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Finding finance

Miners are being forced to seek alternative financing to bridge the funding gap

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Since the beginning of the global financial crisis in 2008, mid-tier and junior mining companies have faced significant challenges in raising development funding for projects. For the past five years, there has been a persistent funding gap.

At times the gap has been on the debt side. Initially emerging when a number of commercial banks, traditionally major providers of mine project financing, suspended their activities in 2008/9.

Later it was caused by the disappearance of a number of these institutions or their unwillingness to fully return to project finance, preferring shorter tenor, less capital intensive business lines.

At other times, the gap has been on the equity side. Whether due to the periodic closing of the markets or the steep dilution that would result from an equity raise, the lack of available equity capital has become a significant issue, particularly over the past 18 months.

While continuing to compete for their share of the much smaller pool of liquidity in traditional debt and equity markets, mid-tier and junior mining companies have been forced to seek new pools of capital and consider non-traditional products to meet their funding needs. These include royalty or streaming transactions, commodity-linked facilities, investments by private equity funds and high-yield or project bonds.

Suddenly it looks as if pools and products that were once rarely tapped by mining companies – commonly referred to as 'alternative financing' – could now be entering the mainstream of options for funding mining projects.

In fact, royalty or streaming transactions have arguably already become mainstream financings in the mining industry. Many expect to see private equity as well as high-yield bonds achieve similar success in the near term.

The challenge is how to couple these alternative sources, which are typically not sufficient to fully fund project costs, with more traditional sources and structures.

As a number of projects that pioneered the use of these financing tools are nearing the stage of development at which full financing must be implemented, the ways in which alternative financing affects a company's flexibility in implementing a full financing-plan becomes clear.

Effects on flexibility

How can alternative financings affect the ability of a company to raise capital – debt or equity? Some are quite obvious as the alternative financing structures by their terms may include outright limitations on the incurrence of debt, granting of liens or issuance or sale of equity. Others are more subtle.

Photo: Christopher Brown

Passengers on the London Underground are told to 'mind the gap'

"Suddenly it looks as if pools and products that were once rarely tapped by mining companies could now be entering the mainstream of options for funding mining projects"

Restrictions and defaults

The most obvious way that alternative financings can affect the ability of a company to raise capital is by imposing restrictions on the activities of the company or providing defaults that result from entering into specific transactions.

The effect of these restrictions is to provide the alternative financier a veto right over such activities or transactions, because any such activity or transaction would require the consent of the alternative financier, or at least those which do not fit within pre-agreed parameters.

These restrictions could include limitations on the incurrence of debt and granting of liens. Depending on how broadly debt is defined, this could limit the ability to enter into equipment leasing transactions and hedging facilities, in addition to borrowing under loan agreements or issuing bonds.

On the equity side, the limitations could include restrictions on the issuance of equity or actions resulting in a change of control. Such limitations would not only limit the ability to issue common or preferred stock in the capital markets or through private placements, but also affect the ability to raise debt through the issuance of convertible securities or those with attached warrants.

Additionally, they could affect the ability to bring in joint-venture partners and in certain instances limit the ability to grant liens on the equity of the company to secure other debt financing.

Finally, the limitations imposed could restrict the sale of assets, which would limit the ability of the mining company to enter into a royalty or stream transaction or a commodity-linked financing.

Moreover, depending on how broadly the restriction is written, it could limit the ability to raise funding through sale leasebacks or the monetisation of contracts or non-core assets.

Another more obvious way in which alternative financing can affect a company's flexibility in raising capital is if the alternative financing is secured by some or all of the assets of the company. Unless that financing can and is refinanced in full, it is likely that consent will be required to do any future secured financings.

Additionally, an inter-creditor arrangement may

need to be negotiated between the alternative financier and future lenders or bondholders.

Even when documentation for alternative financing includes 'feel good' language by which the alternative financier agrees to negotiate in good faith and take such actions needed to facilitate future financings, in the end it requires negotiation. And when it comes to negotiating, what one party thinks is reasonable, the other may not.

More subtle

There are subtle effects that alternative financings can have on the ability of a company to raise capital, whether debt or equity.

With respect to future debt raisings, alternative financings can affect a company's borrowing capacity and the cost of any debt it may raise.

This depends on the consequences for the company's coverage ratios once alternative financing is incorporated into its projections.

Based on the view of traditional lenders and other debt investors as to whether alternative financing is debt or equity – or something else altogether – future lenders and bond purchasers will take a view on the resultant gearing or leverage ratio of the company.

Finally, the question remains as to how rating agencies adjust (if at all) the debt and other credit metrics they use in assigning or re-evaluating a rating for the various types of alternative financings. This is a particularly interesting question with respect to royalty, stream and commodity-linked financings.

There are other complications for future debt deals that can arise from alternative financings. For example, complications arise if an alternative financing includes an exit right at a time likely inside the maturity of future debt financings.

Thus, a provision in a preferred stock investment by a private equity investor requiring a mandatory redemption in year five of the investment, will raise an issue if the company intends to enter into a 12-to-15 year traditional agency or commercial bank project financing.

Similarly, complications can occur if a company enters into a strategic partnership with a private fund and again intends to include a traditional project financing as part of its full capital raising plan.

In such cases there is the question of how the requirement for a completion guaranty, cost overrun support and other potential sponsor support will be addressed by the fund, or between the company and the fund.

With respect to future equity raisings, alternative financings can complicate the ability to bring in partners. Such complications can arise not only from the consent rights mentioned above, but also because of more subtle consequences of various alternative financings.

These include limitations arising from the tax structuring of some forms of alternative financing, which can necessitate creating complex structures or imposing costs on bringing in partners, particularly if the result is a change of control.

Moreover, there is the impact on a potential partner's valuation of the company, having factored in the effects of the alternative financing. Finally, some equity investors prefer to maintain the potential commodity price upside, which is lost as a consequence of commodity-linked financings and stream transactions.

Photo: Bloomberg News

How will rating agencies, such as Moody's Investors Service, adjust the debt and other credit metrics they use in assigning or re-evaluating a rating for the various types of alternative financings?

Looking forward

The funding gap that opened in 2008 and has since persisted shows no immediate signs of closing. Thus, mid-tier and junior mining companies will need to continue to be creative in fashioning their financing plans.

Alternative financing such as royalty or streaming transactions, commodity-linked facilities, private equity or hedge fund investments and high-yield or project bonds have many benefits. Thus, despite the challenges noted above, no doubt they will all be important parts of many such plans.

As the terms of alternative financings evolve and the areas of friction among all potential funding sources clarify, the key to success in implementing a full financing plan could well be ensuring maximum flexibility to unwind arrangements that prove sub-optimal in a broader plan. That means having the right to unwind and minimise the cost of unwinding. ▼

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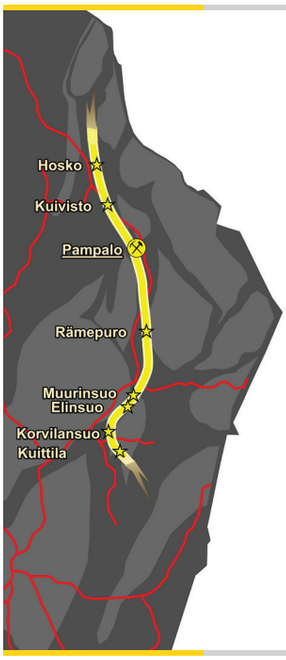

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