

Mergers, acquisitions and capital raising in mining and metals

1H 2014



EY

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Subdued first half but momentum is gathering

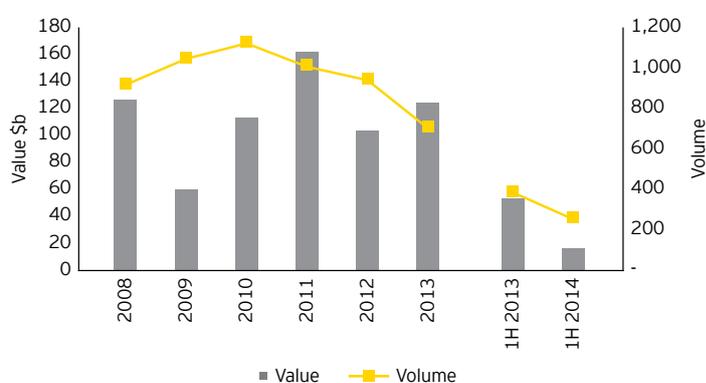
M&A and capital raising activity remained subdued over 1H 2014, largely the consequence of a continuing commitment to capital discipline and a lack of urgency over investment, given the relative lack of competition for assets. Improving signals of economic growth in the US and the apparent subsidence of a looming emerging markets crisis have lowered broader market volatility but failed to offset ongoing concerns surrounding growth in China and further near-term commodity price volatility.

As a result, the mining and metals industry lags a broader confidence revival in equity markets, while price weakness continues to place stress on certain sectors of the industry, despite considerable efforts by management to strengthen balance sheets and improve margins and returns.

For those brave enough to invest against the cycle, there would appear to be good buy-side opportunities, albeit driven from a place of distress and opportunism, rather than out-and-out growth-seeking. The prospect of large-scale M&A remains unlikely for those looking to win back the hearts and minds of investors, such as the industry's majors.

But as we look ahead to the remainder of 2014, some standout deals and hostile bids over the first half, combined with a strong deal pipeline and substantial capital waiting to be deployed by mining-focused funds, suggest that momentum is building. The recent and relatively rapid rise in the share prices of major mining and metals companies, on the back of improving base metals and gold prices, may prove to be a catalyst.

M&A value and volume (completed deals, 2008-1H 2014)



Capital raising by asset class, 2008-1H 2014

Proceeds \$m	2008	2009	2010	2011	2012	2013	1H 2013	1H 2014	YoY change
IPOs	12,406	2,987	17,948	17,449	1,388	815	459	1,168	154%
Follow-ons	48,751	73,806	49,705	49,745	25,950	26,233	11,222	10,378	-8%
Convertibles	12,238	14,431	5,477	2,365	3,537	7,738	5,799	505	-91%
Bonds	38,146	61,016	72,502	83,804	112,539	87,890	55,563	34,567	-38%
Loans	171,691	62,420	183,875	187,059	105,981	148,881	94,651	95,263	1%
Total	283,232	214,660	329,507	340,422	249,394	271,557	167,694	141,881	-15%

Note: The data includes completed deals only and is primarily sourced from ThomsonONE. \$ refers to US dollars.

Mergers and acquisitions in 1H 2014

Global mining and metals deal activity falls, but sector outlook remains positive

A continued downward trend in M&A values and volumes suggests 2014 is shaping up to be another “wait and see” year. Much of the industry remains focused on optimization of existing assets, while uncertainty surrounding near-term commodity prices is likely to keep deal values and volumes subdued. But the recent emergence of competitive hostile bids and narrowing price expectation gaps suggests the market believes that we have passed the bottom of asset pricing and that the time will soon be right to commence strategic buying.

Mining and metals deal values in 1H 2014 are down 69% year-on-year, to \$16.7b from \$53.8b, with deal volumes down 34% over the same period. So far this year, we have only seen 4 megadeals (>\$1b), compared with 11 in the same period in 2013. Furthermore, 87% of first-half deals were valued at less than \$50m, but comprised less than 9% of total deal value.

Divestments feed the pipeline

Major diversifieds continue to consider divestments as a way of reducing debt, maximizing return on capital and driving value across the portfolio. This year Rio Tinto completed the sale of its Clermont coal assets for \$1.02b, while Glencore’s disposal of Las Bambas to MMG Limited is expected to complete in August. Anglo American also announced plans to divest up to \$4b worth of assets, including its strike-affected platinum mines in South Africa and its Chilean copper mines.¹

However, with balance sheets largely stronger on the back of capital management, the urgency to divest has diminished and management can afford to focus on achieving an optimal exit for non-core assets. The market is speculating that BHP Billiton may divest its aluminium, nickel and bauxite assets, potentially worth \$20b.² Kazakhmys also announced plans to transfer some of its underperforming assets into a private company to help improve running of the operations and return cash to shareholders.³

Depressed steel market drives activity

Overcapacity and lack of clarity around global demand growth continue to pose a challenging environment for steel, metallurgical coal and iron ore, which could lead to increased deal activity in these commodities. As weaker steel producers struggle to stay afloat, stronger operators are likely to take advantage of their distress, buying up assets and using scale to focus productivity on higher-margin capacity. More steel makers may consider divestment or possibly acquisition of downstream assets to reduce their exposure to the steel outlook. The acquisition of ThyssenKrupp’s North American operations by ArcelorMittal and Nippon Steel and Sumitomo in February 2014, for example, was largely aimed at strengthening their North American operations and consolidating their positions in the growing automotive metal market.

1. “Anglo American plans radical £2bn sell-off,” *The Sunday Times*, 29 June 2014.

2. “BHP eyes \$20b demerger,” *Australian Financial Review*, 1 April 2014.

3. “Kazakhmys pushes ahead with de-merger plan,” *MineWeb*, 23 July 2014.

Joint ventures to mitigate risks

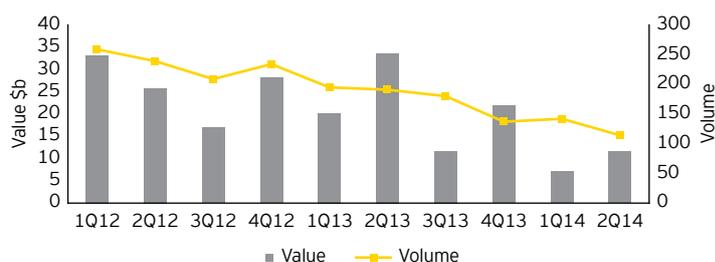
We may see more joint ventures and mergers in an effort to consolidate positions, achieve synergies and weather the continuing market uncertainty. Barrick Gold and Newmont Mining, for example, were in merger discussions earlier this year. While discussions were terminated, both companies agreed that the merger of their Nevada assets would be value-accretive, through synergies and rationalization of the combined assets.⁴ This year's largest deal so far was a joint venture between Yamana Gold and Agnico-Eagle Mines to acquire Osisko Mining, in a deal that complements both companies' existing North American interests and secures access to Canada's largest gold mine.

Many trading houses are actively selling their stakes in underperforming assets while still pursuing new joint ventures and alternative investment options in the mining space. Itochu and Sumitomo, for example, are looking to dispose of their Newland Collinsville and Abbots Point projects, while Sumitomo recently formed the GS Coal joint venture with Glencore to purchase Rio Tinto's Clermont assets. Noble Group has committed to reducing its direct interests in commodity production through the sale of assets but remains indirectly involved, sharing the risk by joining forces with resource-focused investment vehicles such as X2 Resources and EIG Global Energy Partners.

Outlook

We expect deal making to pick up from current levels, but with a continued focus on low-risk transacting for the remainder of 2014. The industry is waiting for some commodity price stability before taking any adventurous steps, so the next half year may prove to be a waiting game. However, the emergence of competitive bids and execution of deals in the now-strong pipeline should drive momentum, instilling some renewed confidence that there are valuable gains to be had through mergers and acquisitions.

Deal values and volume by quarter



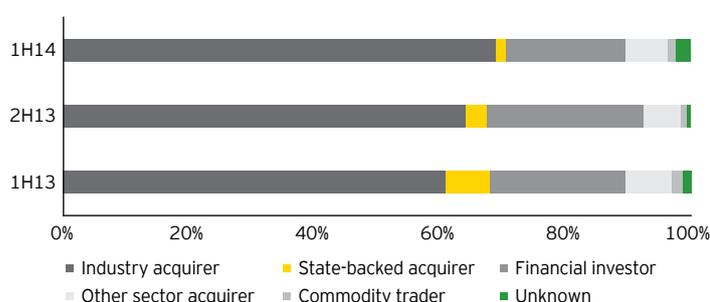
Who's buying?

- ▶ Industry acquirers continue to undertake the majority of deals, and acquisitive activity by financial investors was down slightly in 1H14 compared to the previous quarter. However, financial investors and participants from outside of the industry remain heavily invested in the mining and metals sector, accounting for just under a third of deal volumes in 1H 2014. The much-anticipated influx of substantial capital from new mining-focused private funds is taking longer than expected to hit the market, and contributors to these funds are unlikely to wait much longer to see their investments put to use. There should be a flurry of activity within the next 6-12 months, as these countercyclical investors who have been waiting for clear signs that we are at the bottom of the market begin to make their move when assets prices are at their lowest.
- ▶ The volume of activity between explorers at the lower end of the price spectrum reflects distress, with many including exploration equipment as part of the sale. Consolidation may be sought as a means to improve access to finance.

4. "Why the Barrick Newmont merger makes sense," *Forbes*, 27 May 2014.

Outlook: Distressed selling may lead to opportunistic buying, particularly by mining-centric funds. The majority of industry players are unlikely to undertake large-scale acquisitions in the near term, given their continued focus on capital management and discipline.

Share of deal volumes by acquirer type



31%

of deals were undertaken by investors from outside of the mining sector

\$8b-\$10b

is the estimated value of private capital available to the mining industry⁵

What are they buying?

- ▶ **Commodity appeal:** Activity across all commodities was subdued on continuing volatility in commodity prices, but the common “buying” theme was distress, with coal and steel briefly taking the lead in terms of Q1 2014 deal value due to underperformance of the sector.
- ▶ **Gold still shines:** Gold continues to stand out as the most targeted commodity, capturing over a third of deal volume in the first half of the year. We are seeing opportunistic buying at the lower end of the gold market and consolidation at the higher end as producers seek cost savings and economies of scale.
- ▶ **The deal with steel:** One-off large steel deals in 1H 2014 do not necessarily reflect increased confidence in the sector, while continued weakness in iron ore and coal prices, along with uncertain Chinese demand, is limiting the appeal of investment in these segments. Two of the year’s largest steel deals, for example, were the re-nationalization of troubled steelmaker SIDOR by the Venezuelan Government and the reacquisition of Acciai Speciali Terni by ThyssenKrupp.
- ▶ **Offloading coal:** Several coal assets are likely to hit the market as the outlook for oversupply remains grim. The top three coal deals in 1H 2014 were divestments, driven to return value to shareholders. Rio Tinto recently announced the disposal of its Mozambique coal assets for \$50m, having previously spent \$3.9b on the project in 2011.⁶ Mechel,⁷ Severstal⁸ and Tata Power⁹ (part of the Tata Group) have all announced decisions to sell stakes in their coal assets.

Outlook: We anticipate increased interest in nickel and copper assets, driven by an improved commodity price outlook, Asian investors looking to secure supply and divested interests from the majors. Further coal and iron ore projects may be put up for sale on the challenging supply/demand outlook, particularly across North America.

5. “Mining’s \$8 Billion of Private Equity Seen Reviving M&A,” *Bloomberg*, 3 February 2014.

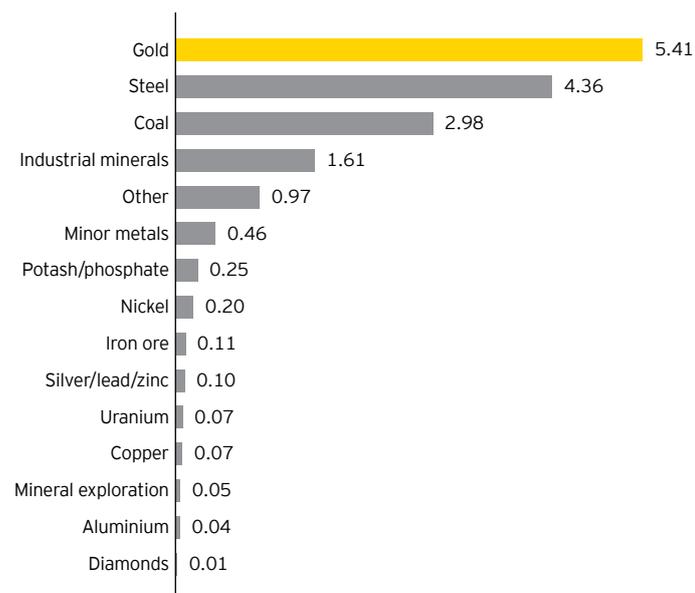
6. “Rio Tinto sells Mozambique coal assets for US\$50 million,” *Sydney Morning Herald*, 30 July 2014.

7. “Mechel seeks \$1 billion for coal stake from Asia Bid to cut debt,” *Bloomberg*, 26 February 2014.

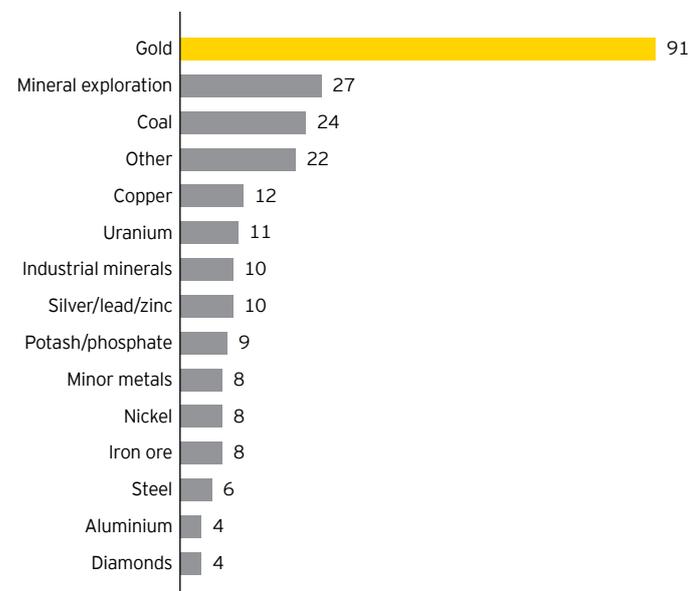
8. “Russian steel giant Severstal is selling its US plants for \$2.3 billion,” *Business Insider*, 21 July 2014.

9. “Tata Power signs option agreement to sell 5% stake in KPC coal mine,” *Business Standard*, 5 July 2014.

Value of deals by target commodity, \$b



Volume of deals by target commodity



35%

The share of total deal volume taken by gold acquisitions since the beginning of 2012

\$4b

The value of acquisitions targeting industrial minerals (such as graphite and potash) since the beginning of 2013

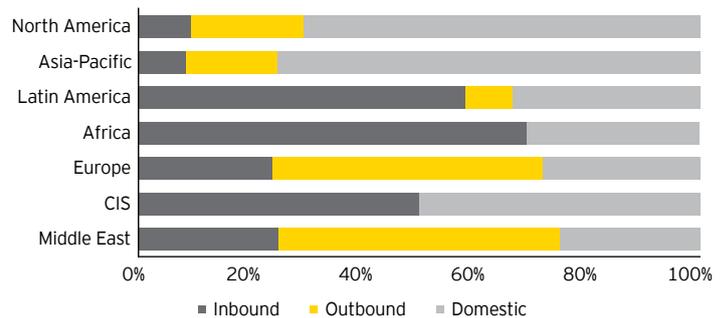
Where are they buying?

- ▶ **Hot regions:** North American companies continued to be the most active players during 1H 2014, with 51% of deal volumes involving the US or Canada as either the target or acquirer. Economic confidence in North America has created a slightly more positive environment with which to generate domestic synergies rather than looking abroad. There is also a significant amount of distressed selling in the coal, iron ore and gold sectors in North America as explorers struggle to secure the capital to advance early stage projects and majors look to streamline and monetize nonessential assets.
- ▶ **China advancing abroad:** China is expected to increase its cross-border acquisitive activity on the easing of the approvals process for overseas deals under \$1b by the new Government in May 2014. The country has also been the source of several large pending deals in 1H 2014 in the copper and iron ore space, two of its chief imported commodities. MMG Limited has agreed to the acquisition of Glencore's Las Bambas copper mine in Peru for an estimated \$5.85b,¹⁰ while Baosteel is working with consortium partner Aurizon to acquire the \$1.3b iron- and coal-focused Aquila Resources in Australia.¹¹ Chinalco has also signed on with Rio Tinto as a partner in a \$20b iron ore project in Guinea.¹²

- ▶ **Developing vs. developed:** There is a continued trend away from potentially costly emerging markets in favor of lower risk deal-making in developed economies. Latin America and Africa were the targets of less than 10% of deal volume in 1H14. Forays into emerging regions will be limited to well-developed assets (such as the Las Bambas mine in Peru) and risk-reduced partnerships (such as the Chinalco-Rio Tinto iron ore project in Guinea).

Outlook: We expect China to recommence its push for overseas assets to secure supply through partnerships in existing operations or near-term projects instead of greenfield projects. Australia, as a relatively safe environment for doing business, remains slated as a favorite investment target going forward, particularly from Asian investors.

Share of deal flows by volume



51%

of deals involved Canada or the US as either target or acquirer

61%

of 1H 2014 deal volume were acquisitions of domestic targets

10. "MMG shareholders approve \$5.85bn purchase of Las Bambas project," *Financial Times*, 21 July 2014.
 11. "Baosteel, Aurizon Gain Upper Hand in \$1.3 Billion Bid for Aquila," *The Wall Street Journal*, 18 June 2014.
 12. "Rio Tinto, Guinea seal deal on \$US20 billion Simandou mine," *The Australian*, 27 May 2014.

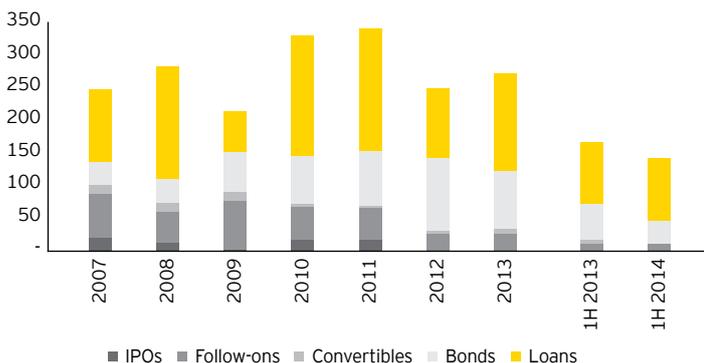
Capital raising in 1H 2014

An overall decline in proceeds raised in 1H 2014, to \$142b from \$168b, masks an ongoing divergence of fortunes within the mining and metals industry. As discussed in EY's *Business risks facing mining and metals, 2014-15* report,¹³ the "wealth gap" between producers and explorers appears to be widening - or to put it another way, between those that have access to the public debt markets and those that don't.

The happy coincidence of thirst for yield among bond market investors and competition between banks for scarce major deal opportunities, against a backdrop of near-zero real interest rates, has proven a boon for borrowers in recent years. This is even the case for the leveraged and higher-risk sectors of the mining and metals industry. The debt markets have supported a range of the industry's financing needs in 2014, from acquisitions, to bond repurchases, to extension and refinancing of revolving facilities.

Many mining and metals companies have been able to reduce borrowing costs further this year, and, critically, secure refinancing deals, as robust liquidity and strong demand has led to large and sometimes oversubscribed syndicates, driving down pricing and terms. These market conditions look set to persist for at least the remainder of 2014, with the wide expectation that the US Federal Reserve will wait until mid-2015 before raising benchmark rates.

Capital raising by asset class – proceeds (\$b)



Risk-seeking supports mid-tiers, while project finance is back on the table

Sub-investment-grade borrowers took an increased share (35%) of total bond proceeds in 1H 2014, compared with previous years, as investors continue to move further down the risk curve in order to secure yield and as many investment-grade majors had less need to access the markets. Coupons on US dollar and euro high-yield issues paid an average of 7.2%, while an ArcelorMittal Eurobond maturing 2020 paid a low of just 2.9%.

Project finance is also once again flowing into the industry's growth projects - albeit on a highly selective basis. The mining sector saw a nearly tenfold increase in project finance deals compared with 1H 2013, with Roy Hill Holdings' \$7.1b deal helping the sector to take the fourth-largest share of the global project finance market in 1H 2014.¹⁴

Mining equities trail the confidence revival

However, we only need look to the equity markets to witness the stubborn contradiction of flagging investor confidence in the sector, and the extent to which the mining and metals industry is lagging prolonged growth acceleration in other sectors. Despite a recent rebound in mining and metals share prices, the Euromoney Global Mining and Steel index still hovers dishearteningly close to its 2009 trough, while the Dow Jones Industrials all-share index continues to reach new highs. A bounce in technology and health care IPOs revealed a revived appetite for growth stocks generally, but junior mining IPOs remain all but nonexistent. Secondary equity fundraising continues to be muted, with 40% of issues by juniors raising as little as \$500,000 - barely enough to maintain the most skeletal of operations. However, the strong performance of TSX-listed juniors over the first half - and momentum picked up by ASX-listed miners in July - is giving some ground to hopes that sentiment may be on the turn.

13. Visit www.ey.com/miningandmetals to view the report

14. "Global Project Finance Review, first half 2014," Thomson Reuters.

Alternative financing sources, while not captured in our data, are now a staple component of industry finance and continued to play an important role in 1H 2014 - for example, the \$100m equipment financing facility provided by Caterpillar Financial Services for First Quantum Minerals' Trident project in Zambia, as part of a broader suite of financing initiatives.

Outlook: favorable debt markets for those who can take advantage

A narrowing of the wealth gap is unlikely to occur in the near term. A sustained and expectation-beating commodity price recovery would be needed for risk investors to return to the exploration sector. As a result, capital will continue to be targeted toward more proven projects and management teams via opportunistic M&A or offtake agreements, joint ventures, peer-to-peer consolidation and alternative funding structures. On the other side of the gap, the majors' ongoing focus on internal cash generation through volume growth will continue to strengthen balance sheets and increases capital allocation options over the medium term, limiting the near-term need to access significant new sources of funds in light of reduced capex plans.

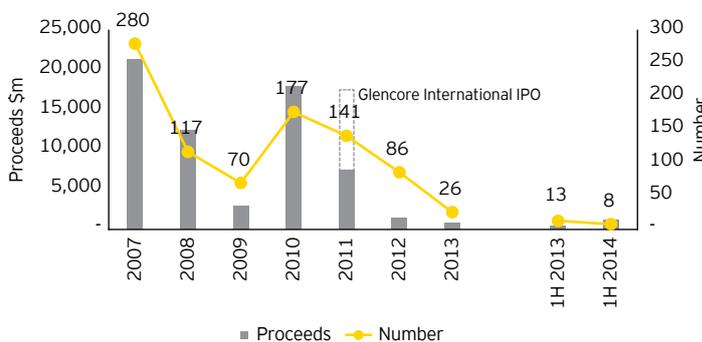
However, the era of "cheap" public debt will not last forever. The end to bond buying by the US Federal Reserve is targeted for later this year, while expectations surrounding the timing of interest rate rises set the scene for revived volatility and tightened terms for borrowers. This brings additional risks to an already capital-constrained and politically charged infrastructure problem for the industry's major long-term growth projects and the economies they support.

Yield-seeking is likely to persist in the near term, providing an important crutch to mid-tier mining and leveraged metals companies. But what appears to be "risk complacency" among investors today may be challenged tomorrow in the face of growing geopolitical threats such as the Ukrainian and Middle East conflicts. Being best-placed and able to spot and react to capital markets and other funding opportunities will increasingly provide a competitive edge in the advent of changing and changeable financial conditions.

IPOs

8	Number of IPOs, compared with 13 in 1H 2013
\$1.2b	Proceeds raised – a 154% y-o-y increase due to two standout deals

IPO value and volume



- ▶ Shaanxi Coal Industry marked the reopening of China's IPO market, following a 14-month moratorium, with a \$662m IPO on the Shanghai Stock Exchange.
- ▶ US coal producer, Foresight Energy, listed a 13.5% stake on the New York Stock Exchange (NYSE) at a difficult time for the US coal industry. The company promoted its status as a low-cost Illinois Basin producer with over three billion tonnes of coal reserves. The deal was priced in the middle of its offer range, at \$20 per unit, valuing the company at an estimated \$2.6b,¹⁵ and making it the third-largest coal company on the NYSE by market value. SNL reported that the company was trading at a price/earnings ratio "well above" its US listed coal peer group average.¹⁶
- ▶ Australia hosted just two IPOs - Valence Industries and U&D Coal - while Toronto and London saw no new listings.

15. "Coal miner Foresight opens below target," *Wall Street Journal*, 18 June 2014.
 16. "Foresight Energy market valuation shows investors recognize producer's strengths," *SNL Coal Report*, 30 June 2014, via Factiva.

Follow-on equity

34%

The share of the \$10.3b total proceeds raised by just two equity issuers, Turquoise Hill Resources (\$2.4b) and Outokumpu (\$1.1b), for debt reduction

39%

The share of issuance volume raising less than \$500,000

Convertible bonds

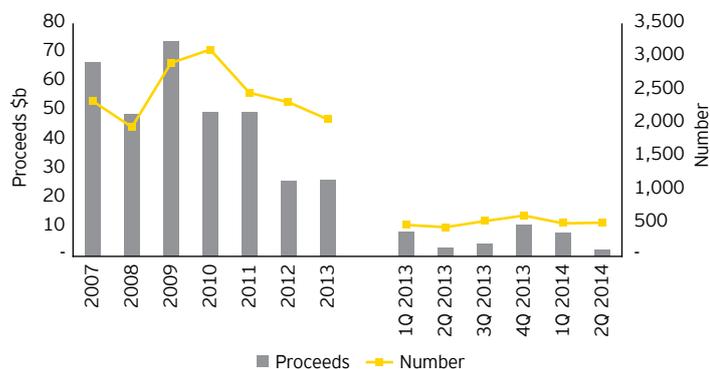
-91%

The y-o-y fall in proceeds raised in 1H 2014 (\$595m versus \$5,799m in 1H 2013)

\$9m

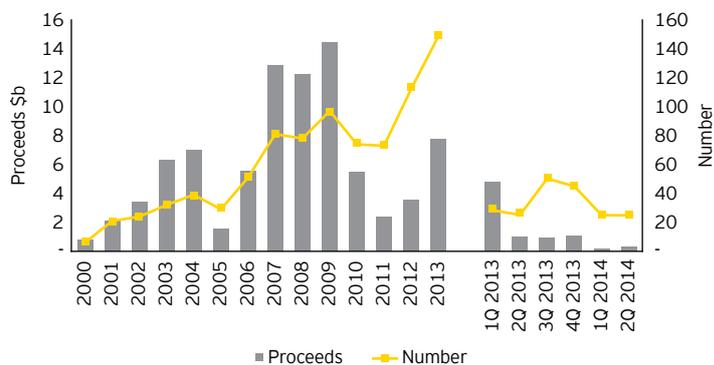
Average proceeds raised from 1H 2014 convertibles, versus \$50m in 1H 2013 (excluding ArcelorMittal's 2013 \$2.3b issue)

Follow-on issues – proceeds and volume



- ▶ Aquarius Platinum raised \$229m toward repurchase of an existing convertible bond.
- ▶ Wolf Minerals, Hudbay Minerals, Detour Gold Corp, Ivanhoe Mines and Torex Gold Resources were among companies raising proceeds in excess of \$100m for mine development, debt reduction or to increase financial flexibility.

Convertible bond proceeds and volume



- ▶ Convertible bonds fell out of favor in 1H 2014, contrary to strong demand across other sectors. Mirabela Nickel and Discovery Metals issued the two largest bonds, at \$115m and \$100m, paying 9.5% and 10%, respectively, with five-year conversions.
- ▶ Recent examples of companies struggling to meet maturing conversion payments may be behind the dramatic fall in proceeds. Increased perception of risk, accentuated by the large share of unrated and junior issuers, has increased the average coupon on convertibles to 11%, from 9% in 2013.

Bonds

\$35b

Proceeds raised from 1H 2014 bond issues, a 38% fall on 1H 2013

35%

Share of total proceeds by high yield issuers, compared with just 10% in 2013

Syndicated loans

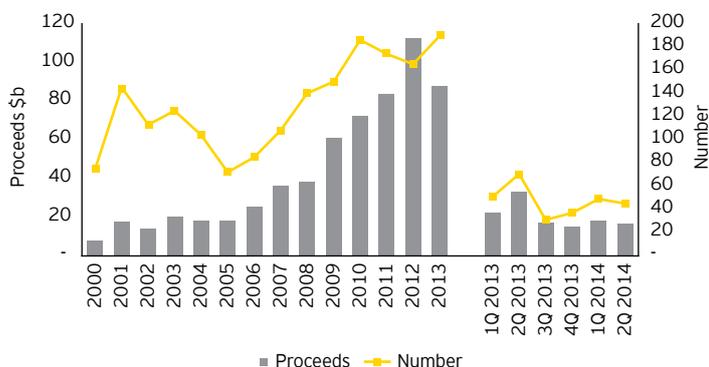
\$95b

Proceeds raised from syndicated bank lending in 1H 2014, on a par with 1H 2013

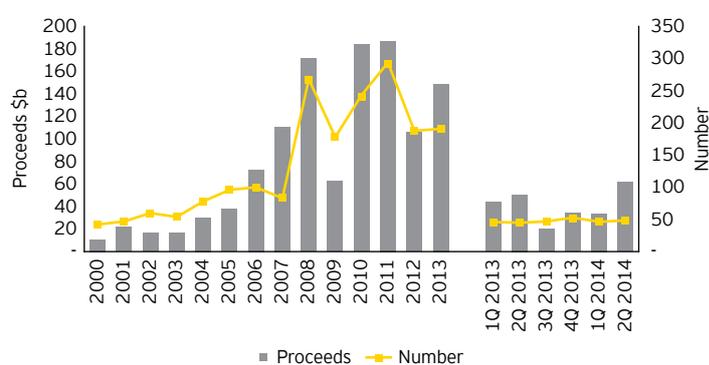
\$25b

Value of loans for project financing and capex

Bond proceeds and volume



Loan proceeds and volume



- ▶ Anglo American and Glencore were among investment-grade issuers issuing Eurobonds in 1H 2014, achieving low coupons amid growing confidence in Europe. Anglo American's €750m 2018 tranche was issued with a coupon of just 1.75%.
- ▶ Leveraged coal and steel producers found demand in the high-yield markets. The average coupon on US dollar issues by high-yield coal companies was 8.6%, on an average tenor of 6.7 years. Comparable steel US dollar and euro issues achieved an average coupon of 4.9%.

- ▶ Majors continue to refinance on favorable terms. Glencore's \$17b of revolving credit was priced at 50-60bps, reportedly an improvement of 30bps. BHP Billiton replaced a \$6b revolving credit facility at just 20bps above the benchmark London interbank rate.
- ▶ While the majority (40%) of proceeds were for refinancing or retirement of existing debt, this represents a smaller share than the 50% consistently seen in recent years. Instead, project finance took a greater share, at around 20%.
- ▶ A \$7.2b project finance deal closed by Roy Hill Holdings reportedly represented the largest-ever land-based project finance deal in the mining sector. Lenders in the syndicate included 5 export credit agencies and 19 commercial banks from Australia, Japan, Europe, China, South Korea and Singapore.

EY's Global Mining & Metals Center

With a volatile outlook for mining and metals, the global sector is focused on cost optimization and productivity improvement, while poised for value-based growth opportunities as they arise. The sector also faces the increased challenges of changing expectations in the maintenance of its social license to operate, skills shortages, effectively executing capital projects and meeting government revenue expectations.

EY's Global Mining & Metals Center brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. The Center is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow. Ultimately it enables us to help you meet your goals and compete more effectively.

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