Down on the upside

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After more than a year of upheaval, the global mining sector is showing some signs of recovery. With a number of new and existing projects looking for funding, financiers are getting out the spit and polish to woo potential clients and win mandates. Prices in the metals markets are starting to improve, especially for gold, and this is reflected in the number of deals that have already been mandated.

But it is a far cry from the sunshine and happiness of the late 1990s, and base metals in particular continue to suffer in the face of low pricing, high inventories and a stagnant global economy. With fewer commercial banks participating in the project finance markets for mining and with bond investors still shying away, it is a tough road ahead for the mining industry and for those companies looking to find funding.

However, with prices beginning to rise, many companies are doing just that and it may be getting easier, according to market participants. David Rhodes senior manager at Standard Bank, says that precious metal markets have been improving over the past six months: ?We have seen a significant number of new projects in the gold sector, and there are quite a few transactions in the pipeline.? For example, Randgold Resources is looking for financing for the Loulo project ? its gold mine in Mali ? which should come in at under $70 million to complete. The company is expected to put in about $12 million from its own coffers and finance the rest through project loans. It has also announced a new exploration target near the Loulo mine, which is next on the agenda for development.

In Egypt, Centamin is expanding its Sukari Gold Project, for which Standard Bank is arranging a $30 million project loan. Centamin is the only company with a gold and base metals concession in Egypt ? a 4,500 square km area covering many of the old gold workings from ancient Egypt, no less. After a new feasibility study, the project will include a larger processing facility handling up to 5 million tonnes per year and expected output is around 300,000 ounces a year. The study and necessary due diligence should be finished by mid-2003. Drawdown is expected in July.

There are also projects under way for other precious metals, such as silver. Polymetal in Russia is looking to refinance existing debt and launched a R750 million ($24 million) bond issue in March, all to be used towards the cost of developing existing assets, such as the Dukat mine ? with an expected project cost of $212 million, and the Pirquitas project being explored by subsidiary Silver Standard ? which has an expected $133 million price tag.

But there are a limited number of high-quality gold projects now being developed, according to bankers, and the base metal markets are facing even tougher conditions. Thomas Watters, an analyst at Standard & Poor's, says base metal prices are, ?low ? to say the least. Smaller companies, in particular, are curtailing exploration and development to conserve cashflow?.

According to Hugo Dryland, senior managing director at Rothschild, the industry as a whole has struggled, particularly the mid-range and smaller operations, with the impact of the depressed metal markets. ?Aside from nickel, we have had several years of very low commodity prices in base metals, especially copper and zinc,? he says. ?As a consequence a number of the expansion prospects were shelved or put on hold.?

Projects on hold at the end of 2002 accounted for almost $21 billion of financing, according to Swedish research firm Raw Materials Group. For example, the El Arco copper project in Mexico was deferred, as were the Konkola Copper expansion plans in Zambia. In iron, the Homestead expansion planned by Hammersley Iron in Australia was also deferred.

However, this is beginning to change and many market participants believe that base metals will soon follow precious metals in an upswing. In the Middle East, the Saudi Arabian Mining Company's (Maaden's) projects are going forward. Its SR12 billion ($3.19 billion) Al-Zabirah bauxite mine is being developed in conjunction with the SR9.4 billion ($2.5 billion) Al-Jalamid phosphate project, on which Maaden is working with Saudi Oger. ANZ Bank and Riyadh Bank are acting as financial advisors. And in Canada, a highlight of the nickel market is the $1.9 billion Voisey's Bay project from Inco, which just recently got the go-ahead.

Dryland says that the biggest impact of the distressed metal and equity markets is on the potential for future greenfield developments. ?This has led to an evaporation of the junior markets and many smaller companies disappeared. Gone are the great days of early 1990s where there was a glowing junior mining industry that provided the pipeline of new development opportunities for the larger players.?

Although there are some junior players still in the exploration game, such as Randgold, greenfield exploration has indeed taken a backseat across the mining industry. Some greenfield developments continue to happen ? Barrick's Alto Chicama development in Peru comes to mind ? but what is driving the market is brownfield development of new and existing projects.

Technology gives better returns

The pipeline is made up of deferred projects now being taken out of mothballs and also a number of new mines to be built on brownfield sites. According to some industry players, it is new projects that will drive the market in the coming year. Says Rhodes at Standard Bank: ?A lot of people still have growth in their minds. What we are seeing are a number of new, low-cost mines in the works.?

Partly as a result of the poor metals prices and industry-wide retrenchment there has been a drive to lower costs, both in existing projects and in new projects. This has had a two-pronged effect: on the one hand it has led many companies to expand existing projects rather than to explore expensive and potentially unprofitable new greenfield opportunities. But on the other hand, with developments in technology that can most easily be implemented on new projects, this means that often opening a new mine can give better returns than trying to drive down costs in existing operations. Explains Rhodes: ?Primarily because new projects can be done at such low costs, and because they can use modern technology and modern mining methods to have lower operating costs, it is profitable to open new mines.?

The effect of this can also be seen in the continued consolidation within the market. Explains Watters at S&P: ?Companies are buying reserves or potential reserves instead of getting involved in greenfield expansion. Those companies that can access the capital markets, mainly the larger ones, will continue to do so in order to pick up assets. Valuations are low given current pricing, so it is a good time to buy.?

One such transaction expected for later this year is the acquisition by Xstrata of MIM in Australia. Also in Australia, industry players expect WMC Resources and Alumina to be picked up this year. Rio Tinto, Anglo American or BHP Billiton have been tagged as potential buyers of WMC, while Alcoa is expected to take on Alumina. Canadian group Wheaton River launched a C$333 million ($230 million) private equity placement ? the largest ever gold equity financing for a Canadian company ? to buy Rio Tinto's 25% interest in the Alumbrera gold-copper mine in Argentina and to buy its Peak gold mine in Australia. The group will pick up another 12.5% of Alumbrera later this year, as it has agreed to team up with mid-tier company Northern Orion, another Canadian group, to buy BHP Billiton's 25% stake in the mine for $180 million.

It is not just on the corporate side that consolidation is changing the face of mining. For those companies looking for project sponsors, they face a different market than they did a few years ago, as consolidation and cutbacks on the banking side have reduced the availability of funding and the number of financiers looking to participate. Explains one banker: ?There has been significant retrenchment of commercial banking from the mining industry: mining teams have, in many cases, been retracted or eliminated to focus on more lucrative opportunities. We now have a much smaller group of banks that remain supportive, and this has taken its toll on the structure, pricing and terms on offer.?

Aside from the commercial banks, institutional interest also remains low. After taking huge losses on the laterite nickel projects of the late 1990s, followed shortly by the troubles with Western Metals and Pasminco in Australia, institutional investors are steering clear of mining projects. Says the banker: ?Bondholders suffered significant losses in Australia and remain gun-shy of mining exposure, especially greenfield.?

With fewer players out there and limited institutional appetite, the project banks can ask for more, which has also taken its toll on the appeal of using limited recourse finance. Many larger mining companies are now looking to straight corporate financing as a cheaper, and less time-consuming, alternative to a large-scale project financing.

But as metals prices improve and more entities again look to growth, project markets should once again flourish on a diet of mid-tier and junior companies exploring new properties and developing existing assets. And even institutional investors are willing to evaluate deals, says the banker: ?If quality projects are brought to the market and appropriately structured, there continues to be some appetite from institutional players, but they are steering away from technically riskier projects.?

Dryland at Rothschild says that projects involving new assets and new regions will make up much of the project finance pipeline in the coming years: ?Project finance is now going to be brought to bear on projects in more difficult country environments. In addition, where you have partners in a given transaction that have disparate credit spreads, limited recourse financing will continue to be attractive. But I don't see project financing being used as readily by bigger players in more established and lower risk countries.?

Indeed, although traditional markets, such as Australia and Latin America, continue to account for a big part of the market, many projects now in the pipeline and much of the activity for the coming year is focused on under-exploited, mineral-rich areas ? such as Africa and Russia. Says Watters at S&P: ?We are seeing companies increasingly, especially US companies, looking for overseas reserves where environmental and labour costs are lower.?

The big question on many a market participant's mind is what happens once the brownfield projects have been completed? With few companies now focused on greenfield exploration, there is little in the pipeline beyond this year. Says Rhodes: ?We have a lot of deals that will be coming to market in next 6 months, there is a strong appetite out there from banks for transactions. But when you look ahead, there is some uncertainty because the pipeline is pretty dry for next year.?

Dryland says the future of the mining markets depends on the small players: ?We obviously need to see better metal prices and get some confidence back in the equity markets. Then we should see more money being spent on exploration. What that means is that we have to see some recovery in the appetite of the equity markets for the junior mining industry to produce greenfield projects for major players to tap.?

Adds Watters: ?It all depends on the global economic development. Demand side is going to be a key indicator for pricing: if demand really picks up we should see some pick up in pricing.? With major consumers such as China slowing down in consumption ? as a result of the global economic conditions and local effects such as SARS ? it could be some time before the cycle can really be described as nearing a high point, but in the meantime some markets are on the rise and some confidence is returning to the beleaguered mining sector. With a number of deals in the pipeline, 2003 already looks set to be a big improvement over last year. The only way to go is up.

Mine investments by country 2002

US$ billion % Change 01/02

1. Australia 13 17 +

2. Chile 8 11 +/?

3. Canada 7 9 +

4. South Africa 6 8 +

5. Peru 5 7 +

6. Brazil 5 6 +

7. USA 4 5 ?

8. Philippines 2 3 ?

9. Papua New Guinea 2 3 +

10. Mexico 2 3 +

TOTAL 54 71

Source: Raw Materials Data, Stockholm, Sweden 2002.