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Major to miner

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Thanks to a spike in gold and general commodity prices, the volume of exploration in the Australian resource market is again on the rise, after years of relative inactivity. As long as commodity prices stay buoyant, project finance bankers expect the current hustle and bustle to lead eventually to a rise in the number of financing transactions. In the interim, market consolidation-related asset sales will provide the staple deal diet for the banking sector.

It will be several years before the market is anything like as busy as it was in the 1990s. As a source an Australian banks comments, ?there has been a substantial reduction in the volume of greenfield exploration that both juniors and majors have done in the last six years, probably of the order of 20%.?

The reason behind this reduced volume of activity has less to do with global economics and supply and demand, (although slow global growth and lower commodity prices have certainly played their part) than with the issue of native (Aborigine) title legislation. Native title claims have been an increasingly important factor in the Australian resources industry since the 1992 Mabo versus Queensland case. In the case the Australian High Court gave, for the first time, legal recognition to inherent indigenous rights in land. This recognition was formalized the following year in the 1993 Native Title Act.

?As a result of the evolution of native title legislation, resource companies now need to invest significant amounts of time and resources in negotiation with claimants, as the native title issue remains an uncertain area of law with regards to exploration rights, mining and related uses of land,? says the banker.

The procedure for obtaining unfettered exploration and mining rights has been arduous enough, say financiers, to encourage small exploration and mining companies to turn their backs on Australia and instead look to alternatives such as South Africa for resources ventures.

And the difficulties associated with native title claims are not over. ?A number of requests for mining licenses are still being bogged down by land title issues,? says a second banker. However the resources sector is at least coming to terms with the issues and the process for dealing with native title claims. ?For instance, mineral sands company BeMax handled their land title problems very well. They got out and negotiated with potential claimants on a proactive basis,? the source says.

An additional, longer-term problem for resources companies in Australia has been increased competition in the equity market for investor funds. Resources companies once accounted for about 30% of Australian stock market capitalization, but other, more attractive sectors, and government privatizations, have increasingly drawn investor attention away from the industry. Equity research in the entire Australian resources companies has reduced while global funds continue to chase the bigger liquid resource stocks for investments.

Some financiers hope to see special purpose equity funds become a feature of the Australian resources industry, similar to the funds Macquarie has specialized in, in transport and other domains. However, as far as Project Finance is aware, there are no firm plans yet to set up dedicated Australian resources funds.

Recent relief for minor resources companies seeking equity has come from half a world away, on the London Alternative

Investment Market. Financiers note the increasing interest of junior Australian resources plays like Murchison United and Portman in tapping the market for European funds. More may be encouraged to seek a listing as the first Australian-based financial firms have been given permission by the London Stock Exchange to work as listing advisers. ?As a result the cost of listing is coming down quite significantly from the current average of over $300,000,? says a banker.

In the local debt capital markets there is no indication that bonds will become an important feature in sub-investment grade Australian resources financing. Only a handful of US dollar-denominated bond issues have been used to finance Australian based resources developments. The Australian market is not thought deep enough to stomach long term US Dollar resource paper.

Even in the transport sector, such as the Australian dollar-denominated toll roads and airport bond financings, bankers note the market has tended to be a provider of funding rather than taking outright underlying credit risk with most bond issues being credit wrapped.

As there are only a handful of greenfield resources projects likely to be financed in the near term, investment banks are looking to the continuing consolidation in the resources sector for businesses. ?Amidst all the M&A activity some companies have ended up with a suite of assets which are not necessarily a good strategic fit,? explains Grant Thompson, at Commonwealth Bank of Australia (CBA). Having sought debt to fund their strategic purchases, a number of companies are also uncomfortably geared and all the more keen to divest non-core assets to lower debt to equity ratios. Handling non-core asset divestments is expected to form the bulk of resources-related business for banks in the next 12 months.

Other bankers agree that resources companies are trying to streamline their portfolios. One adds, ?we are seeing some of the larger players getting out of smaller, short term, five- to seven-year projects and instead concentrating on long term, large scale projects?.

Thompson notes that market consolidation (which started in base metals and commodities and has progressed into the gold market) has also forced the majority of Australian resources projects into foreign hands. The market transformation has been breathtaking in its rapidity. In 1999 nearly all Australian gold ventures were in domestic hands. Now approximately 70% are in the hands of foreign firms such as Canada's Newmont Mining Corporation, Rio Tinto and Anglogold.

More consolidation is expected this year as another Canadian major, Placer Dome, has made a $1.7 billion hostile bid for AurionGold. Bankers suggest that Placer could eventually be outbid by another gold major for AurionGold's assets, despite the fact that the bid places a 30% premium on the Australian company's market value. Two of the remaining Australian gold producers, Sons of Gwalia and Newcrest, are also expected to be the targets of takeover bids. Newcrest is the only sizeable gold producer left in Australian hands.

As a consequence of the foreign buying spree there has been a steep fall in the volume of banking exposure to Australian gold producers. For that reason Newcrest can expect reasonably kind treatment when it comes to market for its Telfer financing (see below). On a local basis there is now far less opportunity for project finance business as a result of the acquisitions by foreign firms. ?Funding for Australian developments is almost exclusively being raised on balance sheet and at more attractive rates by the new parents themselves,? says Brad Glynne, Industry Head Metals and Mining Australia, at Citibank, Melbourne.

Another project soon to come to market, the Sally Malay nickel venture will be a test of banking appetite for small mining companies, particularly as certain junior mining projects have performed badly in recent years, notes a banker. The mixed track record in the lower tier of the resources market noticeably weakened banking appetite, notably amongst institutions such as Rothschilds, which have specialized in financing smaller ventures.

Few resources projects have been funded on a strictly project basis in the recent past as resources companies have typically had the balance sheet strength to finance on a corporate basis. One of the last big deals to tap limited recourse financing was BHP and Mitsubishi's refinancing of their Queensland Coal Trust acquisition last year. Market sources say consolidation makes corporate deals all the more likely. Newcrest has already announced that it will finance its Telfer scheme on balance sheet.

Perhaps the most disturbing trend for bankers as a result of the market slowdown and the hot competition for deals has been a loosening of financial covenants in resources deals. ?Smaller ventures, in particular, have been able to exercise more leverage and get more favourable terms than they would have been able to realize a few years ago,? says one banker. This is not a market-wide phenomenon. Banks remain wary of resources ventures selling to the open market, particularly those producing commodities for which long term hedges are difficult to obtain.

Three upcoming greenfield projects to watch are Newcrest's Telfer gold development, BeMax's mineral sands project and the smaller Sally Malay nickel venture.

Ginko Mineral Sands project

According to Stephen Everett, managing director of BeMax Resources, the majority (75%) shareholder of the $160 million Ginko mineral sands project, financial close is still expected in September although the project timetable has slipped by several months. ?The development will now be commissioned in the second half of 2003 and the first shipment of product is now expected in the second quarter of 2004,? Everett says.

Everett argues that the delay does nothing to reduce the attractiveness of the project as the cycle for titanium dioxide pigment is only now bottoming out. ?In the first half of 2002 we probably saw the worst of the market conditions in terms of demand and supply,? the managing director says. He adds, ?we naturally expect a pick-up in pigment consumption with general the economic recovery. The next two years will see the elimination of stockpiles and by 2004 there should be a very favourable demand and supply situation for us.?

ABN Amro, the project financial adviser, has dispatched an information memorandum on the project to five selected banks. The shortlisted institutions include CBA, Bank of Scotland, WestLB and ANZ.

Everett says the financing will be recourse to the sponsors at first and then non-recourse after completion tests in 2004. The scheme is being financed with 30% equity and 70% debt.

Like gold, the mineral sands sector is also expected to witness considerable consolidation. ?This will help make the niche that much more attractive,? says a banker. ?it's an area where you do need scale and consolidation will, of course, help to create that.?