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## Dig Into Mining Sector For Deal Opportunities

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In recent years, despite continued demand from China, margins have been squeezed for mining and metals companies due to a fall in commodity prices and rises in operating and capital costs.

The traditional sources of funding for the sector such as IPO and debt financings have been reduced (or are otherwise prohibitively expensive) – particularly for high-risk projects – so it is likely that alternative financing sources will emerge, including private equity funds looking to participate in returns.

While buyout firms have increasingly targeted mining since 2012, only about 14% of the almost \$10 billion raised in the last two years has been deployed. The huge cash piles available, coupled with a renewed interest for PE investment by the sector itself, has led many to speculate that mining and metals might soon see a flurry of investment in a few key areas, especially considering the restriction on traditional sources of funding. Although PE funds have shown a growing interest in making “pure play” commodity investments it is likely that they will only invest mining projects where infrastructure solutions for transporting product already exist or are funded. Since the largest

mines and newest projects tend to be located in remote areas in developing countries, while smelter and refinery productions are in developed countries, the need for infrastructure is vital.

Further, since the value of the investment will depend largely on the fluctuating price of metals, any investor will be cautious when investing in “pure-play” firms. The exception may be for high value metals such as gold, which benefit from continuing, non-industrial, demand from India and China. In the post-credit crunch period, many large mining firms are focusing on divesting certain non-core assets to raise cash and to refocus on their core business. The lowest-risk, highest-quality projects have been the focus, with Australia (having strong mining areas and stable governments) increasing its estimate for iron ore exports for the fiscal year 2013-14 to 650 million tonnes. Vale, Rio Tinto and BHP Billiton have all announced divestment plans.

As a result of these asset sales, there are growing opportunities for PE funds which have the capital and possibly the expertise to restructure, leverage and/or operate such non-core mining projects more efficiently. It is estimated that there are about 5,000 juniors in the mining industry, many of which operate a single mine

or project. Traditionally, one of the most common exit routes for juniors has been acquisition by a major mining company. However, given the focus of large majors on divestments and capital expenditure reductions, exit opportunities are restricted. PE funds may be able to provide an alternative source of necessary capital. The low valuations for junior exploration companies may make them attractive targets for PE, with the potential for a significant rise in value in a mine if a good deposit is proven or if there is an expectation of an uplift in the relevant commodity price.

The mining and metals sector may present an attractive opportunity for PE funds, however both mining companies and PE firms will be under pressure for greater transparency and from continuing risks, including regulatory obstacles, resource nationalism, infrastructure solutions and currency volatility.

While PE funds will seek to invest for a pre-determined time only, it is arguable that structural barriers will present difficulties for exit – particularly in emerging markets. PE funds will need to build strong relationships with management (and in certain circumstances governmental authorities too) in order to align stakeholder interests and exercise control on exit.