchwork of financing over the life of the project, starting in 2010, up to its most recent 2014 financing.

In 2010, a US\$300 million credit facility was secured, in 2012 a US\$750 million stream with Silver Wheaton and US\$500 million of unsecured notes, in June 2013 further unsecured notes, an equipment financing and a further stream with Silver Wheaton, in December 2013 further unsecured notes and in 2014 a C\$150 million (US\$133 million) bought deal financing.

Of course, as companies' circumstances, interests, and perspectives differ, so too will their appetite for—and access to—types, grades, and levels of funding. A junior miner with speculative interests in a central African state is not a dual-listed major with far-flung enterprises around the world and a mid-sized European gold company is not a large aluminum producer with significant operations in the Americas.

In assorted financings at corporate and project levels, mining companies will need to inject equity from the sources available outside traditional equity capital markets, draw debt, float bonds, and enter into forward sale contracts to fund projects that they could have previously financed in a far simpler fashion.

They will rely on conventional and high-yield bonds, off-take agreements, and joint ventures or partnerships with state-supported enterprises.



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They will also turn to new investors, such as a class of firms straddling the spaces of acquisitions and finance, that is to say they will interact with state-owned enterprises, private-equity firms, and hedge funds, much more frequently.

As part of their move to diversify funds, mining companies will increasingly look to types of non-conventional funding, once pioneered by smaller, more risk-prone, risk-embracing or risky miners. Along with interested investors, they will rely on alternative techniques to get deals—such as streaming, forward sales, royalty financings and convertible debt instruments—done.

Mining companies seeking to monetise the precious metal by-products of certain mines, for instance, silver produced at copper mines, may consider streaming arrangements. In a streaming arrangement, an investor agrees to purchase all or some of a company's precious metals, whether from a mine or a series of sites, at a fixed price.

The investor makes an upfront payment for the right to purchase a percentage of production; as the miner delivers units to the investor over time, the investor recoups its upfront payment, which is credited to it by the miner until, in theory, the initial deposit has zeroed out.

The investor then continues to pay the mining company the fixed price for each unit delivered over the agreement's life.

### Learning by example

Recent examples are significant. Silver Wheaton invested US\$1.9 billion in a Vale venture in exchange for gold streamed from copper and nickel mines. As for gold-focused investor Franco-Nevada, it paid US\$1 billion to stream precious metals from a Panama project operated by First Quantum, which was known as Inmet at that time.

Mining companies looking to construct or expand certain projects could turn to royalty companies for funds. In a royalty financing, a mining company essentially commits to paying fixed royalties, which are equal to a share of a project's projected revenues, to an investor that provides it with upfront capital payments.

London Mining, for example, raised US\$110 million in funds from BlackRock, which then received 2% of revenues derived from iron ore from the Marampa mine in Sierra Leone. Other active royalty companies include Anglo Pacific Group and Royal Gold.

In forward sales contracts, meanwhile, a mining company agrees to sell all or some of its production at an agreed price and upon delivery at an agreed date. The size and scope of these agreements, of course, reflects their purpose: raising working capital or repaying loans.

In February 2012, Yukon-Nevada and Deutsche Bank entered into a US\$20 million forward sale arrangement for gold.

Later that year, First Majestic sold US\$50 million of lead and zinc forwards to the Bank of America Merrill Lynch at roughly US\$1.00/lb of lead and US\$0.96/lb of zinc.

Of course, all that glitters is not gold. Non-conventional financings have their costs and risks too. Since non-conventional techniques are linked intimately to the projected production of a particular mine or set of mines, investors will carefully conduct technical due diligence or assess political and operational risks.

Mining companies that "stream" their metals may find it difficult to unlock the full value at a later stage or reconcile existing arrangements with the interests of prospective banks or bondholders in subsequent financings. Royalty financings, by their nature, reduce the amount of cash available to the mining company, and thereby restrict its ability to invest or provide shareholders with returns.

The use of a mix or patchwork of financing has also created its own issues.

The key challenge facing companies using a patchwork of traditional and non-traditional financing is to ensure the intercreditor issues are addressed at each step, such that there is sufficient flexibility to progress the project, through exploiting other sources of financing.

The early streaming and forward-sale contracts failed to address this issue, resulting in a significant impediment to the ability of companies to progress development using other capital sources.

Even so, money matters. Moreover, as the drop from boom to bust has demonstrated, no enterprise, whether funded conventionally or non-conventionally, is risk-free.

The mining and metals sector has dug itself into quite a hole. Mining companies and other pivotal participants will try every tool in the capital toolbox to dig themselves out.

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