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Mining *Insights*

Reminiscing over the last 12 months

The last 12 months finally saw the glimmer of beginnings of a change in fortunes for the mining sector as a whole and the junior minors in particular, with new monies being dedicated to investing in the sector.

We saw the emergence of, and greater activity from; dedicated mining private equity funds, royalty and streaming companies, various joint venture agreements as well as industry restructurings with vertical integration programmes. Explorers however still found the going tough with limited funds for development projects and the threat of consolidation for smaller players and the larger players continuing to take out costs across the board.

Funding for the mining projects that did materialise in the last year however took on a more creative edge with complex funding structures (no longer plain vanilla equity or debt) and a growing use of convertible bonds, earn in arrangements and staged payments, which could be argued as necessary given the general risk profile of the sector.

Playing well into the hands of the investors it was only those mining projects with the best rates of return and lowest risk profile that received funding with companies wanting to retain high returns at worst case commodity prices, and continuing to look for cost cutting opportunities as well as reserve and resource expansion. Projects with near term production, low capex and high grade resources were favoured.

Example deals

Appian Capital investment in Peak Resources

- Total potential investment of $25m dependent on various milestones
- The innovative financing structure included a purchase of a minority equity stake in the Listco, a bridge loan, a convertible loan note and an option on a 2% gross sales royalty
- Further equity funding dependent on the future feasibility study achieving set milestones

Greenstone Resources acquisition of an interest in North River Resources

- $12m total potential investment
- Involves upfront cash payment for equity, followed by staged equity investments according to agreed milestones
- Final funding structure may also involve convertible bonds

Looking forward to what we can expect in 2015/16

We fully expect the current consolidation in the junior mining sector to continue with the number of listed companies likely to reduce as companies merge or go under.

Arguably there are still too many ‘zombie companies’ with many management teams sitting on assets and conserving cash. The difficulties in raising finance to fund exploration and development has been well documented however this consolidation does have its benefits. Aggregating assets of synergistic companies enhances the equity story and drives value creation. Focussing on one or two core projects and chopping the dead wood from exploration portfolios will reduce overall spend so generating efficiencies and increasing value. Overheads can be driven down and the best management and operations teams can be cherry picked to take the enlarged business forwards which in turn will attract a stronger shareholder base. It is these companies that will have the edge.

We anticipate that share mergers will be a feature of deals given the ongoing cash constraints with potentially reverse takeovers (junior miners reversing into cash shells) and public to private deals led by the private equity sector.

If those companies with the edge do not emerge in 2015/16, and consolidation does not happen, we will see an increased number of companies voluntarily delisting and going private. We will see cash strapped companies going into administration at worst and at best management teams continuing to conserve cash and reducing exploration expenditure to the bare minimum. Potentially companies are likely to be stripped of their exploration licenses or not have them renewed due to minimum exploration spend thresholds not being met.

Fundamentally we believe that there is every opportunity for those companies with an edge to be successful as the mining industry is simply not finding enough economic deposits to replace mine production. Quality deposits and the people capable of finding them are becoming both increasingly rare and valuable.

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