



Grant Thornton

An instinct for growth™

GLOBAL MINING REPORT 2014

---

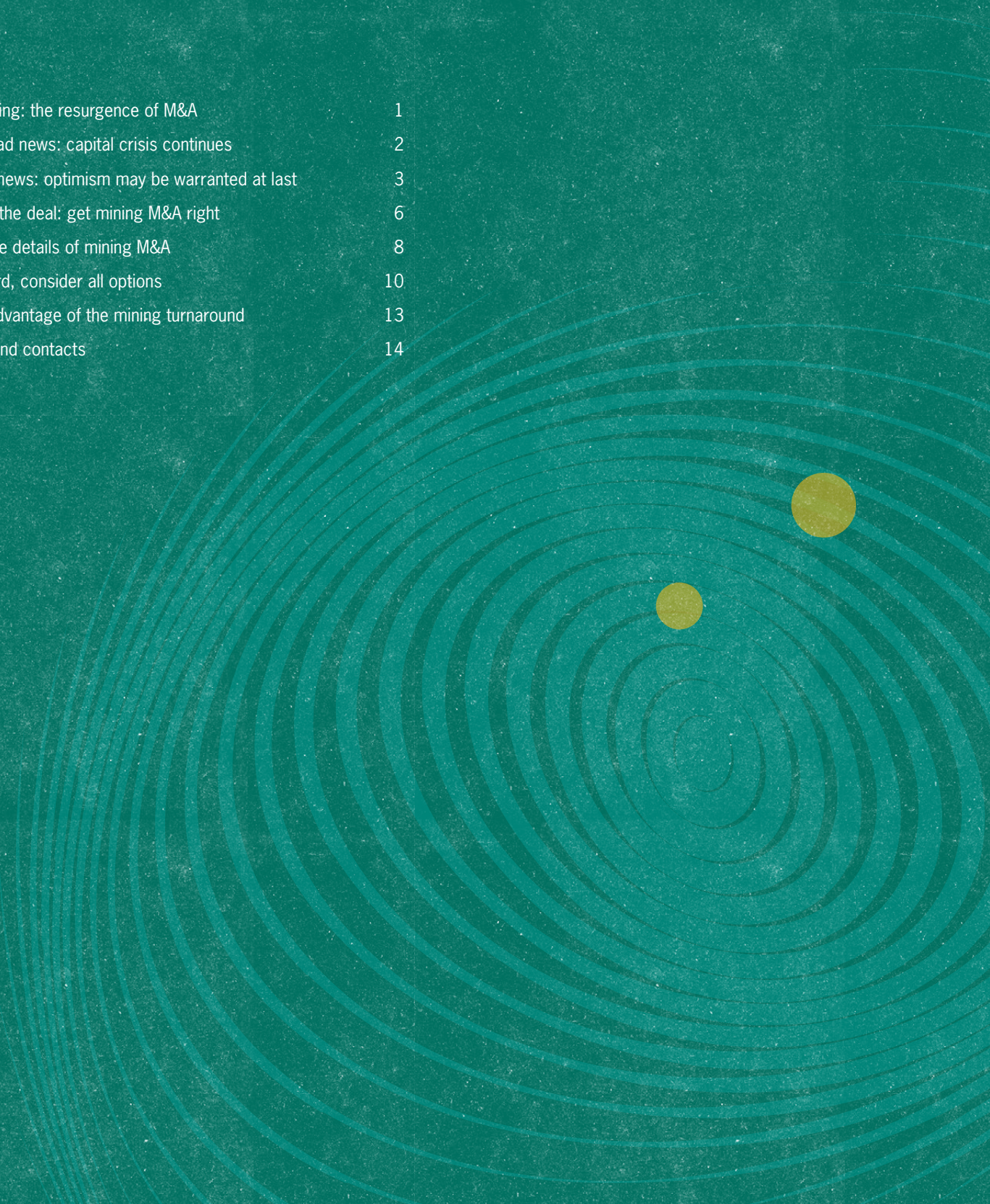
# Gathering momentum

*The resurgence of M&A*



# Contents

Global mining: the resurgence of M&A	1
First the bad news: capital crisis continues	2
The good news: optimism may be warranted at last	3
The art of the deal: get mining M&A right	6
Manage the details of mining M&A	8
Look inward, consider all options	10
Take full advantage of the mining turnaround	13
About us and contacts	14



---

# Global mining: the resurgence of M&A

*This report draws on data from our global mining study\* and insight from Grant Thornton mining specialists. It explores the potential for the mining M&A market and the implications for mining executives looking to prepare for a turnaround.*

The mining industry has always promised enormous potential rewards and equally dramatic risks. In recent years, however, there have been far more risks than rewards. Recession, economic uncertainty, and market volatility have forced many miners out of the industry and brought others to the point of insolvency. The downturn has been especially hard on junior miners and their important exploration activities. This has further slowed growth and jeopardised future mining projects. Major miners have recorded billion-dollar losses, as have industrial firms that supply the industry, for example, Caterpillar ended 2013 with sales down \$11 billion.<sup>1</sup>

But industry executives and suppliers expect the sector to bounce back. They express optimism for the future and view recent turmoil as a correction – a painful but necessary overhaul that will lead to a more robust future. One critical strategy in eventually making that future a reality will be mergers and acquisitions (M&A). After a slow 2013 and Q1 2014, the signs in our survey and the market point to an increase in the value of mining M&A deals<sup>2,3</sup> in the rest of 2014 and 2015.

---

\*The Grant Thornton Global Mining Survey was conducted using an online questionnaire. There were 259 total respondents, with questionnaires received between November 2013 and January 2014.

<sup>1</sup>Christopher Harress, "Caterpillar (CAT) ends an awful 2013 with \$11 billion in losses amid a slowing global mining sector," International Business Times, Dec. 27, 2013.

<sup>2</sup>Global Energy, Mining & Utilities Trend Report: H1 2014, Mergermarket, July 2, 2014.

<sup>3</sup>ThompsonOne database

# First the bad news: capital crisis continues

*“When junior miners don’t hold funds to support operations, they enter a capital ‘Catch 22’ – weakened so they can’t sustain operations to generate cashflow and unable to source affordable funding.”*



**Jeremy Jagt**, National mining leader, Grant Thornton Canada

Hundreds of mining companies still face financial conditions that threaten their existence. Nearly one third of junior miners need to raise additional funds within six months, and 35% of major/other miners<sup>3</sup> anticipate a need to change their capital structure within one year (see figure 1), according to the Grant Thornton Global Mining Survey. “It is an untenable situation for many mining companies, and one that has plagued the industry since the summer of 2010,” said Jeremy Jagt, National mining leader, Grant Thornton Canada.

He continued, “We would ideally like to see junior miners holding sufficient funds to support their operations for a year or more. When they don’t, they gradually enter into a capital “Catch 22” – weakened to the point where they cannot sustain sufficient operations or keep projects moving to generate cashflow, but also unable to source affordable funding because they’re not producing cashflow and/or moving their projects forward. They struggle to get out of that cycle.”

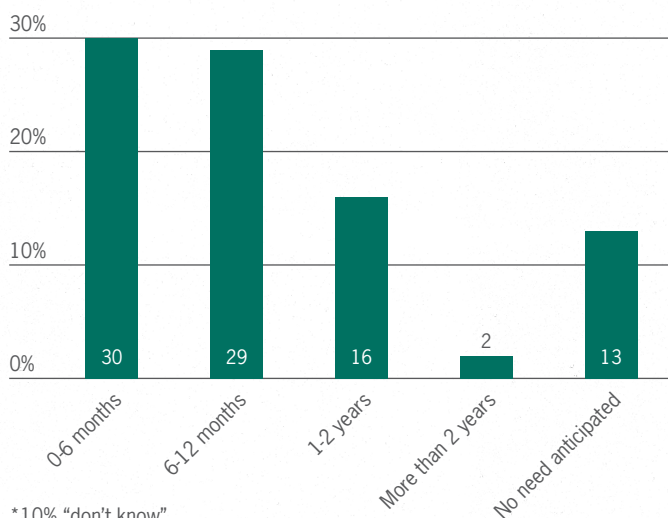
Equity capital markets that have historically supported juniors have been effectively closed to them, contributing to the junior’s downward cycle. This was a function of a reduction in risk appetite from investors.

“The statistics are grim,” said John Kaiser, mining analyst with Kaiser Research Online in The Mining Report. “Of the 1,700 companies we cover, 40% have negative working capital. These are zombie companies, still listed and trading, but in no position to create new wealth. Another 20% have between \$0–\$500,000 working capital. To me these represent good bottom-fishing territory, because the market has already written them off.”<sup>4</sup>

For some mining companies, a rise in M&A and market upturn may come too late. One in 10 junior miners are likely to go into administration, and 16% are likely to halt operations temporarily, according to our survey. And roughly one-quarter of major/other miners anticipate challenges with their debt-to-equity ratio or financial covenants within 12 months.

**FIGURE 1: MINING’S CAPITAL CRISIS**

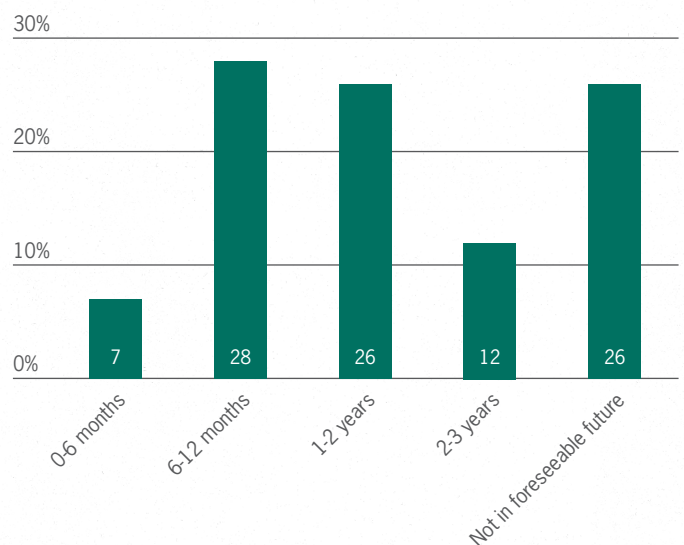
**Junior miners:** Percentage that anticipate need to raise additional funds\*



\*10% “don’t know”

Source: Grant Thornton Global Mining Survey

**Majors/other miners:** Percentage that anticipate need to change capital structure



<sup>3</sup>Major/other miners were categorised as publicly traded mining companies with market capitalisation of US\$500 million or more, or private mining companies with 500 or more employees; all other survey respondents were classified as junior miners.

<sup>4</sup>JT Long, “Mining companies may just have one more year of tough going – Kaiser,” The Mining Report, Mineweb.com, May 14, 2014.

# The good news: optimism may be warranted at last



Miners have to overcome exploration risks to realise cash, so are by nature optimists. Therefore it is not surprising that despite dire straits, our survey found that a majority of junior miners still consider the mining potential in the country of their flagship assets as good. Many believe that specific commodities have high potential in the next 12 months.

Miners with high-potential commodities are in the best position to secure funds, making them attractive M&A targets. Even imperilled miners with shuttered or stalled assets may be attractive M&A targets, but with a wide selection of quality projects available, they will be discount choices for buyers. The attractive M&A targets may not necessarily want to be acquired, since current valuations are still near historic lows. The imperilled miners with idle assets may have no choice. But M&A could be coming to both the imperilled miners and those with high-potential commodities.

How quickly? One-third of mining executives say their companies are likely<sup>5</sup> to acquire a mining company unit, division and/or company by year end 2014. Similarly, another one-third of executives say their companies are likely to be sold or taken over, undergo a partial sale/recapitalisation, and/or sell a unit or division (see figure 2).

**FIGURE 2: PROPORTION OF MINING COMPANIES CITING THAT ACQUISITIONS OR SALES ARE LIKELY**

Source: Grant Thornton Global Mining Survey



<sup>5</sup>Rated 4 or 5 on a scale of 1-5 where 5 equals "highly likely".

This matchmaking balance between buyers and sellers underscores the likelihood of substantial M&A. But there are probably more junior opportunities out there than there are willing and capable buyers, which will lead to choosy acquirers. This together with softer commodity prices will pressure deal values down as vendors compete for the attention of the majors.

The gold industry is representative of the new mining M&A landscape. According to Brien Lundin, editor of *Gold Newsletter*, “The mining industry is facing a three-pronged problem of lower gold prices, higher production costs and a relatively empty pipeline of new projects in development. To counter this, companies will increasingly seek to bolster their production at the expense of their competitors through acquisitions, and to cut overhead through mergers.”<sup>6</sup>

Mining’s inherent risks have not always been attractive to the traditional investment community, especially with regard to financing M&A activity. But that is starting to change. Ken Hoffman, Metals & Mining, Bloomberg Research, said that the mining industry is poised for a turnaround, because valuations are exceptionally low. In addition, private equity funds have raised huge sums to go after the mining space, with plans to hedge their investments and operate for cash. Chinese investors also are likely to continue an aggressive acquisition spree. At its current pace, China will consume two thirds of all mined gold production this year.

*“Some private equity firms are taking a fresh view – they are willing to acquire mining talent and expertise to operate, rather than looking for a quick profit and exit.”*



**Chris Smith**, National mining leader, Grant Thornton UK



<sup>6</sup>“The gold rush for mining M&A coming”. MarketWatch, April 21, 2014.

What may eventually spur mining M&A is that private equity firms are sitting on approximately US \$8 billion of unspent cash. With mining valuations so low amid predictions of resilient demand for raw materials, Michael Rawlinson, co-head of mining and metals investment banking at Barclays Plc, said, “The sand is going through the hourglass, and the money is going to get taken away if they don’t start spending.”<sup>7</sup>

Larger mining companies – based on market capitalisation and the number of active projects in their asset portfolio – are likely to be M&A acquirers (see figure 3) – but not all the larger miners will buy.

*“Many major miners around the globe are sure to be sellers, intending to shed assets to reduce costs and eliminate marginal projects, as their investors have demanded.”*



**Eddie Best**, Business risk services partner, Grant Thornton UK

38% of executives at majors say their company’s primary strategy is to manage fewer core commodities, and 27% will focus on fewer countries of operation.<sup>8</sup>

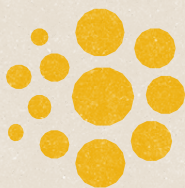
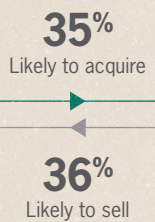
**FIGURE 3: MINING BUYERS AND SELLERS**

Source: Grant Thornton Global Mining Survey

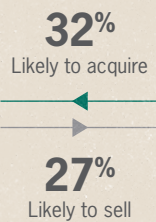
Miners likely to make an acquisition (company and/or unit division) and to sell (company, unit or division, and/or partial sale/recapitalisation)

**Type of mining company**

**Junior miners**

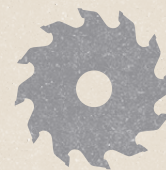
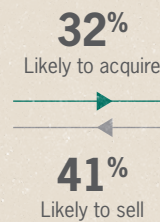


**Major/other miners**

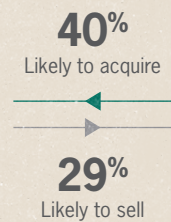


**Active projects in asset portfolio**

**Five or fewer projects**

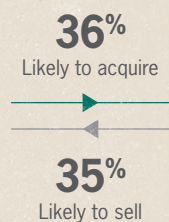


**More than five projects**

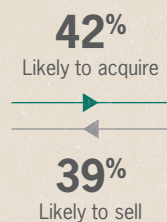


**Market capitalisation**

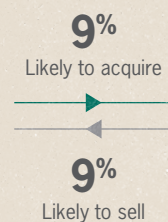
**\$50 million or less**



**More than \$50 million**



**Not publicly traded**



<sup>7</sup>Jesse Riseborough and Ruth David, “Mining’s \$8 billion of private equity seen reviving M&A,” Bloomberg, Feb 3, 2014.

<sup>8</sup>Grant Thornton Global Mining Survey.

# The art of the deal: get mining M&A right

Miners looking to buy will focus on more than just metals and mineral assets. Savvy leaders will assess a target's strategies thoroughly, looking for signs of poor management, bad planning and lack of cost controls – conditions that may have weakened the seller in the first place.

Discovery of these negatives will not necessarily quash a deal (eg management can be replaced if assets are attractive). But mining sector buyers are conducting due diligence with more intensity than ever. Increasingly acquirers insist that executive teams have clear plans for cost reduction, revenue enhancement, technology investments and effective management controls. Executives say that all of these improve day-to-day operations as well as the likelihood of raising additional capital and driving growth (see figure 4).

FIGURE 4: DRIVERS OF MINING GROWTH

Source: Grant Thornton Global Mining Survey





Improved investor sentiment may also drive M&A activity through 2014. When JP Morgan issued a double upgrade in May for the mining sector – from underweight to overweight – it kicked some large-cap mining stocks upward and set a more optimistic tone for the sector for the rest of the year.

According to the bank's statement: "We believe the risk-reward for miners appears better due to strong cost-cutting drives, a huge past repricing in earnings and in performance, especially if near-term data flow picks up." JP Morgan analyst Fraser Jamieson added: "While the remainder of [the second quarter] could lack momentum, we believe this is an opportune time to build exposure ahead of expected outperformance [in the second half]."

Improved commodity prices could drive the M&A market further. For example, after nickel prices rose by 50% into May 2014, BHP Billiton added its Australian nickel assets (potentially worth US\$1 billion) to its mega sale. The world's largest miner by market capitalisation had already netted US\$6.5 billion worth of asset sales over the previous two years, and was looking to further align itself around core competencies and profit strengths.<sup>10</sup>

*"Improved commodity prices, particularly in key minerals required for developing countries, could drive the M&A market further."*



**Simon Gray**, National mining leader,  
Grant Thornton Australia

<sup>9</sup>James Titcomb, "Market report: Boom time for mining stocks as JP Morgan gives sector double upgrade," The Telegraph, May 12, 2014.

<sup>10</sup>Sonali Paul and Richard Pullin, "BHP Billiton in talks to sell Australian nickel business," Reuters, May 14, 2014.

# Manage the details of mining M&A

Miners with an interest in M&A will complete all the customary deal steps: structured bidding process, due diligence, background checks and strategic planning for integration. Yet mining M&A is unusual in that the length of time necessary to explore, prove and develop projects means that the ultimate value of assets may not be known for years.

Our experience of working with mining clients globally shows that buyers and sellers need to pay special attention to the considerations outlined below.

## KEY CONSIDERATIONS FOR BUYERS AND SELLERS IN M&A DEALS



### Mining buyers

Does the deal fit the current profile for the acquirer's commodity portfolio:

- **commodities:** does management have appropriate technical expertise in the relevant commodity?
- **geography:** does the deal align with management expertise and in-country experience?

**Buyers will need to consider** factors when developing a bid, some of which could prohibit a deal altogether:

- **rate of return:** based on existing feasibility studies, how much can the acquired assets be expected to produce and by when?
- **infrastructure:** what are the costs of accessing the site and getting minerals produced from the site to a port or to the customer?
- **regulations:** how restrictive are federal, regional and local laws – for example, on labour rights and sustainability – and where are regulations trending?
- **social/political environment:** how could the current or potential climate negatively affect mine value – for example, in regard to resource nationalism, corruption, labour unrest or in-country beneficiation?
- **management:** how qualified and experienced is the management team?
- **suppliers:** how efficient and cost-effective is the supply base?
- **capital structure:** what is the shareholder structure of the target, and are there any blocking stakes that could prohibit a successful takeover?



### Mining sellers

Mining companies most likely to sell fall into two distinct categories: majors optimising their portfolios, and weakened miners in danger of going under. But any mining company interested in selling will need to exercise caution, given low valuations and volatile commodity pricing.

**Sellers will need to:**

- **position the company in the best possible operational and financial light** for example, prepare a strong information package and resolve any outstanding legal or liability issues
- **formally conduct a valuation assessment** of the company
- **implement financial and legal strategies to minimise tax implications** from a sale
- **develop a strategy** to solicit bidders, evaluate acquirers and negotiate a deal
- **identify post-sale objectives** for the company – for example, future of employees and management, access to intellectual property rights, requirements of ownership – that may be impossible to change once a deal is signed

The lack of available capital for pre-production assets has created a buyer's market for larger, better capitalised players. Vendors achieve balance in this market through the execution of a careful marketing strategy to create value and maximise the probability of success. Buyers achieve balance in this market through a disciplined approach to project evaluation that will focus efforts on the most strategically appropriate transactions and allow for maximised return on invested human resources and capital.

Among the few key features that would make an acquisition target attractive to an acquirer are:

- deal achieves value creation for shareholders – for example, through realisation of synergies, improvement in returns through the combination of contiguous tenements or supply of additional tonnage to improve the efficiency of acquirer's processing plant
- deal is undertaken at bottom of the valuations cycle, particularly where the target company is experiencing financial distress
- diversification of risk through adding projects to the acquirer's portfolio, particularly where there is diversification of commodity focus
- acquirer has the relevant management experience to maximise the potential of the target's project/s.

*“The lack of available capital for pre-production assets has created a buyer's market for larger, better capitalised players.”*



**Jacques Barradas**, National mining leader, Grant Thornton South Africa



---

# Look inward, consider all options

*“There are willing investors that recognise a healthy ‘middle’ of the mining industry.”*



**Jeremy Jagt**, National mining leader, Grant Thornton Canada

The huge volumes of assets for sale by majors, such as Rio Tinto and BHP Billiton, will not all necessarily find new homes. Buyers will need to be large enough to acquire and operate them. Private equity investors and mid-tier firms will be likely suitors for pieces of these large organisations, and they are expected to also pursue acquisitions of juniors, trading scale for manageability.

Even deals that seem to make sense may falter. Chinese companies have bid billions of dollars on acquisitions that have fallen through in recent years, and a deal between the world’s largest gold producers – Newmont Mining Corp and Barrick Gold Corp – collapsed in April 2014.<sup>11</sup>

Mining executives unable to find a partner will explore other financing options. For example, 27% of mining executives are likely to sell one or more material claims/projects. Almost one quarter will restructure their debt.

At the Prospectors and Developers Association of Canada conference in March, executives of junior miners voiced optimism that project-by-project funding was again available as investors seek to strategically fund assets. These leaders said that they had begun to tap equity financing from investors still wary of larger projects and M&A.<sup>12</sup>

“There are willing investors that recognise a healthy ‘middle’ of the mining industry,” said Jagt. “There is an enormous bell-shaped curve of companies in our industry – juniors and majors – that continues to go about their business as usual and has been able to weather lower valuations and commodity pricing as they wait for better days to return.”

These miners have begun to find the cash they need – creating cash internally through business and process improvements and investments to improve the efficiency of their operations – and using those funds to develop existing resources and look for new ones (see figure 5).

*“Some juniors are also pursuing creative financing strategies using hybrid financial instruments, such as earn-in and funding-related joint venture arrangements or convertible notes.”*



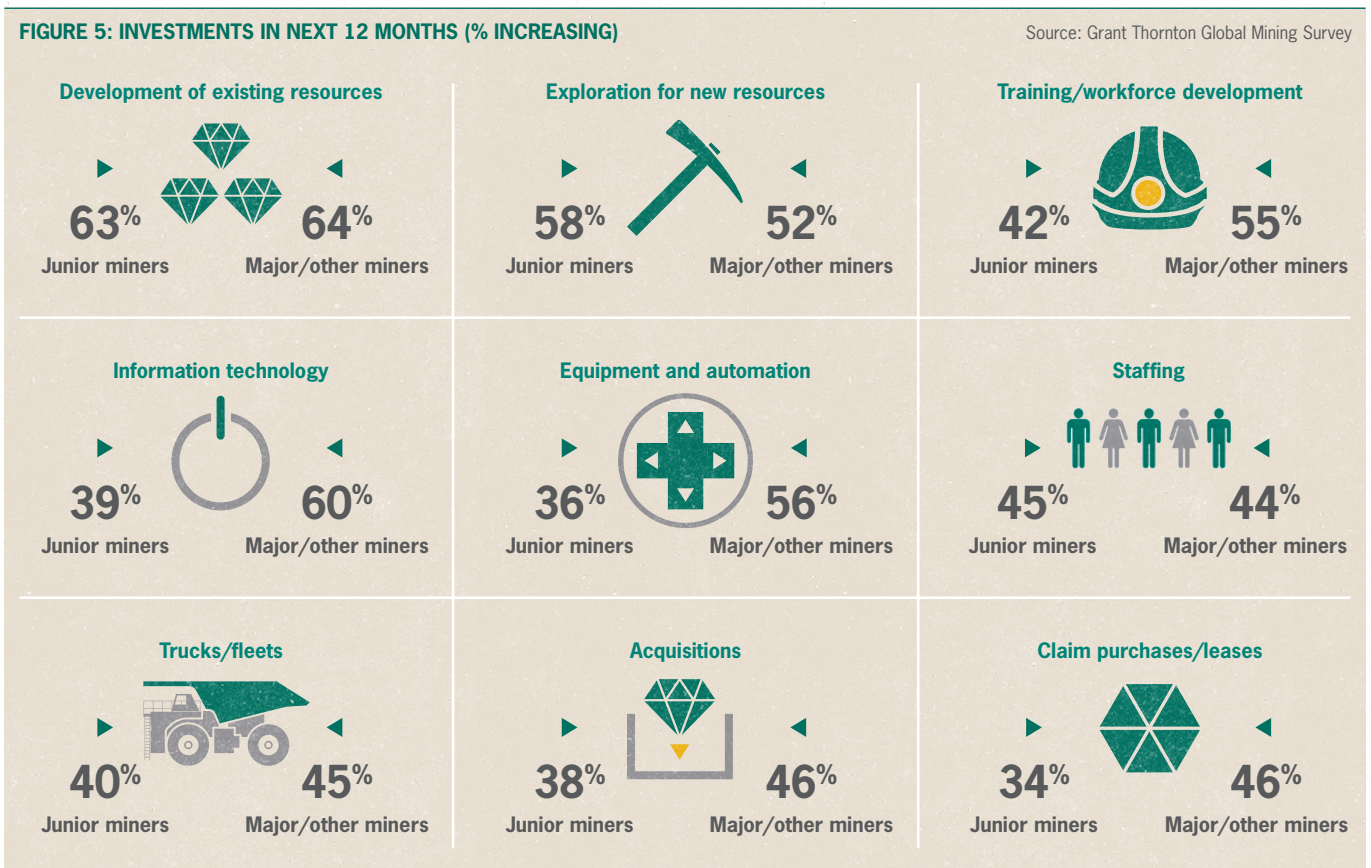
**Mark Wentzell**, Corporate restructuring partner, Grant Thornton Canada

<sup>11</sup>Barrick Gold, Newmont Mining blame each other for failed merger talks, The Canadian Press, April 28, 2014.

<sup>12</sup>Peter Koven, “PDAC 2014: How serious junior miners are separating from the pack in recent M&A turnaround,” Financial Post, March 4, 2014.

FIGURE 5: INVESTMENTS IN NEXT 12 MONTHS (% INCREASING)

Source: Grant Thornton Global Mining Survey



Unfortunately, finding cash continues to be difficult for some junior miners. About half say that limited access to funding is constraining their ability to grow, an obstacle surpassed only by increased government involvement/regulations and volatile commodity pricing. If juniors get the new funding they need, they are most likely to use it for project development (40% of junior miners) and exploration (19%).<sup>13</sup> These companies are doing everything possible to restructure their companies to survive just a little longer.

As Said Jahani, financial advisory partner, Grant Thornton Australia outlined: “Financially troubled mining companies have a number of non-statutory options available to help them get through difficult financial times. At such a time, cash is critical and ways to generate or conserve cash are paramount.”

*“For financially troubled mining companies ways to generate or conserve cash are paramount.”*



Said Jahani, Financial advisory partner, Grant Thornton Australia

<sup>13</sup>Grant Thornton Global Mining Survey.

Many standard cost-cutting and cash-generating measures, around both the profit and loss and balance sheet, should be considered. These could be both general and specific to mining companies:

- **Reduce P&L expenses** wherever possible – cut operational and administrative costs to the absolute necessity. This is usually done in conjunction with a budgeting process, ideally a zero-based budget built up from scratch.
- **Outsource certain operational or administrative functions**, such as payroll, shipping, geological, testing and maintenance functions.
- **Focus diligently on working capital management**, stretch payables, collect accounts receivables, and sell or finance any on-hand inventory.
- **Defer non-essential capital expenditures** or seek out alternatives with smaller initial outlays, such as financing and leasing options.
- **Sell redundant and/or non-core assets.**
- **Sell and lease back equipment** to generate additional cashflow.
- **Request interest or principal holidays** or variations thereof from lenders.
- **Enter into agreements with strategic partners**, including mergers or joint ventures with respect to exploration, development or extraction.
- **Shut down and place on care and maintenance non-cash generating mines.**

To determine which of the above options are most suitable, it is essential that mining companies prepare cash flow projections, budgets and business plans. Once prepared, analysis of the cash requirements and expected inflows over the short term will allow executives to determine their companies' needs and assist with the appropriate decisions.

Many junior mining companies are already doing all they can to conserve limited cash resources. Non-operating mines and projects have been placed into "care and maintenance" and all non-essential expenditures, capital and operating expenses, have been cut to the bone. Lenders and financiers have been lobbied to lend and extend as much as possible. Interest and principal holidays are also a common request.

The existing lenders have reached their limit for some junior mining companies. Junior companies may

also have reached the end of their cash resources and ability to obtain new financing. Aside from consensually handing over the assets to the lenders, the only viable options are formal insolvency proceedings.

Depending on the jurisdiction, there may be protective statutory options available to the mining companies similar to the Companies' Creditors Arrangement Act in Canada or Chapter 11 in the United States. Under formal restructuring options, mining companies may be able to obtain protection from their creditors. This will provide them with an opportunity to restructure and may include the ability to: obtain refinancing; conduct an orderly sale of their assets; compromise their debts or make arrangements with creditors and other stakeholders that would not be available otherwise.

As the formal options available can vary dramatically depending on the jurisdiction, mining companies facing financial challenges should seek accounting and/or legal advice as soon as possible to determine the options available to them. Contacting a restructuring professional early in the process usually provides the mining company with the expertise to identify and investigate more options for tackling their financial issues.

Although such moves can create existential threats to many, they do hold the promise of creating a more stable mining company and, ultimately, helping to create a more resilient mining industry. None of this, arguably, would have happened without a market correction and weeding out of weak players.

---

# Take full advantage of the mining turnaround

Better days are approaching for miners of every size – although the opportunities vary by commodity, region, and corporate structure. To take full advantage of the impending turnaround, savvy mining executives will seek guidance regarding:

- **Potential M&A:** position their businesses as attractive buyers or sellers given their financial stability, assets, commodity pricing and valuations.
- **Access to capital:** develop strategies to get required funding now, exploring alternative sources – such as, streaming or the bond market – if necessary.
- **Management quality:** drive cost efficiencies and productivity improvements, which enhance the likelihood of funding or optimal valuations.

Every mining company can benefit from a fresh perspective. For more information visit:

[www.grantthornton.global](http://www.grantthornton.global)

# About us

Grant Thornton is one of the world's leading organisations of independent assurance, tax and advisory firms. These firms help dynamic organisations unlock their potential for growth by providing meaningful, forward looking advice. Proactive teams, led by approachable partners in these firms, use insights, experience and instinct to understand complex issues for privately owned, publicly listed and public sector clients and help them to find solutions. More than 38,500 Grant Thornton people, in over 130 countries, are focused on making a difference to clients, colleagues and the communities in which we live and work.

## Contacts

### Africa

<b>Vijay Kalyanaraman</b>	Botswana	T +267 395 2313	E vijay.kalyanaraman@bw.gt.com
<b>Adrien Degbey</b>	Gabon	T +241 07 63 72 55	E adrien.degbey@ga.gt.com
<b>Amadou Barry</b>	Guinea	T +224 6262 1303	E amadou.barry@gn.gt.com
<b>Mostapha Coulibaly</b>	Ivory Coast	T +225 22 42 66 50	E moustapha.coulibaly@ci.gt.com
<b>Dev Pydannah</b>	Mozambique	T +258 21 311 937	E dev.pydannah@mz.gt.com
<b>Thomas Newton</b>	Namibia	T +264 61 381 200	E tnewton@gtneuhaus.com
<b>Jacques Barradas</b>	South Africa	T +27 11 322 4715	E jacques.barradas@za.gt.com
<b>Constant Awesso</b>	Togo	T +228 22 25 87 74	E constant.awesso@tg.gt.com
<b>Christopher Mulenga</b>	Zambia	T +260 0122 7722	E cmulenga@gt.com.zm
<b>Tinashe Mawere</b>	Zimbabwe	T +263 44 42 511	E tinashe.mawere@zw.gt.com

### Americas

<b>Jeremy Jagt</b>	Canada	T +1 416 360 2369	E jeremy.jagt@ca.gt.com
<b>Esteban Uriostegui</b>	Mexico	T +52 55 5424 6500	E esteban.uriostegui@mx.gt.com
<b>Jose Luis Sarrio</b>	Peru	T +511 615 6868	E joseluis.sarrio@pe.gt.com
<b>Anand Beejan</b>	Québec	T +1 514 393 4802	E beejan.anand@rcgt.com
<b>Patrick Gable</b>	United States	T +216 858 3537	E patrick.gable@us.gt.com

### Asia Pacific

<b>Simon Gray</b>	Australia	T +61 8 8372 6620	E simon.gray@au.gt.com
<b>Holly Stiles</b>	Australia	T +61 8 9480 2111	E holly.stiles@au.gt.com

### Commonwealth of Independent States

<b>Yerzhan Dossymbekov</b>	Kazakhstan	T +7 727 3111340	E yerzhan.dossymbekov@gtkaz.com
<b>Elena Dmitrieva</b>	Russia	T +7495 258 99 90	E elena.dmitrieva@ru.gt.com

### Europe

<b>Maria Thuresson</b>	Sweden	T +46856307388	E maria.thuresson@se.gt.com
<b>Eddie Best</b>	United Kingdom	T +44 (0)20 7728 2849	E eddie.j.best@uk.gt.com
<b>Chris Smith</b>	United Kingdom	T +44 (0)20 7728 3446	E chris.smith@uk.gt.com



**Grant Thornton**

An instinct for growth™

© 2014 Grant Thornton International Ltd. All rights reserved.

"Grant Thornton" refers to the brand under which the Grant Thornton member firms provide assurance, tax and advisory services to their clients and/or refers to one or more member firms, as the context requires. Grant Thornton International Ltd (GTIL) and the member firms are not a worldwide partnership. GTIL and each member firm is a separate legal entity. Services are delivered by the member firms. GTIL does not provide services to clients. GTIL and its member firms are not agents of, and do not obligate, one another and are not liable for one another's acts or omissions.

[www.grantthornton.global](http://www.grantthornton.global)

EPI092