

# A new normal, or the bottom of the cycle?

Mergers, acquisitions  
and capital raising in  
mining and metals –  
2015 trends and  
2016 outlook



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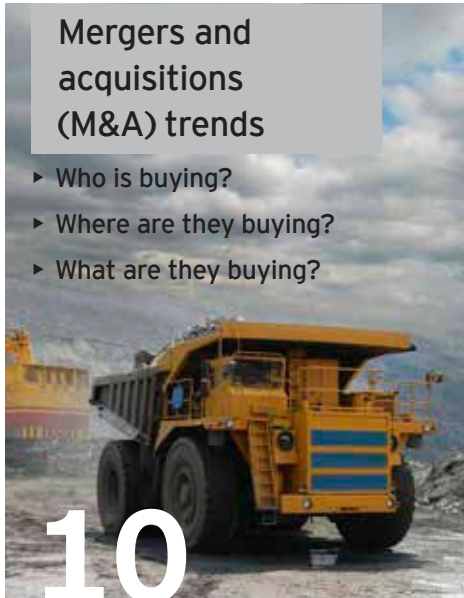


## Widespread signs of distress



## Mergers and acquisitions (M&A) trends

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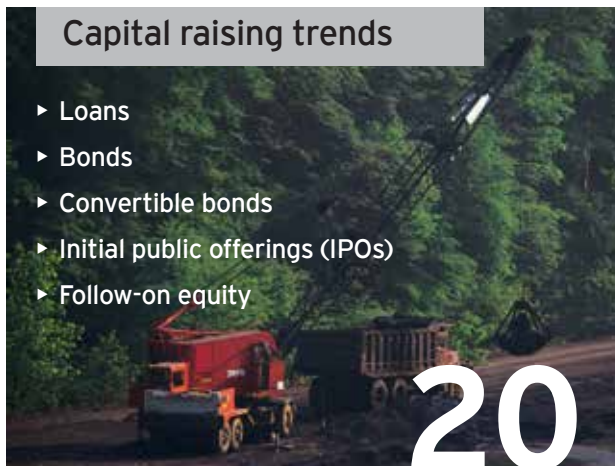


## Divestment: reducing execution risk in a buyers' market



## Capital raising trends

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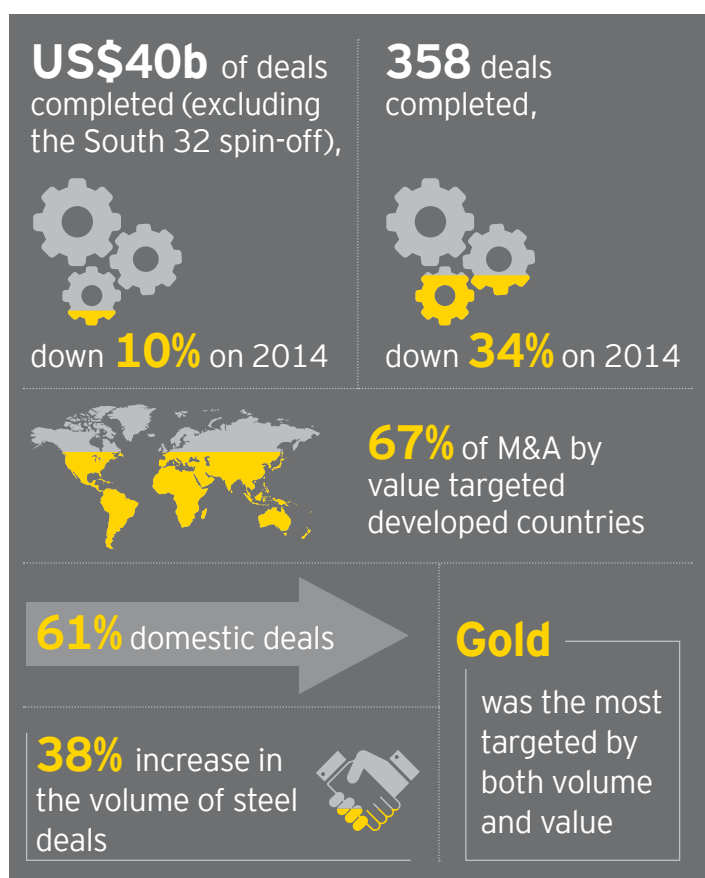




# Executive summary

For the fifth consecutive year, the sector has experienced a decline in deal activity. This comes as no surprise given the huge uncertainty over long-term fundamentals and increasing levels of financial distress throughout the sector. However, this distress may be the precursor to recovery in deal volumes – if not value – during 2016.

## M&A: Distress giving rise to strategic actions



exhausted, management are having to make strategic decisions that have long-term implications on the future direction of the business:

- **Divestments:** With alarming regularity, we are seeing divestment processes announced across the sector. Anglo American, Nyrstar, Freeport-McMoRan and Glencore, to name just a few, have all announced the intention to divest assets in 2016. At a time when prices are depressed, buyers are scarce, and execution risks high, this is a difficult time to be selling.
- **Refinancing:** Balance sheet strength and flexibility are critical in such challenging markets, and there has been an increasing focus to reduce leverage and push out maturities. While there has been some equity raised – and there is likely to be more in 2016 – this has typically been an action of last resort, with Glencore and Lonmin, for example, having to do so in order to stabilize falling share prices. More commonly, debt has been repaid through proceeds raised from divestment, forward sales or streaming.
- **Corporate restructure:** Going beyond a simple divestment or portfolio resizing, some corporates are literally redrawing their strategic lines. A good example, which was the sectors' largest deal of 2015 by value, was BHP Billiton's spin-off of South32, signaling a clear intention to focus on a small number of scalable asset pillars rather than a broad diversified portfolio of assets.
- **Dividend cuts:** Given the context above, it is of little surprise that dividends are increasingly being forgone in order to retain balance sheet strength. Even among the diversified, to which dividend policy is a critical factor in share price performance, we have seen dividends cut and policies change from "progressive" to earnings based, reflecting the realization that future metals prices are inherently uncertain.

Management across all levels of the mining and metals sector continue to focus on balance sheet and margin improvement. Organizations of all sizes have embraced capital expenditure cuts, mothballing of loss-making operations, productivity improvement, and working capital efficiency drives. However, in this market, even these actions are not always sufficient. With internal options

## Shareholders are increasingly influencing the agenda

Many of the actions witnessed during 2015 are likely to be replicated in 2016, and arguably with greater regularity and scale. It is increasingly clear that position on the cost curve is critical as supply-side correction looks to be the only way to restore fortunes. However, with so much uncertainty linked to finance-backed commodity trades, the supply-demand picture is arguably less clear than ever. As a result, the supply-side correction is coming; the question is how much of it will be voluntary shutdowns and how much will be forced via corporate failures.

Perhaps the most stark realization of 2015 is that nobody is sure how long the current downturn is going to persist, and management cannot sit back and wait for an improvement in market conditions.

Investors are increasingly short of patience, as the dramatic fall in share prices in 2015 demonstrated. There is also an increase in the level of activity from activist shareholders, such as Casablanca (Cliffs Resources) and Carl Icahn (Freeport-McMoRan), who have a track record of instigating change at both the management and the operational levels. Unless equity prices begin to pick up, which seems unlikely in the short term, these investors will continue to circle the industry looking for opportunities to stimulate change and drive value out of challenging situations.

## Share market performance relative to peers



Source: S&P Capital IQ, EY analysis

## Capital raising continues to be an issue

**US\$228b** capital raised,  
**9%** y-o-y fall



Loan proceeds down **27%**  
to **US\$122b**

**13** IPOs completed with a  
**78%** drop in value on 2014



**US\$77b** in bond  
proceeds, up **32%**

Overall, capital raised across the sector was down by about 10% y-o-y. The decrease was primarily due to a sharp drop-off in loan finance to the sector, which fell to US\$44b in 2015 from US\$122b in 2014. Much of this was for the refinancing of existing facilities, emphasizing the limited amount of new finance going into projects. However, this trend comes as no surprise given the very difficult – and worsening – trading environment that the industry faced during 2015.

The backdrop of challenging market conditions has led to a number of alternative financing strategies being pursued, with asset disposals featuring prominently and almost US\$3b of streaming finance being announced across the industry.

## Outlook: the face of M&A and capital raising will continue to evolve

Gone are the megadeals with the unashamed focus on consolidating market share. At its 2007 peak, we saw over US\$200b of deal value across the sector, with a small number of proposed deals at the time valued well in excess of US\$70b. This deal rationale has limited currency in the sector right now; size is not all-important, but instead the focus is on higher returns on capital, greater optionality and flexibility across asset portfolios, and an improved cost curve position.

The following are the key M&A trends that EY sees continuing into 2016.

- ▶ **Sell-side** will continue to be the catalyst for M&A, with assets going to market from distressed sellers in need of capital. This isn't expected to turn into a mass fire sale, but there is clearly a greater "push" from sellers than a "pull" from willing buyers. The challenge for those divesting is to present the asset properly so that buyers remain confident in the underlying valuation and a competitive process is maintained.
- ▶ **Private capital** may well be the new face of M&A across the sector, but it doesn't yet dominate proceedings and may forever be a relatively small player in the sector's overall deal activity. Both Magris Resources and Audley Capital demonstrated in 2015 that deals were to be done by specialist funds with a focus on the sector. The model looks more attractive than ever given the relative value of potential targets and the increasingly distressed disposition of sellers. EY expects to see a greater volume of deals completed by these funds during 2016. But, with a significant increase in assets available for sale, only the best assets will attract their focus and pricing will remain disciplined.
- ▶ **Deferred consideration** appears to be growing in popularity, while previously it was largely unheard of in the sector. For example, Anglo American has shown it is prepared to consider bids with upside with the sale of Anglo Norte SA and Rustenburg. With increased sales processes, limited buyers and extreme price uncertainty, EY expects to see a greater level of deals incorporating deferred consideration in 2016.
- ▶ **Spin-offs** are emerging as a key consideration for the diversified producers. This is perhaps best illustrated by this year's highest

value deal, BHP Billiton's spin-off of South32, which raised a number of contrasting views on the process. Whether sparked by the South32 process, or otherwise, the idea of packaged asset spin-offs increasingly feature in boardroom discussions. The challenge in a distressed situation is the level of working capital required to go with the spun-off entity in order for it to survive independently; capital that is much needed for both parties and can often be the critical factor in preventing such a deal from successfully completing. Given this challenge, spin-offs are expected to continue to be high on the strategic agenda, but relatively few will actually consummate during 2016.

- ▶ **Joint ventures and mergers of equals** have also grown in popularity as companies look to leverage synergies and economies of scale in challenging market conditions. Despite the difficulties, a merger of equals can be successfully structured, as demonstrated by Alamos Gold and Aurico Gold's US\$1.5b combination during the year. On the flip side, as the recent discussions between Randgold and AngloGold Ashanti over the redevelopment of the Obuasi mine demonstrate, getting two parties to agree on the terms of such a deal is incredibly challenging. EY expects to see a greater level of mergers and joint ventures pursued during 2016, with the key focus on de-risking and preserving capital; the challenges around execution will remain very high, but an acute need to consummate will drive deals through.

In terms of capital raising, the financing markets are expected to remain challenging in the year ahead, with corporate rating agencies taking a very close look at future cash generation and corporate refinancing strategies. Likewise, the availability of equity will remain an option of last resort only and will be highly dilutive to those looking to raise secondary equity. Now would appear to be the time for well-capitalized producers to look at lending opportunities into the sector that position them for future strategic growth and alternative finance providers to evaluate the opportunities in distress. World-class assets trapped in difficult corporate situations may still provide strong financial returns to the canny investor.





# 01

## Widespread signs of distress

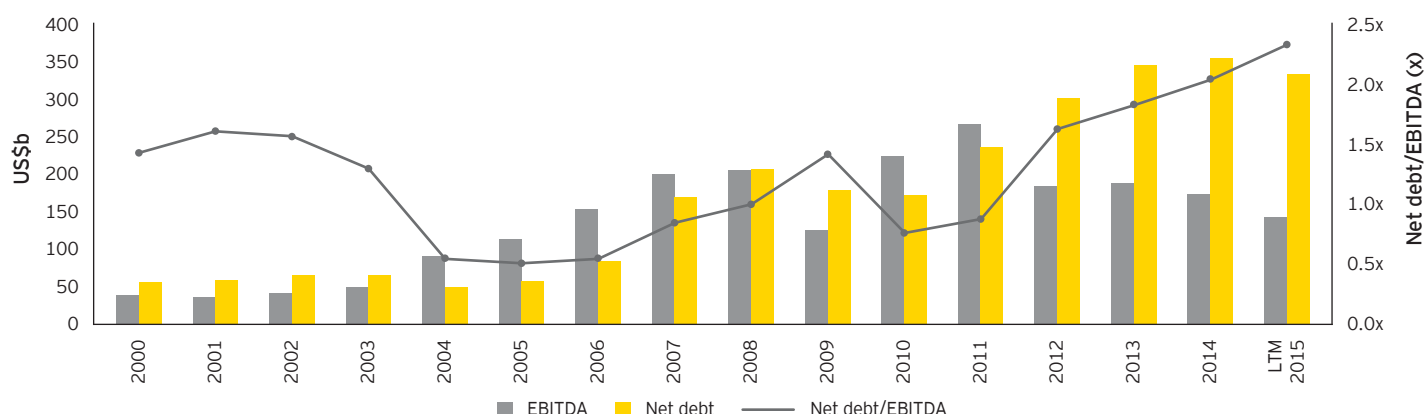
## The disconnect between earnings and leverage in recent years has reduced companies' financial flexibility.

Net debt has continued to rise for EY's sample of 88 companies since 2010, despite earnings falling over the same period; critically, this is the first observable

period of such a disconnect between debt and earnings progression. With net debt/EBITDA at levels exceeding those last seen in 2000, leverage is starting to increasingly

stretch balance sheets and limit flexibility to absorb financial shocks.

### Impact on net debt

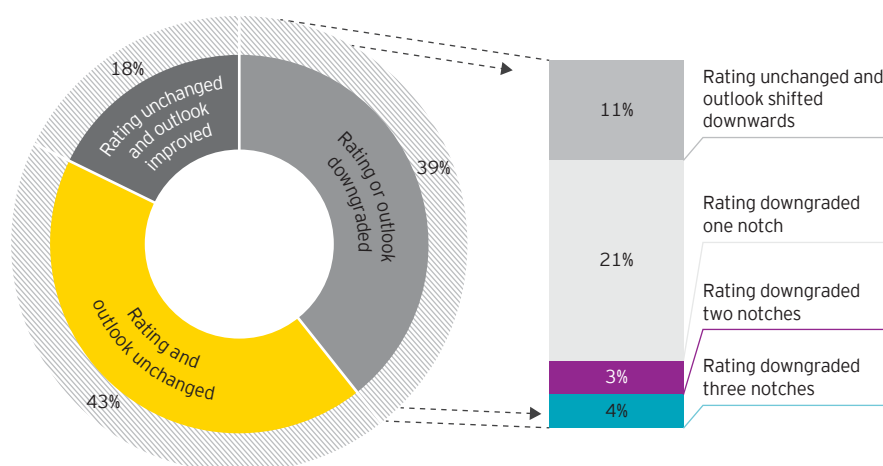


Note: Based on a sample of 88 mining companies from available information provided by S&P Capital IQ.

Source: EY research; S&P Capital IQ

During 2015, a high proportion of corporate credit ratings were downgraded or placed on negative watch as the rating agencies factored in increasing leverage positions and the subdued outlook for commodity price improvements.

While the associated "dollar" impact of a downgrade to the servicing costs of debt may be relatively small due to currently low interest rates, the overall impact on financial flexibility is often severe. This can range from worsening credit terms from suppliers; availability of finance (and terms thereon); through to overall market confidence in the underlying business and, consequently, negative rating of the share price.



Note: S&P rating changed between 31 December 2014 and 31 December 2015 for a sample of 28 companies.

Source: EY research, S&P Capital IQ, Standard & Poor's

#### Some of the companies affected by rating changes include:

- ▶ Teck Resources, which was downgraded three notches by both S&P (BBB to BB) and Moody's (Baa3 to Ba3), cited to be driven by the persistently weak metallurgical coal market conditions coupled with high capital expenditure on the Fort Hills oil sands project
- ▶ Vale, which was downgraded two notches by S&P (A- to BBB) and one notch (Baa2 to Baa3) along with a switch to negative outlook by Moody's, cited as being principally driven by the expectation that iron ore and base metal prices will not experience a meaningful recovery until 2017

**The sustained low commodity price environment resulted in a large number of casualties in 2015, with more than 46 mining and metals companies entering formal bankruptcy proceedings**

The formal bankruptcy cases presented below are heavily skewed toward US companies. This is likely to be partly driven by the US Chapter 11 procedures being generally considered “softer”<sup>1</sup> than the formal bankruptcy procedures in other jurisdictions and, therefore, more companies opting to enter this protective environment.

The coal sector in North America was by far the worst hit, with at least 20 companies including Alpha Natural Resources, Arch Coal and Walter Energy entering bankruptcy

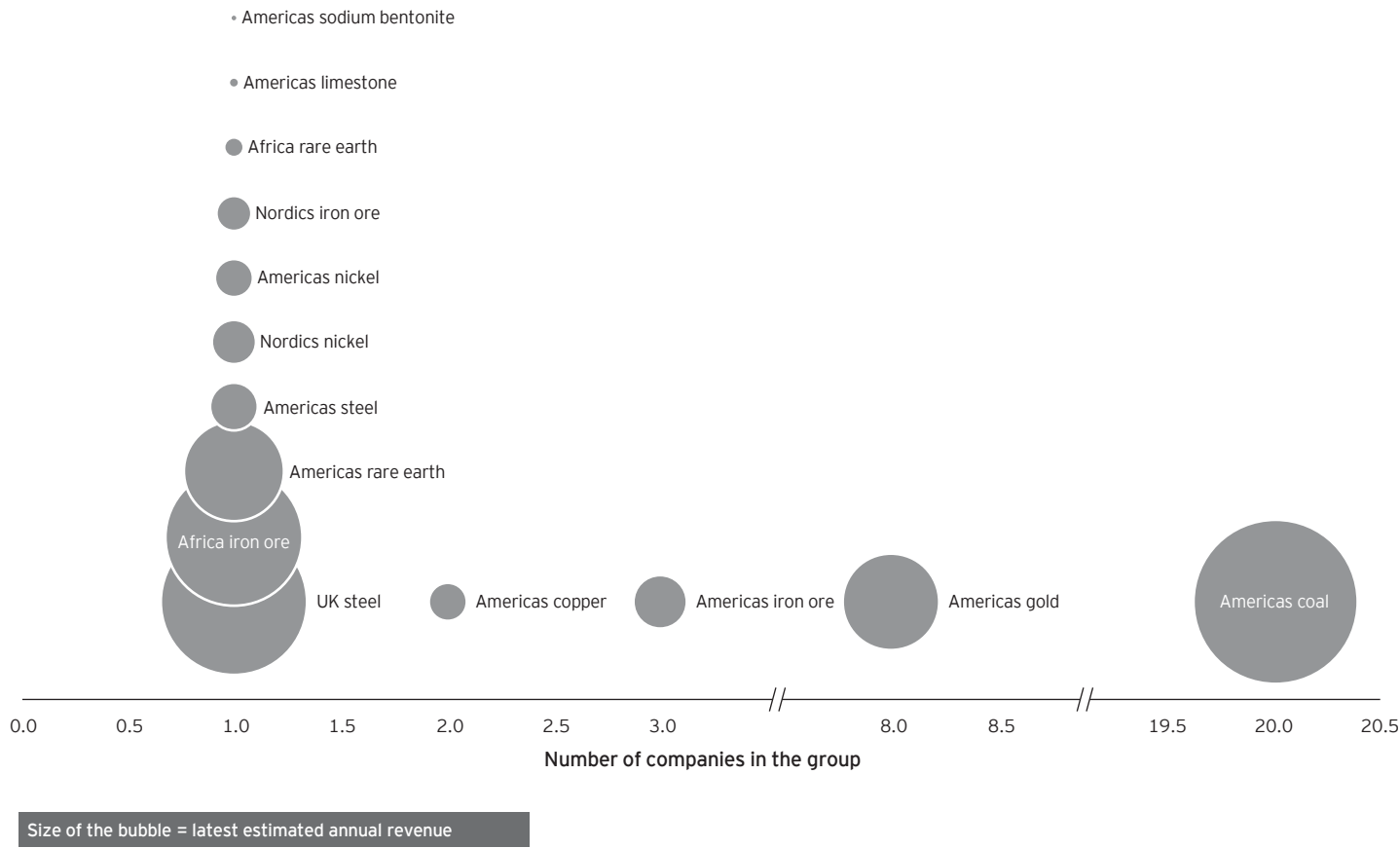
proceedings. The unprecedented decline in the North American coal sector has been driven by several structural factors, including the switch to natural gas-fired power stations owing to both the sustained glut in low-cost natural gas, and environmental and pollution regulation. Coal companies that overinvested in the high-sulfur coal of the Appalachian region are the worst affected.

The Americas gold sector also suffered, with casualties from the juniors and mid-tiers, including San Gold Corporation, Midway Gold Corporation and ATNA Resources Ltd. These companies were generally highly leveraged or had limited flexibility in their capital structure and operated at the upper end of the cost curve, forcing them into bankruptcy when gold

prices continued their decline coupled, in some cases, with operational issues.

These, however, are not the only sub-sectors experiencing financial difficulties. Others, such as the Chinese steel and nickel sectors, have been able to stay afloat only because of government subsidies and support. These actions have limited the competitiveness of these sub-sectors in the free market economies, and without sufficient compensating actions being taken, we are likely to see further examples of bankruptcy proceedings being initiated in 2016.

**Formal bankruptcy cases by commodity and region of operation (2015)**



Source: EY analysis, S&P Capital IQ, SNL

<sup>1</sup> P. Povel, “Optimal ‘Soft’ or ‘Tough’ Bankruptcy Procedures,” *The Journal of Law, Economics, & Organisation*, 1999.







# 02 M&A trends



## Macro uncertainty inhibits activity

The ongoing uncertainty in global markets and concerns over Chinese growth continue to weigh on corporate strategy. Deal activity is now in its fifth consecutive year of decline across the sector, with overall volume dropping 34% to 358 deals, from 544 deals in 2014. Deal value also dropped 10% to US\$40b (when excluding the South32 spin-off), down from US\$44.6b in 2014.

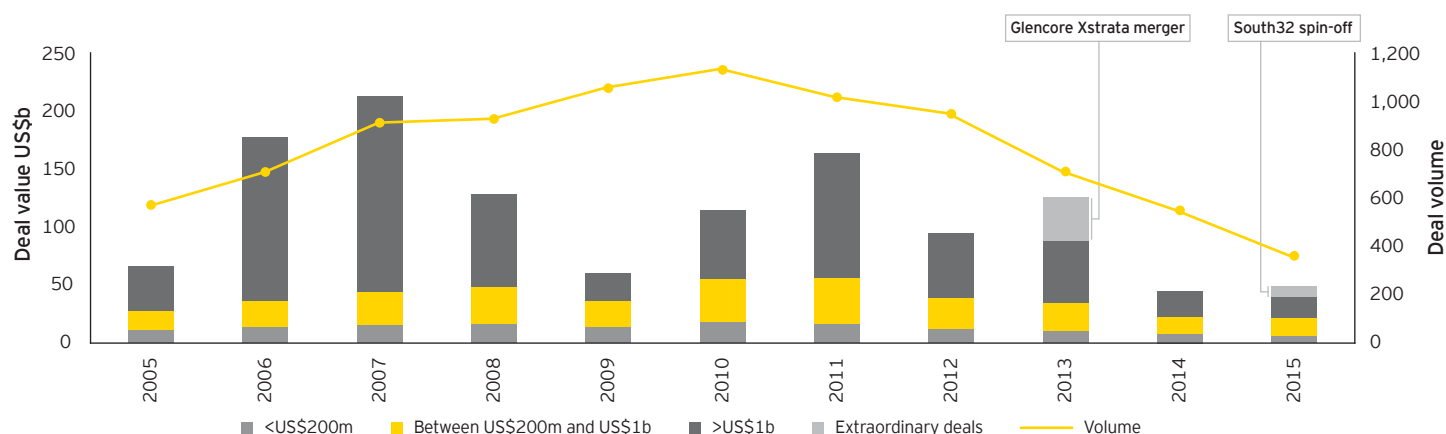
## Divestments slowly gather momentum

The largest deals of the year were predominantly driven from the sell-side as a way to unlock value for shareholders, by reorganizing and streamlining the business to focus on core operations. An example was BHP Billiton's spin-off of its aluminum, manganese and nickel assets into South32, which was also the year's biggest deal. Similarly, we saw high-value non-core divestments by Vale, Anglo American and Barrick Gold.

## Strategic buying grows at the junior and mid-tier end

Whether opportunistic or desperate, mergers between equals and strategic purchases of prospects at the junior/explorer end of the market carried a slightly higher overall price tag this year. The median deal value for 2015 was US\$7.2m, compared with just US\$3.2m in 2014.

## Volume and value of deals by size (2005-2015)



## Megadeals 2015

Rank	Value (US\$m)	Target name	Target country	Target commodity	Acquirer	Acquirer country	Acquirer commodity	Share owned (%)	Deal driver
1	8,719	BHP Billiton (South32)	Australia	Diversified	Shareholders	Australia	Shareholders	100.0	Non-core divestment
2	5,384	Polyus Gold International	UK	Gold	Wandle Holdings	Russia	Financial investor	59.8	Strategic growth
3	1,953	Globe Specialty Metals	US	Silicon	Grupo FerroAtlantica	Spain	Silicon	100.0	Consolidation
4	1,500	Alamos Gold	Canada	Gold	AuRico Gold	Canada	Gold	100.0	Merger of equals
5	1,413	Sirius Resources	Australia	Nickel	Independence Group	Australia	Diversified	100.0	Portfolio expansion
6	1,411	Golden Energy Mines	Indonesia	Coal	United Fiber System	Singapore	Other	67.0	Diversification
7	1,370	Foresight Energy	US	Coal	Murray Energy	US	Coal	50.0	Merger of equals
8	1,268	RTI International Metals	US	Other non-ferrous metals	Alcoa	US	Aluminium	100.0	Diversification
9	1,185	Minerações Brasileiras Reunidas	Brazil	Iron ore	Fundo de Investimento em Participações Multisetorial Plus II	Brazil	Financial investor	36.4	Non-core divestment
10	1,148	Hyundai Hysco	South Korea	Steel	Hyundai Steel	South Korea	Steel	100.0	Diversification
11	1,064	Rio Alto Mining	Canada	Gold	Tahoe Resources	US	Silver/lead/zinc	100.0	Merger of equals
12	1,005	Barrick Gold (Zaldivar copper project)	Chile	Copper	Antofagasta	UK	Copper	50.0	Non-core divestment



# Who is buying?

- Corporate vs. private equity:** In a year where many expected to see private equity dominate, investment into the sector was actually dominated by corporates, which accounted for 73% of deal volume in 2015. Two of the standout corporate deals in 2015 occurred between industry players consolidating their position in the market: the Alamos Gold and AuRico Gold deal for US\$1.5b and the Rio Alto and Tahoe Resources deal for US\$1.1b.
- Most acquisitive countries:** The US undertook the highest value deals (US\$7b or 17%), while Canada undertook the greatest number of deals (119 deals, 33%) when excluding the South32 spin-off. China followed the US with US\$6.1b worth of deals, of which US\$4.0b and 67% of volume was targeted domestically. Notably, there were no Chinese deals valued in excess of US\$1b – the first time that we have failed to see a Chinese megadeal since EY's analysis commenced in 2008.
- Most acquisitive regions:** Asia-Pacific based acquirers were the highest value dealmakers with 41% of value (US\$16.3b) and 39% of volume (139 deals) when excluding the South32 spin-off. North American acquirers were the most prolific, undertaking 43% of deals (152) worth US\$11.9b. These were dominated by small-cap deals in Canada, mostly in the gold sector.
- Private equity investment remains elusive.** The standout deals during 2015 were made by the Magris Resources-led investor group which purchased IAMGold's divested niobium asset for US\$530m, and by Audley Capital which purchased Anglo American's divested Norte copper asset for US\$300m plus potential future payments up to US\$200m.

## 27%

of deal volume was undertaken by acquirers from outside the industry

## 43%

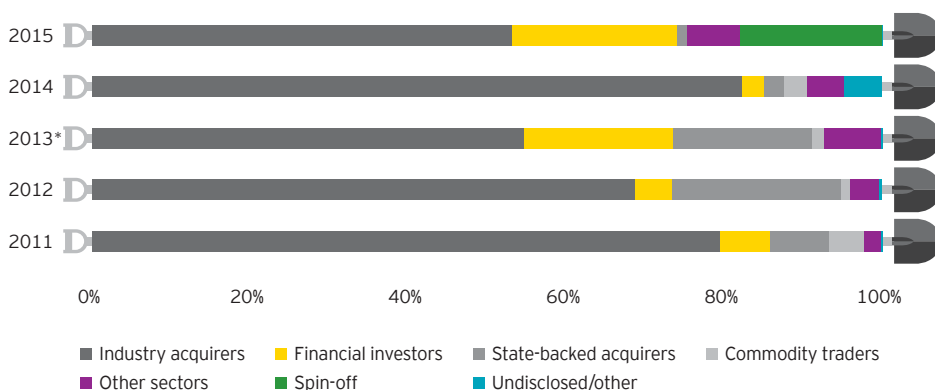
of deal volume was undertaken by North America based acquirers

## Outlook for 2016

Assets being divested by distressed sellers will continue to come to market during 2016, and it appears to be only a matter of time before the valuation gap that has held back dealmaking in the past couple of years will begin to close. Some assets look like they may be divested without any consideration being paid by the acquirer, such as mid-tiers undertaking joint ventures. These assets may also attract the interest of private equity looking to capitalize on well-priced opportunities.

At least one major company has hinted it would be interested in making acquisitions when the market enters a phase of distressed pricing, however, the large caps, for the most part, will remain focused on streamlining, cost-cutting and balance sheet preservation.

### Share of deal value by acquirer type



# Where are they buying?

# 57%

of deal volume and 67% of deal value targeted assets in developed regions such as US, Canada and Australia

# 73%

of deals targeted assets within the acquirers' region

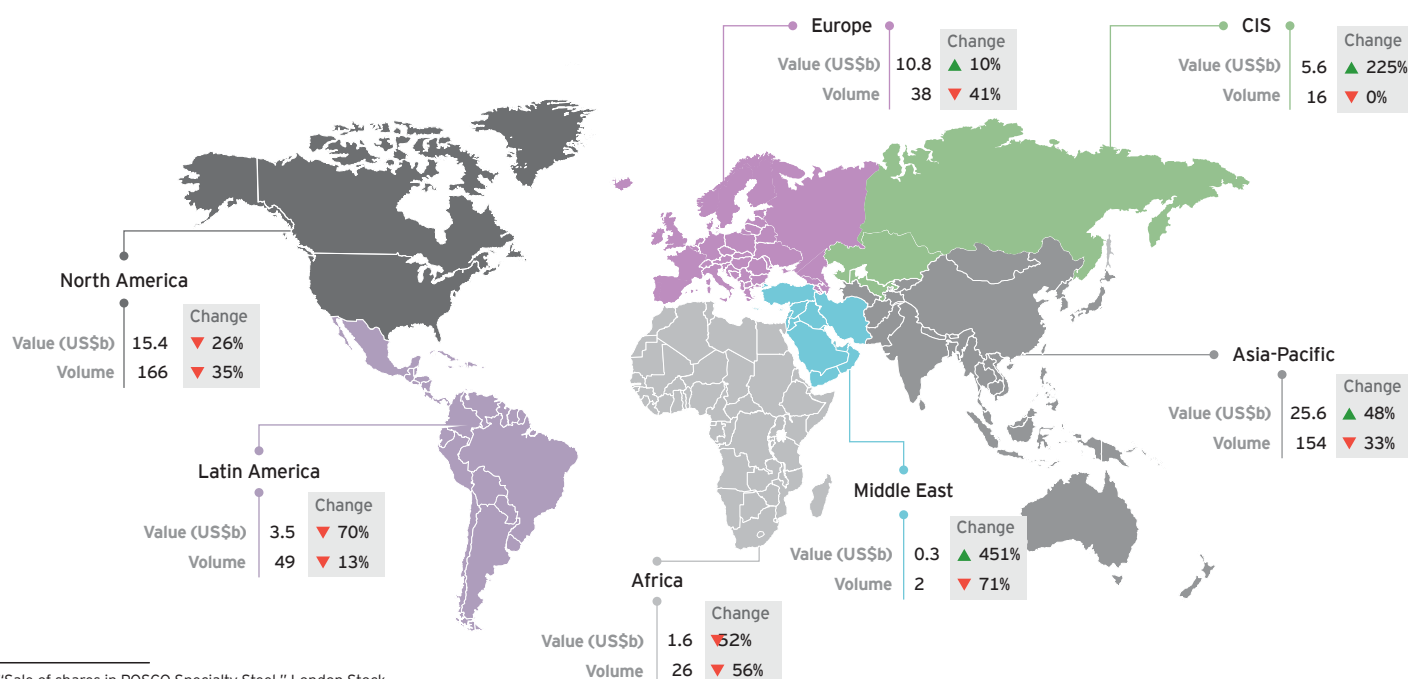
- ▶ **Domestic vs. cross border:** The ratio of domestic to cross-border transactions increased slightly in 2015 y-o-y, with 61% of deal volume and 60% of deal value targeting domestic assets, compared with 58% volume and 43% value in 2014. In a relatively benign period of M&A, this is unsurprising as operators seek value through mergers with entities in geographic proximity to their existing assets, thus leveraging existing infrastructure and experience in the regions.
- ▶ **Most targeted region:** Asia-Pacific was the most targeted region, taking 37% of deal volume. Among the higher value deals were Independence Group's strategic acquisition of Sirius Resources

for US\$1.4b and two of Barrick Gold's divestments this year (Cowan in Australia and Niugini in Papua New Guinea). Also of note, in terms of deal size, was South Korea, which saw two major domestic steel deals, namely the Hyundai Hysco and POSCO Specialty Steel acquisitions.<sup>2</sup>

- ▶ **Emerging markets lose appeal:** Deals in emerging regions declined during 2015, with a 46% drop in deal value. The only significant deal was Vale's divestment of a stake in Minerações Brasileiras Reunidas for US\$1.2b. Investment into Latin America and Africa remains scarce due to the higher associated valuation risks and political uncertainty during a period of low-risk capital investment across the sector.

## Outlook for 2016

Falling currencies may help lower the costs associated with operating in commodity-rich countries, such as Brazil and South Africa. However, with the focus still firmly on reducing capex, it's unlikely there will be a significant amount of investment into undeveloped projects in the near future. Investors are more likely to continue their interest in select advanced projects in North America and Australia, especially in the historically well-run divested assets on the market. EY expects to see further restructuring deals within Asia and ongoing consolidative deals in North America.



<sup>2</sup> "Sale of shares in POSCO Specialty Steel," London Stock Exchange, 18 March 2015, <http://m.londonstockexchange.com/exchange/mobile/news/detail/12285197.html>, accessed 29 January 2015.

# What are they buying?

- **Most attractive commodity:** Gold retains the lead as the most targeted commodity with 117 deals. It also took over as the most targeted commodity by value at US\$13.9b, representing a 64% increase on the 2014 deal value. This was primarily driven by three of this year's megadeals, namely the Polyus Gold acquisition by Wandle Holdings, the Alamos Gold and AuRico Gold merger, and the Rio Alto and Tahoe Resources merger. The mergers are indicative of a developing trend between mid-tier pure plays to join forces while commodity prices are low, potentially paving the way to becoming leading producers when prices recover.
- **Least attractive commodity:** Aluminium and iron ore are among the least

attractive targets, with a factor of oversupply and uncertain demand outlook from China creating concerns over long-term price forecasts. Copper also saw very low deal activity, although this is likely due to the scarcity of assets on the market rather than embedded concerns about long-term fundamentals.

- **Steel deals rise on structural changes:** The number of steel deals increased by 38% to 29 deals, but value dropped 53% to US\$4.6b. This trend is reflective of the number of steel producers divesting to reduce debt, diversifying to minimize exposure or making acquisitions to explore new markets. Steel producers are focused on rebalancing as prices fall under pressure from increased Chinese exports.

## 86%

decline in the number of iron ore deals in 2015 y-o-y

## 29%

of 2015 deal value targeted gold

## Outlook for 2016

Struggling bulk commodity producers continue to suffer, despite having aggressively cut cost and refinanced balance sheets. The protracted period of low prices and dwindling demand out of China looks set to continue, so there may be more distressed assets entering the market or facing closure.

Aluminium			
	Change	Drivers	
Value (\$b)	0.2	-63%	Cost reduction/ portfolio optimization
Volume	2	-75%	Strategic investment  Financial distress

Coal			
	Change	Drivers	
Value (\$b)	5.4	22%	Corporate distress
Volume	38	-25%	Portfolio realignment  Opportunistic investment/consolidation

Copper			
	Change	Drivers	
Value (\$b)	3.0	-18%	Expansion
Volume	27	-29%	Fund-raising  Divestment

Gold			
	Change	Drivers	
Value (\$b)	13.9	64%	Non-core divestment
Volume	117	-32%	Debt reduction  Strategic growth

Iron ore			
	Change	Drivers	
Value (\$b)	1.2	-36%	Non-core divestment
Volume	4	-86%	Debt reduction and financing  Distress and industry exit

Nickel			
	Change	Drivers	
Value (\$b)	1.9	397%	Distress
Volume	7	-46%	Strategic investment  Expansion

Potash/phosphate			
	Change	Drivers	
Value (\$b)	0.1	-50%	Securing supply
Volume	6	-40%	Expansion  Divestment

Silver/lead/zinc			
	Change	Drivers	
Value (\$b)	1.7	437%	Secure supply
Volume	19	12%	Expansion  Consolidation

Steel			
	Change	Drivers	
Value (\$b)	4.6	-53%	Portfolio optimization
Volume	29	38%	Access new markets  Consolidation







03

How do you reduce execution risk in a buyers' market?



There was a steady flow of announced and concluded disposals in 2015, which accelerated during the second half of the year as market volatility increased and balance sheet concerns became more pronounced. Companies were pressed by stakeholders into demonstrating adequate liquidity and preserving investment-grade credit ratings against a backdrop of falling prices. Some were opportunistic in disposing of non-core assets, to free up financial capacity to deploy in higher-yielding areas, or in anticipation of leading future industry restructuring.

Financing any acquisition may not be straightforward for the following reasons:

- ▶ **Corporates** can take on debt or issue shares, though it will require robust justification to satisfy debt and equity holders, which will be unlikely if balance sheet concerns remain.
- ▶ **Private equity** continues to evaluate opportunities, with significant committed capital being available. However, with falling prices and sellers being inclined to run auctions instead of bilateral processes, the scope to demonstrate high-future returns at operating level is reduced, unless other sources of value can be captured.

The first half of 2015 was mostly dominated by portfolio optimization, with South32 successfully spun out of BHP Billiton, and Polyus Gold de-listed and taken private. In addition, two transactions of note included Independence Group acquiring Sirius Resources for US\$1.4b and Alcoa's US\$1.3b acquisition of RTI International Metals. Both either secured assets enjoying a competitive advantage, or seized further supply chain value.

A highlight of transactions during 2H15 illustrates that average transaction values were typically less than US\$1b, and involved assets that could easily be carved

out of core operations, vastly simplifying a divestment process. Another trend witnessed in the divestments executed in 2015 was the use of deferred consideration, highlighting the negotiating power held by acquirers in a market where there is little competitive tension. Historically, the use of deferred consideration has been rare in the mining and metals sector, but EY expects it to continue to be increasingly common as divestment processes ramp up in 2016.

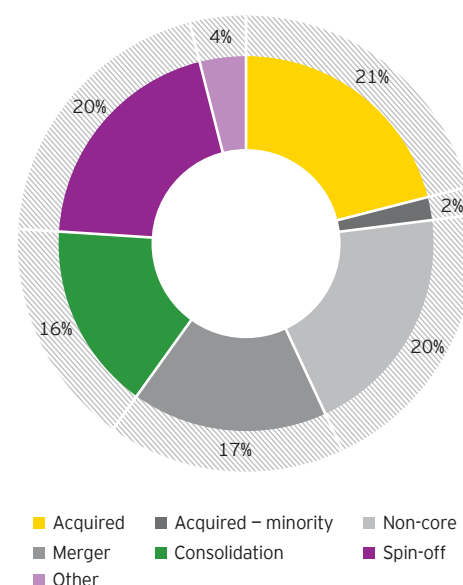
### Completed transactions

- ▶ A\$50m sale of Anglo American's Dartbrook coal mine (Dec 15), and up to US\$500m disposal of their Copper Norte assets (Aug 15)
- ▶ US\$750m disposal of Noble's remaining 49% stake in Noble Agri (Dec 15) and going through final stages of shareholder/regulatory approval
- ▶ US\$720m in disposals by Barrick Gold of several, non-core assets in Nevada (Nov 15), along with US\$1b sale of 50% stake in Zaldivar to Antofagasta (Jun 15)
- ▶ Rio Tinto's US\$606m sale of Bengalla coal assets to New Hope (Sep 15)

### Announced intention to divest

- ▶ Nyrstar's upstream zinc portfolio
- ▶ A minority sale of Glencore's agriculture trading business, and disposals of Lomas Bayas and Cobar copper mines
- ▶ Anglo American's Brazilian niobium and phosphate mines, with others expected after concluding a strategic review
- ▶ First Quantum's nickel assets in Finland and Australia

### Sell-side rationale for divestments in 2015 > US\$100m



Source: Associated Press, S&P Capital IQ

Note: First Quantum's disposal is based on press reports and has not been formally announced.



A total of 77% sell-side disposals during 2015 appear to have been motivated by:

- ▶ Strengthening balance sheets and overall liquidity
- ▶ Lowering cash costs through the sale of non-core assets or entering into mergers to realize synergies
- ▶ Focusing on specific commodities and/or geographies, also through non-core asset sales, or spinning off assets
- ▶ Attempting to share the cost of developing assets by disposing of minority stakes

Not all these transactions may have been prompted by management strategies, with external factors including pressure from stakeholders, which materialized in lower share prices, or rising debt yields. This in turn may have encouraged divestments otherwise not considered, or accelerated such plans.

Equally, not all divestments have sought to improve credit metrics. Rio Tinto's disposal of its Bengalla coal mine has augmented a repositioning toward bauxite, with a US\$1.9b capex commitment to developing its Amrun mine announced in November. Ivanhoe's sale of a 49.5% stake in the Kamo'a project to Zijin Mining, while raising capital, has also enabled project development risk and capital costs to be shared.

### Best practices in maximizing divestment value

**44% of PE buyers say lack of confidence in information is the most significant factor that causes a PE firm to reduce its offer price or walk away from the deal**

Source: EY Global Corporate Divestment Study 2016

**33% more companies generate a sale price above expectations with an operational separation plan**

Source: EY Global Corporate Divestment Study 2016

The importance of correctly structuring a divestment process will prove essential in generating and sustaining sufficient competitive tension prior to financial close. With a glut of assets available, a scarcity of capital and continued risk aversion requiring higher returns to justify acquisitions, poor structuring can undermine the value attained even from disposing of high-quality, tier 1 assets.

This is exacerbated by market conditions prompting sellers to run accelerated sale processes, which combined with the limited attention span of investors underlines the value from comprehensive preparations. This in turn can help guide and satisfactorily de-risk operating characteristics without compromising deal value, reinforce transaction upside and facilitate a smooth process without distracting management from core activities.

### Preparing for divestment

In combination with understanding how best to package a disposal relative to investor appetite, there are several factors that can help increase both sale proceeds and the speed of execution.

- ▶ **Preparation of equity story:** An external review of financial and operating data, besides documentation and data-room preparations, can help identify and



critique potential productivity and working capital improvements while substantiating capex plans to support growth scenarios. For cost reduction and working capital improvements already implemented, it is important to evidence the sustainability of the actions taken.

- ▶ **Anticipating transaction risks:** Examples may include receiving regulatory approval to transfer licenses, quantifying site reclamation or restructuring costs and gaining the support of labor unions. Foreseeing these items and being up-front with bidders about the actions being taken can guard against delays while protecting disposal value.
- ▶ **Tax planning and optimization:** Evaluating how different disposal options will impact net proceeds received, and any post-transaction arrangements, in conjunction with strategies available to investors, may help apportion further value to the seller.
- ▶ **Disentangling company-to-company dependency:** This can vary from implementing suitable transfer pricing arrangements, separating IT and ERP systems, to successfully transitioning HR processes and liabilities (e.g., pensions) to a new owner. Although preferences will differ between bidders with respect to how and what interdependent elements

of the business are separated, it is important for a seller to be able to clearly articulate the “as is” position prior to commencing the sales process.

Optimally, the business would look to embed improvements 12-18 months prior to the sales process to demonstrate to potential buyers that these savings can be realized and sustained over the long term. However, this may not be possible in the current environment. Alternatively, vendors should ensure sufficient data is provided in the seller documentation to illustrate how such savings will be achieved and the costs/process to achieve these savings. If the speed of execution is critical, “quick wins” may still generate value.

## Outlook for 2016

The year will likely see further sale announcements of non-core assets, in conjunction with announced disposals reaching financial close. However, ongoing price volatility could see hostile takeover bids from better capitalized entities, but only where the target operates desirable, low-cost assets in stable jurisdictions.





A background image of a construction site. A large crane is positioned on the left, its boom extending upwards. A red FMC dump truck is parked on the right, facing right. The ground is muddy and uneven. In the background, there is a dense forest of green trees. A grey rectangular box is overlaid on the right side of the image, containing the text '02 Capital raising'.

# 02 Capital raising



## Accessing liquidity continues to remain challenging against a backdrop of falling commodity prices

2015 marked the second year of declines in capital raised, US\$228b vs. US\$251b in 2014. This decline was almost entirely attributable to loan volumes falling by US\$44b to US\$122b, highlighting increased risk aversion among lenders. Though bond and follow-on equity issuance flows improved, partly offsetting such falls, these capital sources were largely confined to major producers that mostly went to market during 1H15.

Commodity sentiment was significantly affected by China-induced stock market volatility during 3Q15, resulting in a 50% fall in capital raised y-o-y during that quarter to US\$32b. Although amounts raised recovered in 4Q15 as the markets stabilized, led by a doubling of loan volumes to US\$36b vs. 4Q14, it was not sufficient to offset 3Q falls, with 2H15 finance down 17% y-o-y.

Concurrently, 2H15 witnessed producers employ a series of alternative strategies to raise funds, resulting in over US\$2.9b in streaming deals being announced, the disposal of non-core assets and

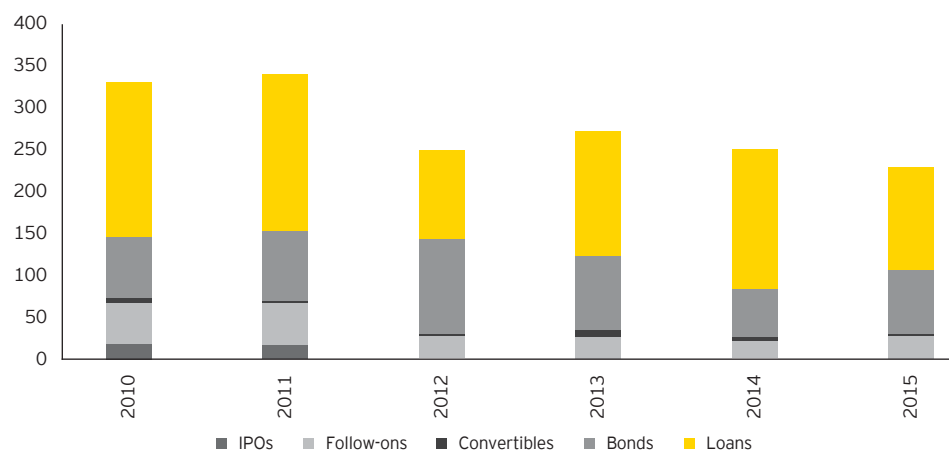
other schemes to raise capital (e.g., prepayments). Though small, it is illustrative of how companies have sought to adapt to the growing selectiveness of conventional finance.

### Cost of capital to stay elevated in 2016 unless pricing environment improves

Corporate credit ratings are continuing to be placed on either negative watch or downgraded, while banks remain wary of extending credit to the sector. Equity markets in Australia, Canada and the UK were also subdued, with the real prospect of further shareholder dilution from placements or rights issues prompted by financial distress.

Notwithstanding, private equity and well-capitalized producers continue to evaluate possible lending opportunities in the sector, with alternative financing sources continuing to be a source of capital for operations best positioned on the cost curve.

### Capital raising by asset class – proceeds (US\$b)



# Loans

Following a two-year period of relatively strong lending into the sector, loan proceeds fell 27% during 2015 to US\$122b compared to 2014. This fall highlighted growing risk aversion and portfolio reorientation by banks mindful of managing future nonperforming loan exposure, reflected in the number of completed transactions being only marginally less than those in 2014.

Producers have been able to maintain credit access, with this in favor of established, mid-size to large companies. Most loan financing has been done under the auspices of general corporate purposes, although it has likely supported debt refinancing, consistent with that observed in 2014. This is underlined by the sum of both elements remaining stable at 66%-67% across both years.

However, declines in project, capex and acquisition finance, coupled with an increase in working capital and trade finance, illustrate an increasingly cautious approach by banks. With falling and volatile commodity prices encouraging a shift toward short-term collateralized lending (inventories and receivables), reducing the risk of illiquid, long-term positions appears evident to avoid future write-downs, should prices continue deteriorating.

A focus on maintaining operating liquidity has further undermined resource development, with price levels jeopardizing the economic feasibility of greenfield projects. Although potentially mitigated by support from a combination of quasi-state entities, equipment vendors or parent-corporate guarantees, only those retaining robust balance sheets and shareholder support have achieved financial close.

## US\$122b

in loan proceeds during 2015

## 27%

fall in loan proceeds raised relative to 2014

## Outlook for 2016

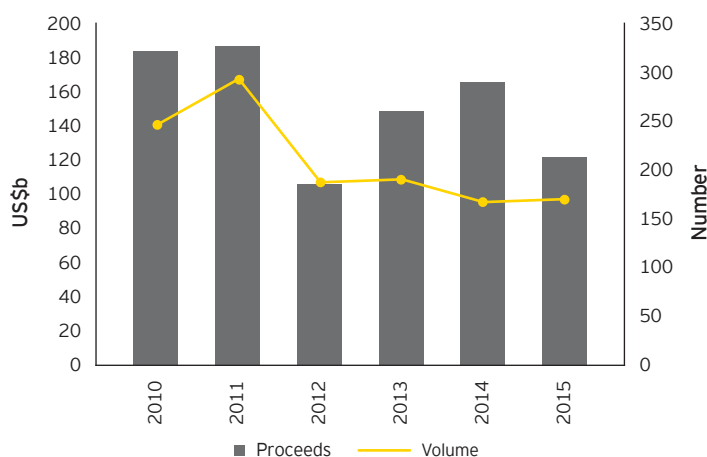
Volumes are likely to remain constrained into 2016, with banks concentrating any credit allocation primarily among cash-generative, large-cap producers. This could create a growing gulf in financing costs among firms, depending on underlying commodity portfolios, geography or size.

These constraints may potentially increase, should there be knock-on effects from the current crude oil price environment, which may prompt banks to impair their overall commodity exposure. It may encourage the continued pursuit of alternative financing strategies (e.g., streaming) while acting as a spur to supporting wider industry consolidation.

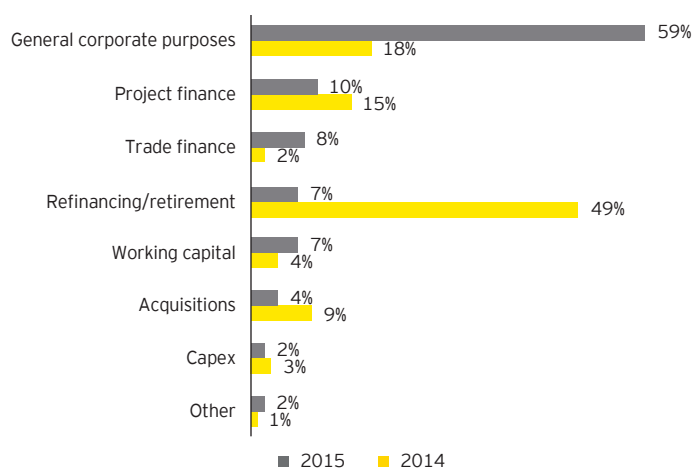
### Transaction highlights:

- ▶ Glencore signed an oversubscribed US\$15.3b revolving credit facility in May, among a consortium of 60 banks.
- ▶ Rio Tinto concluded a US\$7.5b revolving credit facility in November, replacing an existing facility while agreeing on a further US\$4.4b in project finance to support further development of Oyu Tolgoi.

Loan volume and proceeds (2010-2015)



Primary use of loan proceeds (2014 vs 2015)





## US\$77b

The value of bond proceeds offered in 2015

## 32%

increase in proceeds value relative to 2014

### Transaction highlights:

- ▶ BHP Billiton raised US\$6.5b in a multi-currency hybrid bond in October, aimed at improving overall balance sheet flexibility.
- ▶ Fortescue's issued an oversubscribed US\$2.3b senior secured bond in April with proceeds used to refinance existing liabilities.
- ▶ Glencore raised US\$2.3b in 3-, 5- and 10-year notes in April for general corporate purposes.

Bond proceeds increased by 32% to US\$77b in 2015, though comprised two different narratives. A total of US\$61b was raised during 1H15, representing a 71% y-o-y increase, backed by significant issuance from Anglo American, BHP Billiton, Fortescue, Glencore, Rio Tinto and Shenhua Group, among others.

This contrasted sharply with 2H15 where only US\$15b was raised during a period of global stock market volatility and falling commodity prices, which undermined sentiment. Wider bond market sentiment was affected by the expectation of future US interest rate rises, which though led to US dollar strengthening benefiting non-US

producers, impacted the issuance and pricing of high-yield bonds.

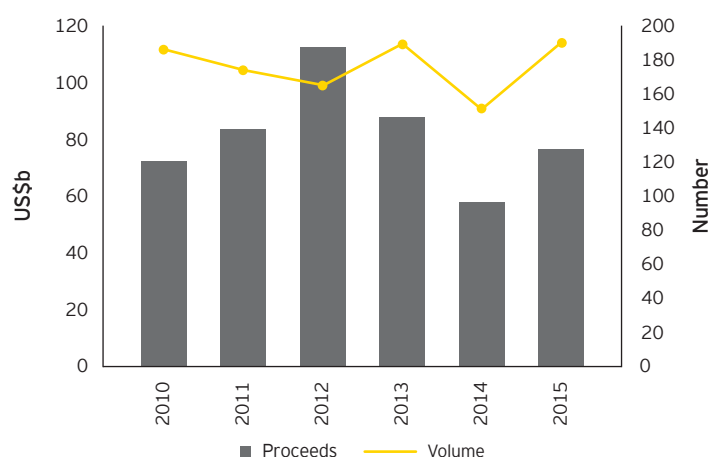
Credit agencies subsequently revised their outlook on commodities, placing several companies on negative watch or downgrading their long-term rating. This led to acute pressure on major producers to deliver debt reductions, significantly reducing the amount raised in 2H15.

The latter remains of paramount importance in 2016, with credit default swaps for some companies exceeding 1,000bps during 4Q15. This may precipitate growing refinancing risk should companies have debt maturing in 2016, without drastic action.

## Outlook for 2016

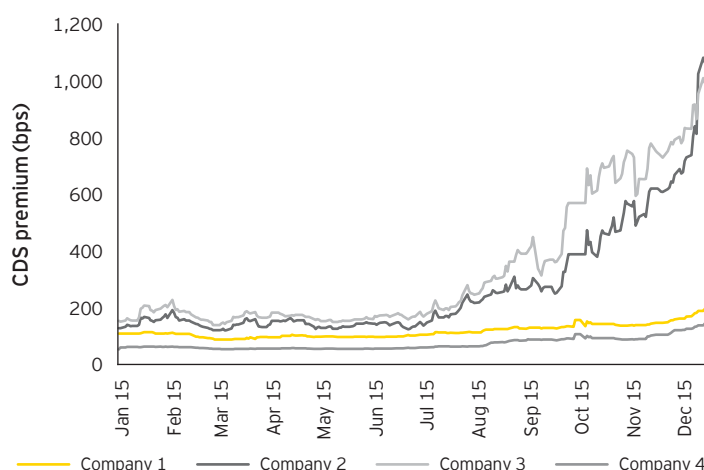
Most bonds, with the exception of those with short-term maturities, are trading at a discount, which may prompt purchases as part of a wider liability management exercise where corporates have sufficient liquidity to do so. Attempting to refinance any liabilities through the bond market may prove more expensive compared to 1H15, especially with further expectations of future US interest rate increases, potentially resulting in lower 2016 levels.

Bond volume and proceeds (2010-15)



Note: CDS swaps are based on senior unsecured debt maturing in five years, with the exception of Companies 2 and 4. Source: Datastream

< 5 year CDS swaps for a sample of mining companies



Source: Datastream

# Convertible bonds

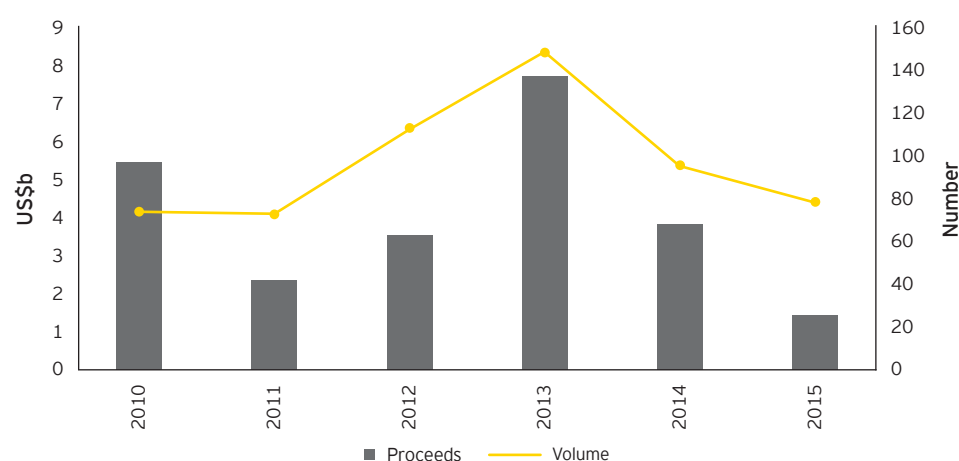
Convertible proceeds were US\$1.4b, down 62% on 2014 levels. This was captured by an 18% fall in issuance to 78 transactions, with the top five transactions representing 75% of total annual proceeds. The vast majority of convertibles were worth less than US\$5m. This reflected general

pessimism about the sector and the unlikelihood of realizing upside through converting to equity. There was a focus by investors on coupon levels and gaining improved priority to collateral in the event of default.

## Outlook for 2016

An increase in convertible issues could materialize, should investors believe commodity prices have bottomed. This instrument may still prove to be popular with private equity when undertaking transactions among small-cap opportunities if they achieve senior secured rights on underlying assets.

Convertible bond volume and proceeds (2010-15)



# 62%

decline in convertible bonds proceeds relative to 2014

# 75%

of convertible bond value was comprised of the top 5 transactions

### Transaction highlights:

- ▶ Baosteel concluded a US\$0.5b zero coupon, exchangeable bond issue in November.
- ▶ Outokumpu completed a €250b senior unsecured convertible bond issue in February.
- ▶ Paladin Energy raised US\$100m in a senior unsecured convertible bond issue in February.





# Initial public offerings

**US\$0.3b**

in IPO proceeds raised during 2015

Listings down

**78%**

relative to 2014

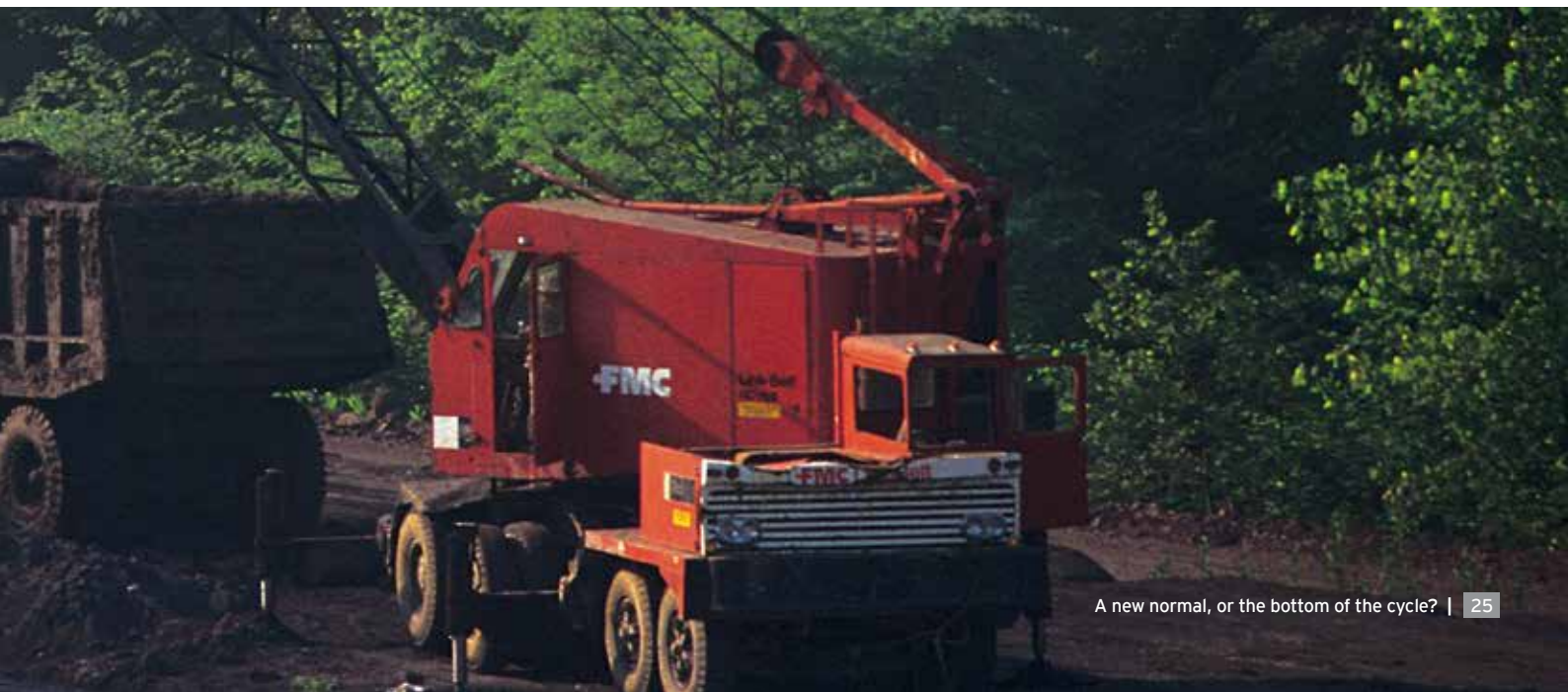
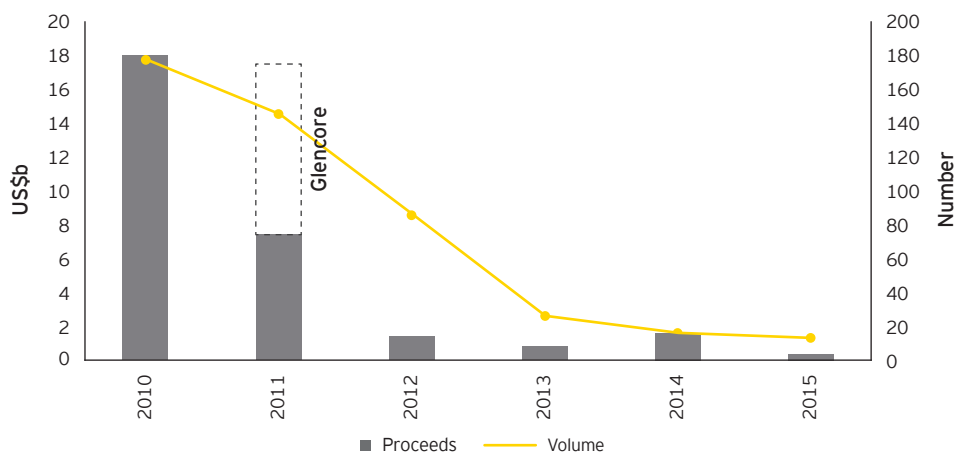
IPO activity since 2011 has been negligible, with 2015 proving no exception. Only US\$0.3b was raised from 13 listings, down 78% y-o-y on a value basis.

TMAC Resources' listing in Canada in June 2015 proved the largest offering made at C\$135m, followed by CNX Coal Resources LP in the US (US\$83m) and Merdeka Copper Gold Pt in Indonesia (US\$63m).

## Outlook for 2016

Activity levels are likely to remain depressed until a demonstrable recovery in commodity prices begins to draw capital away from other sectors.

IPO volume and proceeds (2010-15)



# Follow-on equity

Equity placements during 2015 increased by 32% to US\$28b, and followed a similar story to that witnessed within the bond market, with a robust 1H15 and a depressed 2H15.

A total of US\$19b was raised in 1H15, with several companies including Chalco, Coal India, Inner Mongolia Baotou Steel and Wintime Energy issuing shares worth US\$1b-US\$5b. This increase was based on a supportive environment among shareholders that expected base metal and bulk commodity prices to stabilize or, in some instances, increase (e.g., nickel, zinc). This was premised on pending supply shortages and Chinese demand remaining steady.

Following wider commodity and equity market turbulence, 2H15 would have been significantly more depressed, if not bolstered by both Glencore (US\$2.5b) and Freeport-McMoRan (US\$1b) issuing equity in September, benefiting from shareholder support against a backdrop of turbulent equity markets.

These issues were timed well, given that subsequent share price performance across the sector experienced material declines during 2H15. This was reflected by only US\$5b being raised in 2H15, excluding the Glencore and Freeport-McMoRan transactions.

# 32%

y-o-y increase in follow on equity placements, to US\$28b

Only

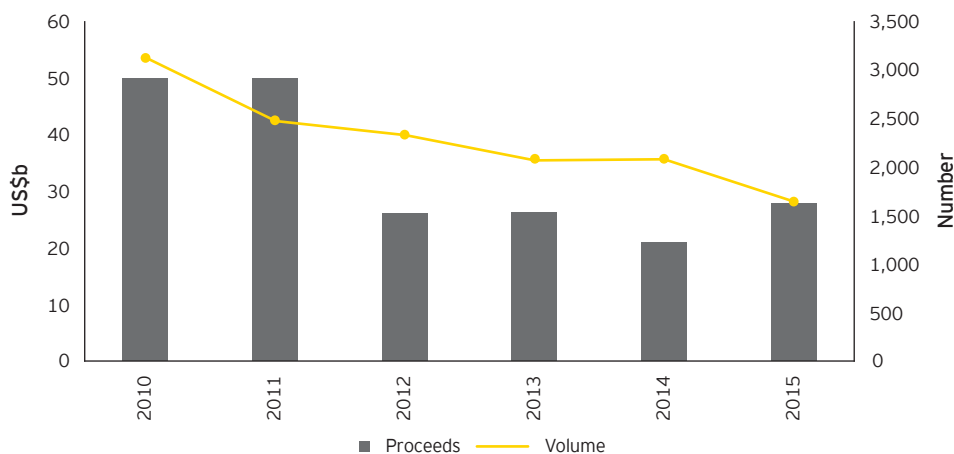
# US\$5b

raised in 2H15 (excluding Glencore and Freeport-McMoRan)

## Outlook for 2016

With prices now depressed relative to historic levels, any future issuance will almost certainly prove dilutive to existing shareholders, and an option is likely to be entertained only if other sources of capital are unavailable. The market is, therefore, likely to see transaction volumes continue to fall during 2016.

Follow-on equity volume and proceeds (2010-15)



# About this study

- ▶ The data is primarily sourced from ThomsonONE.
- ▶ Unless otherwise stated, all values are in US dollars.

## Mergers and acquisitions

- ▶ Only completed deals are included. Deals identified as incomplete, pending, partly incomplete, conditional or intended as of 31 December 2015 were excluded.
- ▶ The acquirer country is based on the ultimate owner's geographic headquarters. The target country is determined by where the primary targeted asset or company is located.
- ▶ "Country-based" refers to domestic and inbound deals.
- ▶ A country's acquisition refers to domestic and outbound deals.
- ▶ Commodity analysis is based on the company's primary commodity focus.
- ▶ The value of M&A activity by commodity includes deals where the given commodity is the acquirer and/or target's primary commodity. Commodity charts illustrate the value of deals where the given commodity is the target.
- ▶ The data does not capture the value of transactions where this information is not publicly available.
- ▶ "Megadeals" refer to all deals with a value equal to, or greater than, US\$1b.

## Capital raising

The primary source for this data is ThomsonONE. Certain details have been supplemented with information from company and stock exchange websites and major business press. Only completed transactions are included.

- ▶ Only initial public offerings, the first time a company issues equity to the public – are included in the IPO analysis. Proceeds are allocated to the primary exchange of listing.
- ▶ Equity issues are geographically categorized by the primary exchange where the issuer's stock trades, except where stated. Where a company offers Global Depositary Receipts or American Depositary Receipts, the issue is allocated to the destination market of those shares.
- ▶ Loan data and proceeds include refinancing and amendments to existing debt, and are as per ThomsonONE intelligence. Proceeds are allocated to the geography of the borrower.

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## How EY's Global Mining & Metals Network can help your business

With a volatile outlook for mining and metals, the global mining and metals sector is focused on margin and productivity improvements, while poised for value-based growth opportunities as they arise. The sector also faces the increased challenges of maintaining its social license to operate, balancing its talent requirements, effectively managing its capital projects and engaging with government around revenue expectations.

EY's Global Mining & Metals Network is where people and ideas come together to help mining and metals companies meet the issues of today and anticipate those of tomorrow by developing solutions to meet these challenges. It brings together a worldwide team of professionals to help you succeed – a team with deep technical experience in providing assurance, tax, transactions and advisory services to the mining and metals sector. Ultimately it enables us to help you meet your goals and compete more effectively.

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