

The 13th Annual Americas School of Mines Non Equity Mining Finance

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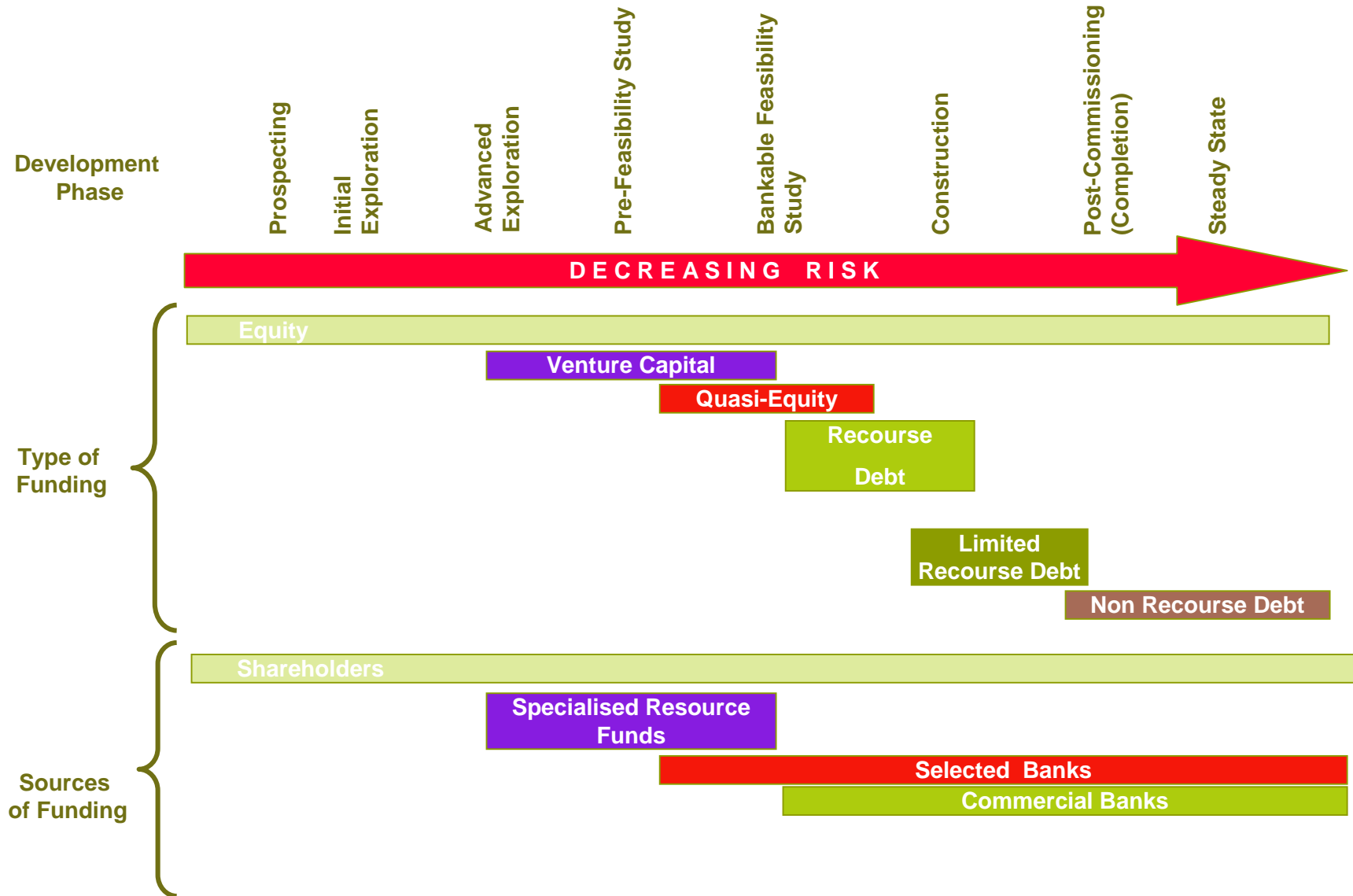
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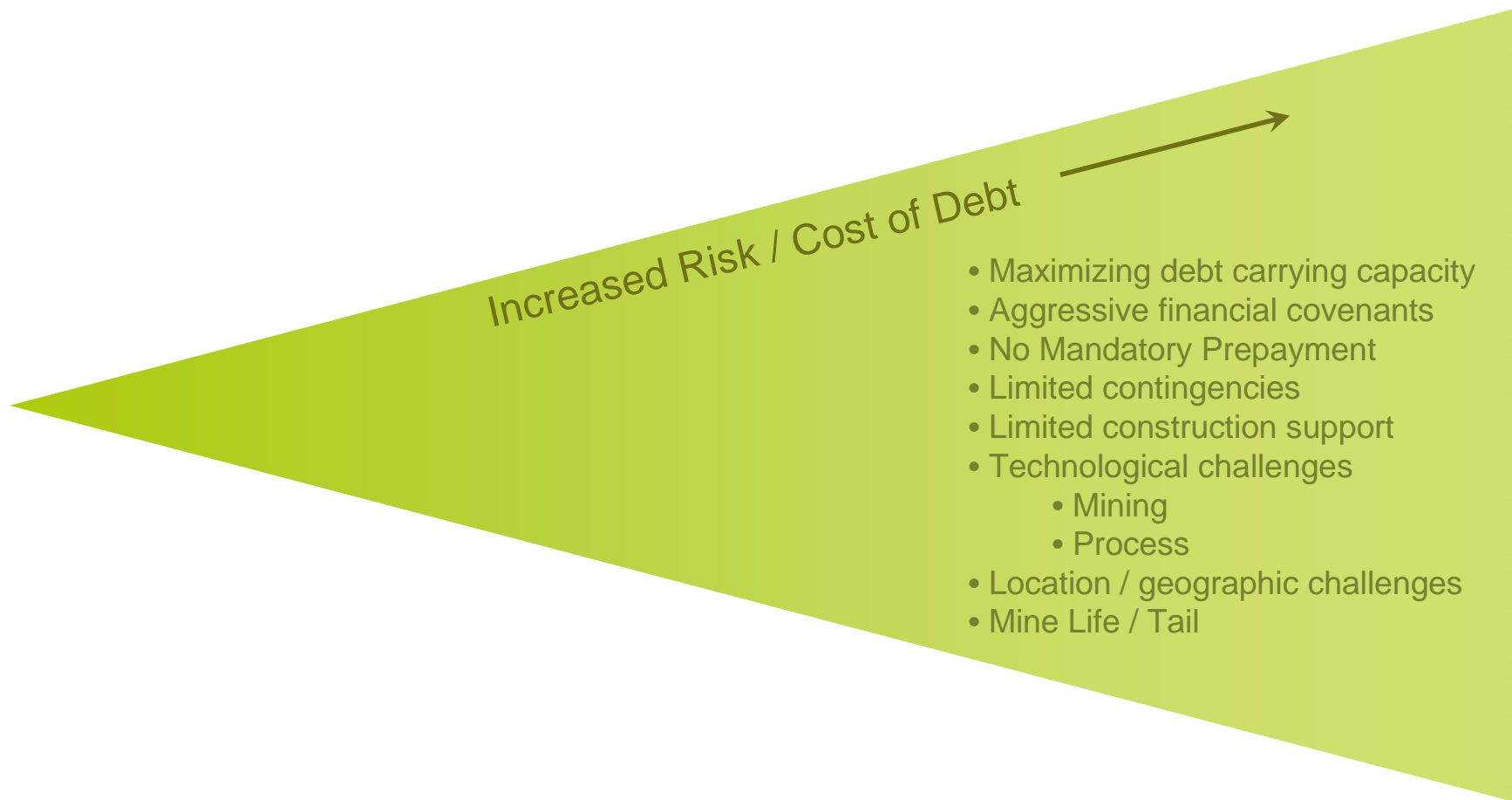
The Mining Finance Continuum



Some questions

- Is equity free money?
- Is there a place for debt in mining?
- Does Project Finance always need to be like giving birth to an elephant?
- Is hedging such a bad thing?
- Are the disciplines required by debt a good thing?
- Do we only remember the bad stories?

Pricing Risk



Project Finance

What is Project Finance?

Method of raising long term debt for a project, based on lending against future cash flows

Each project financing is unique however, certain principles are common:

- ❑ Financing done on a ring fenced basis
- ❑ Lenders rely on future cash flow rather than historical financial results
- ❑ Secured by Project assets (including licenses, titles, deeds etc)

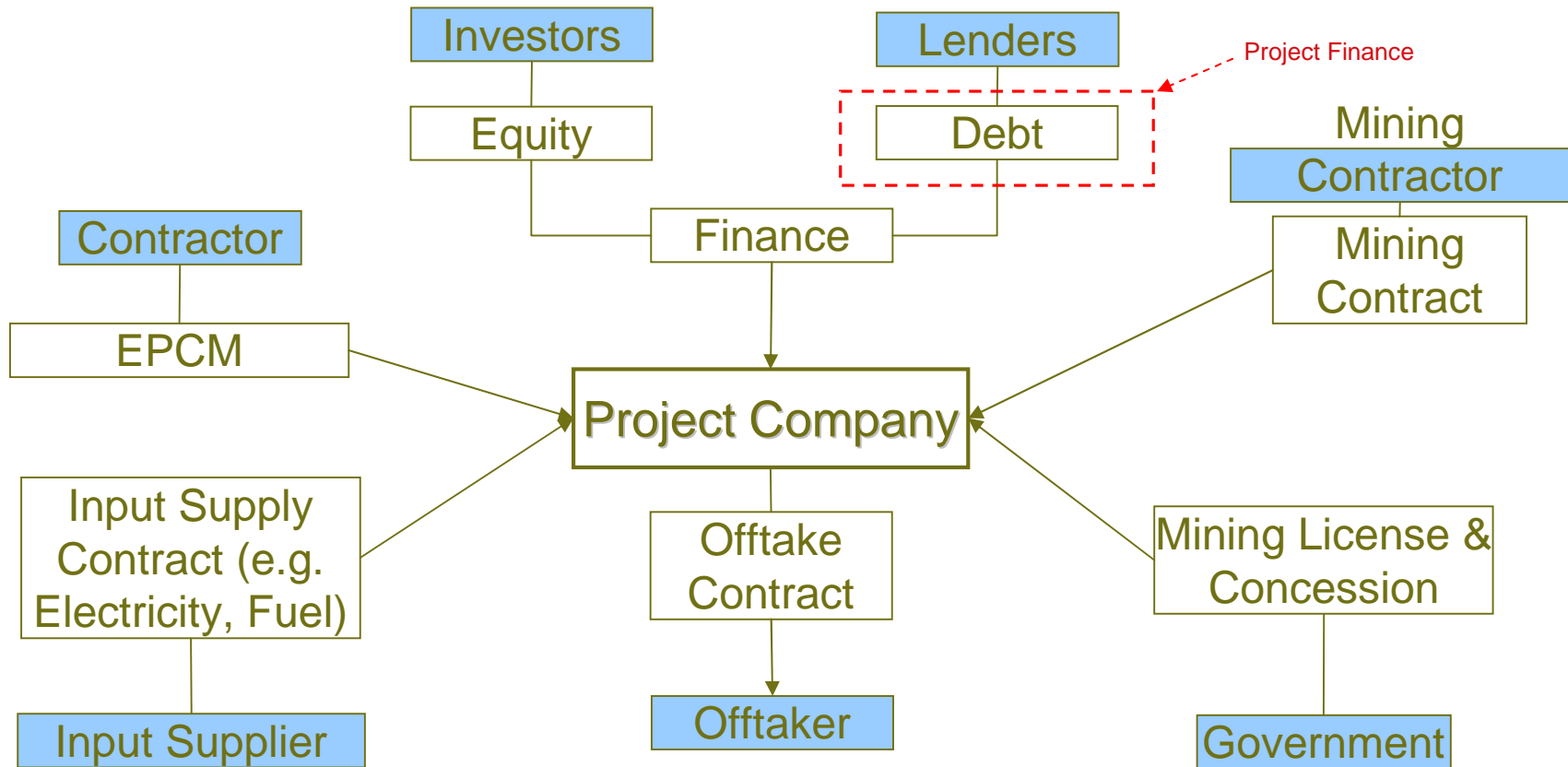
Pros

- 1.No dilution – lower cost of capital to shareholders
- 2.Tax benefits
- 3.Thorough due diligence – M&A opportunity
- 4.Hedging if prices go lower!

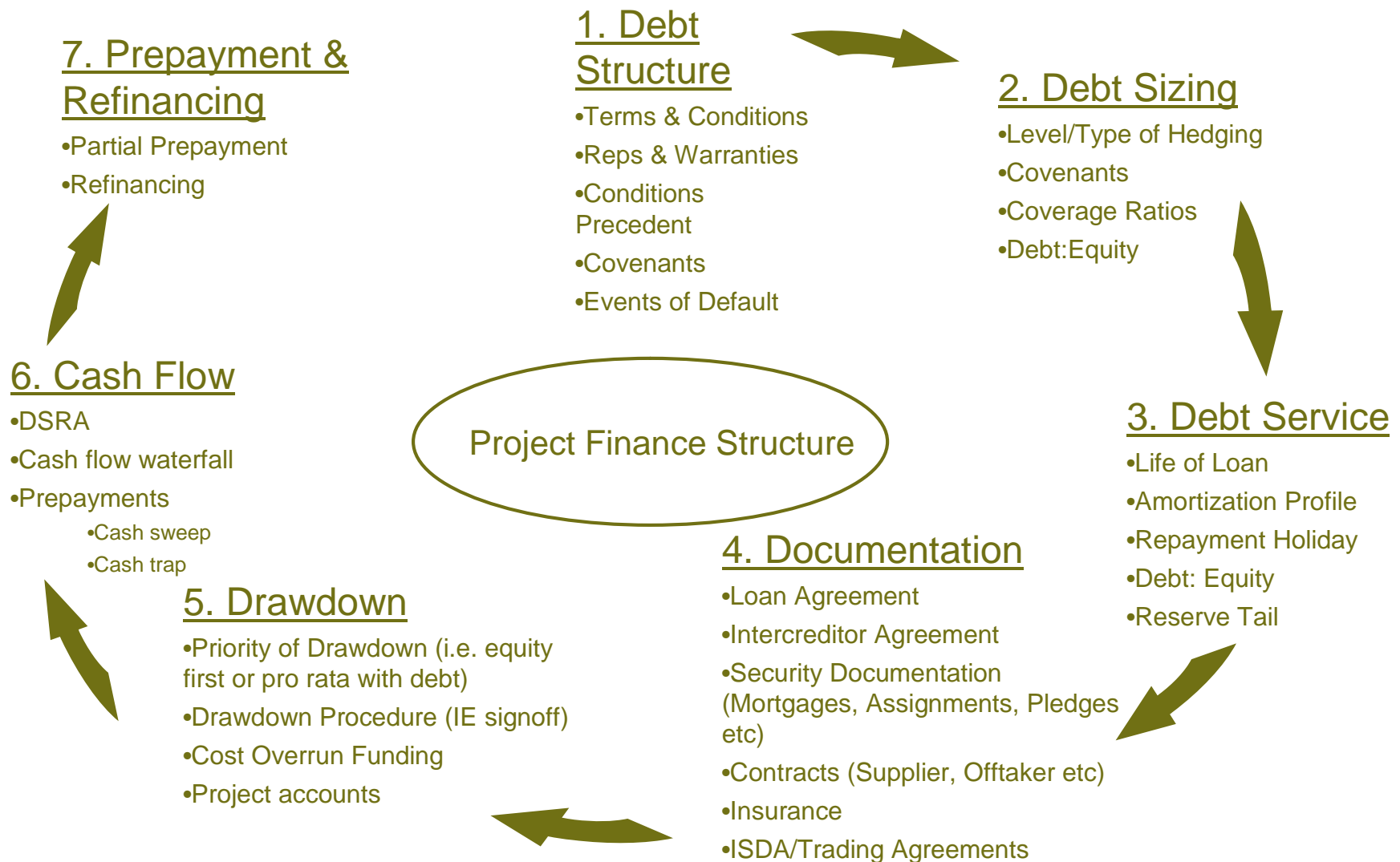
Cons

- 1.Thorough due diligence
- 2.Document intensive
- 3.Time consuming closing process
- 4.Reporting requirements
- 5.Hedging if prices go higher!

Project Finance



Review of Project Finance Structure



Debt sizing

The Model

Debt Maximization

- Increased Hedging
- Flat forwards – more expensive / increased risk for Bank
- Project gives up the up-side of future commodity price increases (but in gold gets the benefit of the contango – i.e. can lock in a higher price than the current spot)
- Tighter covenants
- Tighter documentation (full security) – typical Project Finance structure
- Mandatory Prepayments

Debt Minimization

- Minimal hedging required
- Potential to do puts – cost \$ today and lock in a floor. Project retains full up-side in future commodity price increases.
- Potentially a more relaxed structure
- Minimize covenants

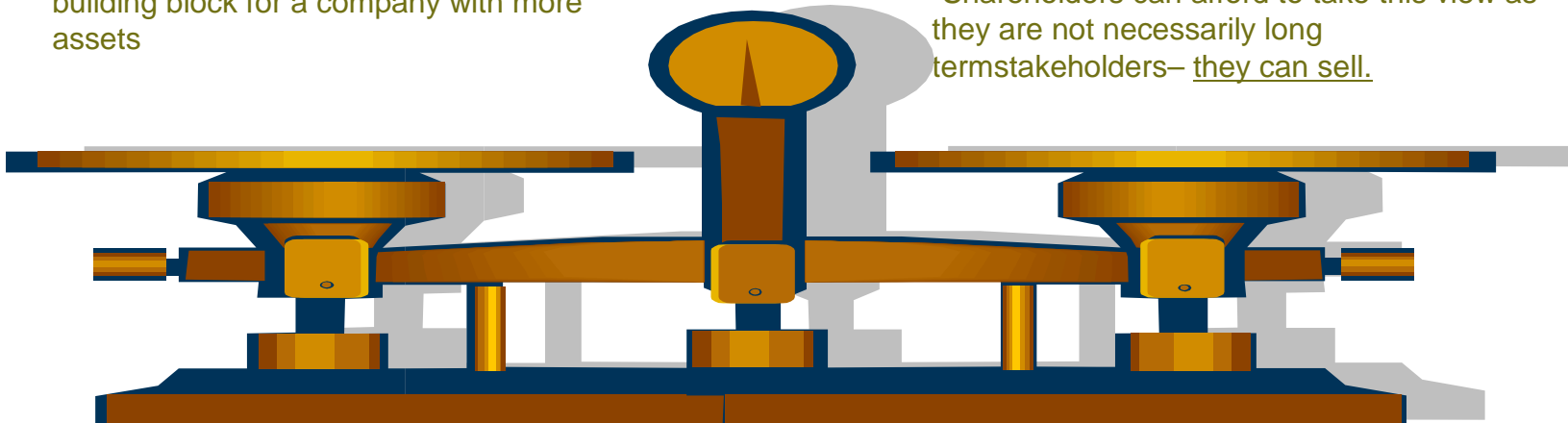
Balancing Act

Management

- Truly the long-term stakeholders in a company's viability, charged with balancing the wishes of current shareholders which may not be the same as other stakeholders.
- Need to consider :
 - The long-term viability of an asset
 - The value of increased stability in revenue
 - Using robust assets and cash flow as a building block for a company with more assets

Shareholders

- Typically invest (in part) to “play” the underlying metal price.
- Some wrongly believe that “hedging” means losing the upside of future price increases – this does not need to be the case.
- They by definition have a bullish view of the commodity.
- Shareholders can afford to take this view as they are not necessarily long term stakeholders– they can sell.



Lenders Risk Assessment

- ❑ Sponsor credentials
- ❑ Track record
- ❑ Management ability
- ❑ Financial status (completion support)
- ❑ Feasibility study (what is bankable)
- ❑ Resources/Reserves
- ❑ Mining method
- ❑ Process risk
- ❑ Infrastructure needs
- ❑ Construction risk and contract
- ❑ Environmental issues
- ❑ Social issues
- ❑ Capital costs
- ❑ Operating costs
- ❑ Market risks
- ❑ Political country risk

Lenders Risk Mitigation

- ❑ Economic Model
- ❑ Cash Flow is the key
- ❑ Ratio Protection (Project Life, Loan Life, Debt Service Cover)
- ❑ Reserve Tail
- ❑ Completion Test
- ❑ Cash flow “waterfall”
- ❑ Repayment schedules
- ❑ Cash sweep
- ❑ Dividend controls
- ❑ Proceeds account
- ❑ Offtake contracts
- ❑ Hedging - Commodity price, FX, Interest Rate, Fuel
- ❑ Technical support
- ❑ Change of control
- ❑ Political risk cover
- ❑ Security
- ❑ Credit Agreement/Documentation
- ❑ Loan pricing and syndication

Other Debt Instruments

Convertibles and High Yield

Key features

1. Possibly longer tenor
2. Possibly tradeable for holders
3. Less due diligence intensive
4. Potential costly prepayment
5. Overall cost higher
6. Dilutive if convert feature included
7. Holders may have less of an understanding of the sector and in the event of a problem, will be more challenging to deal with

Warrants and Equity kickers in financing transactions

What are warrants or conversion rights?

1. Security granting the holder the right to convert debt or acquire shares of an issuer usually with a specified term and at a specified exercise price – conceptually similar to an option
2. The ability to require warrants is correlated to the financing marketplace. Low competition results in strong ability of lenders to require them as part of the deal and vice versa
3. Seen where additional consideration for particularly risky financing propositions and in such circumstances, they can be highly dilutive of the outstanding equity

Other Players

1. Stream financing (public)
2. VPP (banks and funds)
3. Royalties
4. Lease finance (equipment suppliers)
5. Vendor finance (EPC contractors)
6. Offtake finance (more applicable in non-ferrous)
7. Multilateral Agencies (IFC, FAF, ECA)
8. Bonds

All of these types of debt, come with unique features and have roles to play at certain times and in certain situations

Closing

- ✓ What comes easiest, probably comes at the highest cost
- ✓ “A bird in the hand, is worth more than two in a bush”
- ✓ Commodities – going higher FOREVER?
- ✓ Credit markets – bankers will have short memories
- ✓ Be smart enough to know, what you don’t know
- ✓ Credit markets – to remain dynamic and constantly changing. Nothing is typical!
- ✓ Everything in life is about timing and raising capital is the same
- ✓ Bankers like to say know your customer. I say know your banker