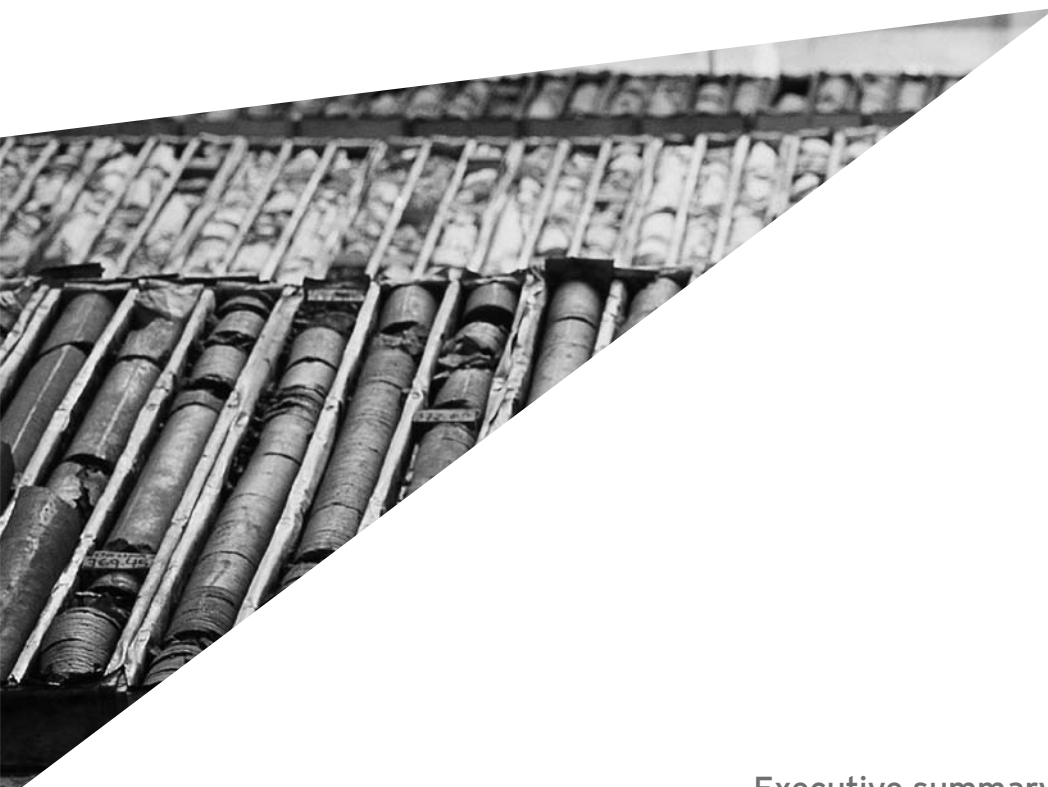


The year of the hunters and the hunted

The mining and metals global transactions survey



Executive summary

2007 provided another record year for transactions in the mining and metals sector. High commodity prices against a background of under-investment in exploration and development, and the long lead time for new projects, has resulted in a continued drive for growth.

Valuation and due diligence have been highlighted as key factors in determining the success of a transaction; the consistent message being that the importance of a robust due diligence process should never be underestimated. Valuation methodologies need to be dynamic and innovative in order to identify value, which traditional techniques may overlook.

The drive for expansion by traditional acquirers, vertical integration and resource security concerns of new players, have increased competition for assets and driven up prices. Given this context, the accurate assessment of both the risk and value of a potential transaction is paramount. Increased competition has also pushed many mining and metals companies into riskier regions, where they are required to take on projects with greater associated risks. Transaction success is intrinsically linked with those that best understand and manage these risks. Fundamental changes to the pricing of commodities has further challenged the valuation process in transactions, with commodity forecasts consistently being below actual prices achieved. Determining the value of long term assets is becoming increasingly difficult and requires valuation techniques of greater sophistication.

As companies are paying more for assets, it is crucial that they realize the true asset value. Integration is highlighted as key to this, and sufficient planning for integration, both in time, money and resources, is paramount.

The appetite for further transactions is strong, the sector is cash-rich, resource security concerns are inspiring new acquirers and the 'credit crunch' is providing new challenges for existing players. New hunters are joining the old to stalk the prey. 2008 will be the year that defines the Hunters and the Hunted.



In late 2007, Ernst & Young carried out a number of telephone interviews with many of the top 40 global mining houses. This report represents their views on the key challenges and issues involved in making deals in this period of strong commodity prices and sustained commodity demand. The ideas they have expressed provide us with leading practices for deal teams executing transactions, especially around areas such as valuations, transactions integration, and risk management.

2007 headlines

Merger and acquisition drivers

- ▶ Forty percent of respondents can only meet their growth targets by way of acquisition.
- ▶ Thirty-two percent have improved their risk profile geographically or by commodity.
- ▶ Twenty-four percent stated vertical integration as a goal either to protect upstream supply chains or help contain costs such as energy.

Transactions activity

- ▶ Ninety-six percent indicated that they had undergone growth transactions in the past 24 months with 87% indicating that this activity would continue.
- ▶ Eighty-one percent have been involved in divestment activity driven by the good prices available, new buyers such as private equity in the market and the need to divest non-core assets or raise capital to help fund further acquisitions.
- ▶ Many respondents cited their lack of experience of divestments and their disappointment with the subsequent value realised. Many feel that they could perform a lot better in this area.

Deal funnel

- ▶ The internal corporate development function is seen as the principal source of deal opportunity with commodity business units contributing in 50% of cases.
- ▶ On average, respondents considered 18 transaction opportunities in the past year with an average of two making it to completion.
- ▶ Increased competition for assets and the consequent impact on value issues was seen as the major reason for not completing a transaction.



Transaction risks

- ▶ Political risk, appropriate valuation and human resource risk are seen as the main challenges to getting a deal done.
- ▶ Factoring these risks appropriately into the valuation is seen as one of the major shortcomings of the valuation techniques that most acquirers use.
- ▶ Whilst political risk is important, 43% of those surveyed still stated there were no regions which would be avoided.

Valuation challenges

- ▶ The majority of respondents use discounted cash flow as their primary valuation tool but many cite its inadequacy in dealing with many of the risks, its failure to deal with long life assets and strategic option value.
- ▶ More than 40% use external experts' assumptions on commodity prices even though they have tended to underestimate the actual outcome and led to conservative valuations.
- ▶ Deal metrics are generally simplified for board approval to speed up the process, without measurement of risk or strategic value.

Transaction integration

- ▶ Many respondents understand the need to plan integration as early as possible. Thirty percent of respondents felt it took more than six months to fully integrate their acquisitions.
- ▶ Fifty-five percent and 68% respectively agreed that in most cases their acquisitions had increased their organizational capability and shareholder returns.
- ▶ Where integration problems have occurred, 36% said that they had lacked an effective communications plan, 29% had not properly managed their integration resources, 25% lacked proper contingency planning and 21% said they had not pre-planned their integration strategy at all.

Transaction success

- ▶ The key financial measurement of success is seen as return on investment.
- ▶ Non-financial metrics such as timing, transaction conversion, turnaround, reserve, resource additions, and the benefits of integration are also seen as important.

Transactions insights

- ▶ Forty-six percent of respondents noted that turnaround time or integration costs were underestimated.
- ▶ Forty percent felt that their due diligence had been insufficient.
- ▶ Fifty percent of respondents said they had learnt from their unexpected post-acquisition experiences and had now taken measures to expand their due diligence teams with appropriate experts, put greater emphasis on their valuation techniques, and commenced integration activities well before control of the target was achieved.

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