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The expert's guide to alternative financing

The economic crisis means mining companies will have to get more creative in finding non-traditional routes to financing, investment bankers and consultants warned at a recent MineAfrica seminar on mining and the financial crisis.



BY TRISH SAYWELL

"We are turning every stone we can to raise money for these companies," Daryl Hodges, senior managing director of investment banking at Jennings Capital told the Toronto gathering of mining executives on Jan. 13. "This struggle for money is going to go on for quite a bit longer. . . we are in for a long haul."

And with analysts on the buy-side re-rating risk and re-pricing juniors, things are becoming even more difficult as funding for the smaller companies has all but dried up.

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Daryl Hodges, senior managing director of investment banking at Jennings Capital, covers financing strategies for cash-strapped mining companies during a recent MineAfrica seminar in Toronto.

MINEAFRICA

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"The cost of equity capital is the highest we've seen it," Hodges declared — especially for base metal companies that are risking extreme dilution. Even the gold companies, which are still in favour, are raising smaller amounts at the low-end of their one-year trading ranges. As examples Hodges cited **Yamana Gold** (YRI-T, AUYN), which raised US\$100 million at US\$6 per share for 3% dilution. (Its 52-week range is US\$4.29-19.79).

Others have included **Semafo** (SMF-T, SEMFF-O), which raised US\$23 million at US\$1.20 per share for 10% dilution. (Its 52-week range is 75¢-\$1.72), and **Mercator Minerals** (ML-T, MLKFF-O), which raised US\$23 million at 70¢ per share for 56% dilution. (Its 52-week range is 29¢-\$12.94).

The overriding message from conference participants: If you have to go out and raise money, think out of the box when you do it.

Speakers identified a number of alternative sources, including export-import agencies, royalty deals, flow-through shares, offtake agreements with strategic partners, and forward sales contracts for resources still in the ground.

Hodges of Jennings Capital noted that companies could consider flow-through shares as one option, citing **Denison Mines** (DML-T, DNN-X) as an example. Last month the company brought in US\$8 million from a flow-through private placement. The bulk of the proceeds will go towards exploration in Saskatchewan.

"Denison did a decent one and they traditionally wouldn't have done one," Hodges said. "It keeps things moving."

If you're in a situation where you are closer to production, Hodges continued, offtake agreements with strategic investors might also be a way to stay afloat.

"Metal trading companies will help finance projects," he said. "Look at strategic investors in China, India and Brazil."

As examples, he cited **Copper Mountain Mining's** (CUM-T, CPPMF-O) memorandum of understanding with **Mitsubishi Materials**. In October, Mitsubishi agreed to purchase a 25% stake in the Vancouver-based company's

Copper Mountain project in exchange for \$28.75 million, a \$250-million project loan, and a contract to purchase all of the mine's future copper concentrate (about 150,000 dry metric tonnes per year) for the first decade of production.

The same month, **New Millennium Capital** (NML-V, NMLNF-O) struck a deal with Tata Steel Global Markets of Singapore, a subsidiary of India's **Tata Steel**, the world's sixth-largest steelmaker.

Under that arrangement, Tata acquired a 19.9% stake in New Millennium's direct-shipping iron ore project for \$23.53 million. The money will be used to complete a feasibility study by the second quarter of 2009.

Forward sales have also become quite common and are likely to grow in popularity as the downturn continues to bite. "As time goes on and things get tougher, we'll see exploration companies considering forward selling off forward revenue streams," Hodges said.

In June 2008, Mercator Minerals agreed to sell **Silver Wheaton** (SLW-T, SLW-N) life-of-mine silver production from Mineral Park, its open-pit copper-molybdenum mine in northwestern Arizona, about 74 miles southeast of Las Vegas. Mercator earned US\$42 million in cash in the deal and said the money would pay for the second stage of construction of milling facilities.

Royalty companies are another option for companies struggling to stay in business.

In June 2008, **FNX Mining** (FNX-T, FNXMF-O), essentially a nickel-copper producer, agreed to sell 50% of its contained gold, platinum and palladium metal to **Gold Wheaton** (GLW-V, GLWGF-O) for about US\$400 million.

"Byproduct metals can get some nice upfront cash," Hodges said. "You give up something but it's a way to finance that people haven't really thought about."

James Kofman, vice-chairman of UBS Securities Canada, agreed. "Royalty companies are in business and they will finance you — this is the kind of market they love — and I would encourage companies to think about that alterna-

tive," he said.

But unlike many in the industry, Kofman refused to rule out the equity markets as a funding route.

"It's a mistake for companies to say they don't want to resort to equity financing at such low share prices and that they will wait for a turnaround," he argued. "If there is something that might be in your future — which could be company-ending — and you have access to equity now, take it even though it's expensive."

Kofman also said he believes that contrary to mainstream views, mergers and acquisitions will be slower this year.

"No management team we've talked to would rationally decide to sell its business or assets today," he explained. "This is one of the worst markets anyone has ever seen. The only reason you'd sell is because you have to, or someone has made a premium offer that is off the charts."

Kofman doesn't think M&A will pick up until companies think they have passed the bottom. "No one wants to be buying and three or six months later find out markets continue to deteriorate and their acquisition looks stupid," he said.

At a time when oil is trading at below US\$40 per barrel and everyone should theoretically be buying, he added, "they all go into their caves, hoard their cash, and don't want to look foolish. M&A activity is unlikely to take off like people expect it will until we're more broadly through this crisis."

High-yield and convertible debt is another option, but one has to be very careful about using it. And with not much more than a 15% premium for convertible debt, experts like Hodges of Jennings Capital, aren't recommending it.

As for high-yield debt, Hodges said, if you do need to take advantage of it, "make it as a bridge but don't get caught. If you have to go down this route, give yourself some flexibility."

In the past, Hodges noted, you could get away with some unsecured high-yield debt but that isn't going to happen right now because lenders are looking for secured debt.

Ted Kavanagh, director of investment banking at Standard



MINEAFRICA

A recent full-day MineAfrica seminar in Toronto featured industry experts covering a wide range of topical issues for surviving the current financial crisis, and drew an audience of 110 delegates.

Bank, South Africa's largest bank, urged executives attending the conference to look at export credit agencies as a potential source of funding.

"Traditionally, they have been viewed as a necessary evil... (and) not that easy to tap into," he conceded. "But the fact is they're very serious lenders. . . They have a lot of money to lend and they are quite happy to lend it."

As proof, he cited the US\$76.5 million in project finance money **Barrick Gold** (ABX-T, ABX-N) received from the Export-Import Bank of the United States to help build its Veladero gold mine in Argentina's San Juan province.

Banks aren't comfortable with project risk, he added, and companies need to be conservative. "We are not lending against resources, we want an adequate reserve tail."

In his presentation, Kavanagh talked about the evaporation of new money and the huge step-up in margins for debt facilities. "LIBOR is a fiction these days," he said. "Banks aren't able to borrow at LIBOR, they're borrowing at the cost of funds."

Kavanagh also urged executives

not to put "all their eggs in one basket" when it comes to making overtures to banks and warned that now is not the time for companies to try to get banks on board with technologies that aren't "tried and true."

Other advice came from Lee Hodgkinson, a partner and chairman of KPMG's Global Mining Group. Hodgkinson emphasized that mining companies should concentrate on preserving every bit of cash they can.

"Stretch your suppliers to the degree you can," he urged. "Minimize commitments, renegotiate contracts . . . Talk to bankers, lenders see if you can consolidate your debt."

Matt Tedford, partner in transactions at KPMG pointed out that companies must really know their financial partners well and said it was imperative to know where your cash is.

"You need to know where your funding shortfalls are," he concluded. "It's best to take a look at each mine site, each country, understand where the cash is, what currency it's in, and do your planning around that, not on a consolidated basis."