Out of sync

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The metals cycle has turned again and as Steve Smith, vice president global project finance at Hypovereinsbank (HVB) observes: "Banks are coming back.

"But this market, inevitably, remains fragmented. In the last few years there has been very little exploration spending. Now this trend is reversing as companies coffers expand on the strength of booming metal prices."

The lag between investment and the metal price cycle means that new greenfield projects are unlikely to benefit from stronger mining company balance sheets. And "perversely, while the market for project finance depends on the metals prices, it is bound to be out of sync with them because of that lag between investment and metals price." By the time a greenfield project comes to the financial market the cycle has begun to move on.

The cycle also means that the majority of major miners remain loathe to offer parent guarantees.

Similarly, junior miners rarely have the balance sheet strength to put up guarantees required by bankers.

However, there are a number of deals in the market that are pushing the boundaries in terms of dealing with metals pricing hedging, political risk and funding for both major and junior miners.

In Russia, Sual's ambitious $1.2 billion bauxite-alumina-aluminium project in Komi comes with a very rare Russian government guarantee. In Chile, the Cerro Casale project will be a gauge of the extent banks and miners will compromise over hedging mechanisms. And in Africa the Moma Titanium deal has presented a new way of looking at funding junior miners.

Sual gets its guarantee

Last month Sual received its first $150 million finance package - half each from the European Bank for Reconstruction and Development and the International Finance Corporation - to fund the expansion of the Middle Timan bauxite mine and a feasability study on the alumina refinery. The EBRD and IFC are each providing a $45 million, nine-year loan. A further $60 million, to be lent over seven years, will be syndicated to international banks.

That is only the first stage. The second stage is a refinery at Sosnogorsk to provide Sual, and the Russian aluminium industry in general, with alumina, which is in serious undersupply. The third, final, stage is construction of a new aluminium smelter. And Sual is set to land a $200 million government guarantee, which will cover the planned alumina refinery at Sosnogorsk, and has been written into the finance ministry's 2005 programme and approved by the government.

A source at the IFC explains: "Previously the corporation has worked mainly with foreign-owned companies in Russia. This is its first major deal with a company owned by the so-called 'oligarchs'. The IFC does not require a state guarantee, but at the second and third stages of the Komi financing, it would be a great help." The EBRD is likewise able to consider more ambitious financings if a guarantee is present, said a spokesman.

Last year finance ministry officials proposed a $500 million non-commercial guarantee for the Komi project, but that was scrapped by former prime minister Mikhail Kasyanov. Then in July the guarantee was offered at a lower level. Finance minister Aleksei Kudrin said that it would be provided "in the normal way", through the World Bank to financing institutions.

The chief non-commercial risks covered are those arising from changes in legislation during the life of the project that make investment conditions more difficult, e.g. changes in the tax regime, Kudrin explained in a statement on the finance ministry web site. The guarantees are only available for large projects costing $500 million plus, he said. "The investors needs to be sure that in force-majeure situations the state will shoulder its responsibilities", Kudrin added.

The guarantee, and a supportive statement by Russian audit chamber chief Sergei Stepashin during a visit to Komi earlier this year, are welcome signs of political support - given the long shadow cast over Russia's largest privately-owned corporates by the state assault on Yukos oil company.

The Yukos factor is impacting banks. Last month SG and ING pulled out of arranger roles for a $660 million pre-export financing for TNK-BP oil company, which shares ownership with Sual, and HSBC spurned an arranger mandate for a $500 million unsecured corporate facility for Russia's biggest non-ferrous producer, Norilsk Nickel. Gaping spreads mean the eurobond markets are effectively closed to new Russian corporate issuers. This is not a large-scale retreat from Russia: another big pre-export deal, for aluminium producer Rusal, went ahead last month, and bankers say that the problem is 'nervousness' on credit committees rather than a strategic shift. But the Yukos affair has heightened political risks associated with Russia's 'oligarchs', and the finance ministry guarantee could not be more welcome.

Cerro Casale hedging row

Consider the irony. Sual's project is moving forward despite the state strictures that so worry investors in Russia. But on the other side of the globe in Chile, it is the strictures of the market that endanger an even larger project, development of the Cerro Casale copper-gold deposit. A $1.65 billion project development plan, dusted off this year as gold rose to $400/oz, could go back into cold storage due to the failure of sponsors Placer Dome, a gold major, Canadian-listed junior Bema Gold and its Chilean subsidiary Arizona Star, to agree on a hedging structure.

Cerro Casale in northern Chile is one of the world's largest undeveloped gold and copper deposits. A feasibility study completed in 2000 and updated by Placer Dome in March this year showed measured and indicated mineral resources of 25.4 million oz of gold and 6.4 billion pounds of copper. The problem is price: Bema says that project economics give a net present value of $1.14 billion, "assuming a gold price of $400 per ounce and a copper price of $1.10 per pound." Sceptics do not believe prices will stay at around those levels for long enough.

Bema found the Cerro Casale deposit in 1995 and made a partnership agreement to develop it with Placer Dome, which took a 51% stake. Bema owns 24% and a linked company, Arizona Star, owns 25%. Earlier this year the three companies talked to banks, including Barclays Capital and HVB, about project finance. While the shareholders' agreement provides that Placer Dome should arrange the first $1.3 billion of financing and build the mine, Placer says it cannot arrange a hedging package without guarantees from all the project sponsors. Neither Bema nor Arizona Star want to provide those.

A banker familiar with the discussions says: "You can't do non-recourse hedging on this. Guarantees are required: you need a balance sheet with cash to fall back on. Placer is naturally reluctant to provide it." Another remarked: "Placer's position is easy to understand. The shareholders' agreement provides for them to bear the burden whereas for Bema it's all upside."

On 7 July the row went public. Bema gave notice of default, alleging that Placer had failed 'to use reasonable efforts' to ascertain the project's financeability. 'Placer claims the project cannot be financed without parent hedging guarantees', Bema complained. Bema insisted that 'it may be possible to arrange a hedging structure that does not require parent guarantees', and argued that Placer was withholding a report from a big international mining bank, drafted in April, that showed how it could be done. A statement from Placer asserted that the project 'is not currently financeable under the terms of the shareholders' agreement'; it is understood that the company wants the agreement changed to provide for the parent hedging guarantees.

On 12 August Arizona Star announced that 'a major international bank' had submitted an indicative term sheet for an underwritten project loan of up to $1 billion to develop the project. The outcome of the talks, and details of the hedging package, will tell the market much about the extent to which banks will loosen hedging structures to get mining project finance in place, and the extent to which short-termist shareholders can be compelled to swallow the commitments needed for longer term mining projects.

Small is more financeable

While billion-dollar deals for oligarch-related Russian companies make credit committees twitchy, project transactions counted in tens of millions to foreign-owned gold companies are all the rage. One of the leaders is Bema's Kupol project in Chukhotka, north-eastern Russia.

Bema last month took a $60 million, two-year bridge loan from HVB to develop Kupol, and says that it hopes to have project financing in place early next year. This year a $25.3 million exploration and feasibility programme is in place and $20 million is being spent on development construction.

Drill programme results in mid-August added to excitement about the quality of the Kupol reserves. An earlier preliminary economic assessment showed that the project has 3.1 million ounces of gold and 41.8 million ounces of silver. Smith at HVB is bullish about the venture: "The project is an impressive one, and confirm's Bema's reputation as a serious player among Russian gold producers."

Barclays Capital, which pulled back from Russia after the 1998 crisis, is now looking closely at deals there - none more closely than Kupol. Gerard Holden, head of the metals and mining team, said that at this stage of development Kupol appears to be 'eminently financeable'. He adds: "Bema established a good track record at Julietta mine, and is working with a local partner. But political risk insurance is likely to be required."

Trans Siberian Gold, the UK-listed producer with assets in Siberia and the Russian Far East part-owned by Anglo Gold Ashanti, last month jointly mandated Standard Bank and the EBRD to raise up to $30 million of project finance for its Asacha gold mine in Kamchatka. The company expected to agree, by the end of August, with the two banks on a financing plan for the project, which is set to produce 100,000 oz of gold per year starting in late 2005 or 2006. Standard provided Trans Siberian with a $23 million, 12-month financing in May, and secured the mandate, which the EBRD joined subsequently.

Other foreign-owned Russian gold project sponsors actively seeking financing include High River Gold of Canada, which is developing the Berezitovoy project in Amur region, southern Siberia. Last month High River bought a second-hand gold ore processing plant from Newmont Mining to ship from Nevada, USA, to Berezitovoy, which is projected to produce 100,000 oz of gold per year over a nine-year period starting in late 2005. High River also completed a share swap deal with the EBRD increased its stake in another Russian producer, Buryatzoloto, to 61%.

Peter Hambro, the UK-listed company with assets in southern Russia, is also seeking project finance for its Pioneer mine; it is talking to banks including HVB, from which it borrowed $30 million on undisclosed terms in April this year. Highland Gold, whose main producing asset is the Mnogovershinnoe gold mine in Khabarovsk in the Russian Far East, is in talks on a $60 million financing package.

Natasha Isakova, director in Barclays' structured trade and export finance team, points out that some regulatory hurdles will need to be overcome for the Russian gold project financings to work. "The regime under which gold exports are licensed one year at a time makes it very difficult to secure long-term offtake. Agreements will have to provide for renewals of licences, and banks will have to satisfy themselves that those will be forthcoming."

African opportunities

The turn in mining companies' fortunes, driven by the gold and copper prices in particular, are opening up opportunities for projects in Africa as much as in Russia. David Rhodes, senior manager on the mining team at Standard Bank (London), says: "Generally, there are many, many more mining finance opportunities coming up. The market is in a 'hot zone' compared to the cold spell of the last four or five years. Companies' balance sheets and market valuations look better, and that makes working in countries where there are political risks, including Russia and a number of African countries, more realistic. Depending, above all, on the way the Chinese economy develops with regard to base metals, this can continue for another two or three years."

Rashad Kaldany, IFC director for oil, gas and mining, says high prices have brought a greater level of inquiries about African metals projects. "We are able to work in frontier countries and address political as well as economic risks. Unlike MIGA, the comfort is not a strictly contractual one. We have a wider role."

The IFC is in talks with Adastra, the London-based miner developing the Kolwezi tailings project in the Democratic Republic of Congo (DRC). Adastra hopes that a feasibility study commissioned last month from a join venture of Murray & Roberts and GRD Minproc will be followed by a project financing backed by the IFC. Under an agreement signed in February last year, both institutions can acquire 10% of Kingamyambo Musonoi Tailings SARL, the Congolese holding company that will own the project.

Projected annual production is 42,000 tonnes of copper and 7,000 tonnes of cobalt, and marketing the latter is a key to the financing structure. In April, Adastra appointed N.M. Rothschild as financial adviser on the project. Charles Mercey, managing director at Rothschild, says: "Lenders will need to see long-term contracts in place. The market's ability to absorb that quantity of cobalt is an important factor."

The largest African mine project agreement completed this year is a $269 million package for the Moma Titanium mineral sands project in Mozambique, which is being developed by Ireland-based Kenmare Resources: at $269 million it slightly outweighs last year's ground-breaking $229 million financing for the Kansanshi copper-gold project in Zambia (for details see www.projectfinancemagazine.com).

Kenmare Resources is, like Kansanshi sponsor First Quantum Resources, a junior miner. And the project is the single largest investment on the African continent made by a UK-listed non-FTSE 100 company. That the deal achieved reasonably priced non-recourse debt financing adds to the peculiarity.

The project sets a useful precedent for an African investment by a relatively small-cap project company operating in an untried market and for which there are no close comparators.

The Moma mine will produce about 600,000 tonnes of ilmenite per annum, with 25,000 tonnes of zircon and 12,000 tonnes of rutile as co-products. In June Kenmare, advised by N.M. Rothschild, signed limited-recourse loan agreements - with a company guarantee covering the period to the end of mine construction, i.e. to late 2007 - with the African Development Bank, Absa bank of South Africa, the European Investment Bank, the Dutch development finance group FMO and the German development finance institution KfW.

Absa also provided a $36 million project finance package, signed on 12 August, to High River Gold for its Taparko-Bouroum project in Burkina Faso. High River, which owns 80% of the project while the Burkina Faso government owns 20%, has put a rolling 'put' option programme in place of the type that are now typically replacing classical hedges.

A larger project finance package, of $60 million, is being sought by Randgold Resources for its Loulo project in Mali. Randgold, which is proceeding with a full feasibility study on long-life underground operations at the site, mandated Rothschild and SG to arrange financing and is said to be 'within weeks' of signing.

The list of projects signed or close to signing this year goes on. Australian-listed Lafayette Mining has received credit approval for a $35 million project loan and standby facility for its Rapu Rapu project in the Philippines from a consortium comprising N.M. Rothschild, ANZ Investment Bank, ABN Amro, Korea First Bank and Investec. Canada-based Yamana Gold is also at an advanced stage of talks with a syndicate headed by Standard Bank, and including Macquarie, HVB and SG, on a $90 million deal for its Chapada gold and copper project in Brazil.

Whether the procession of small projects will continue, and whether the large ones such as Cerro Casale can get off the ground, depends largely on price trends. Strong metals prices have fattened up smaller mining companies to the point where they can confidently seek project finance - even when working in locations laden with political risk.

But if the price analysts are to be believed, there is only another year or two to explore the possibilities created by strong prices before they head down again. Then the robustness of structures erected now will be truly tested.