Mergers Alliance

NORGESTION

Global Mining Sector

M&A update

Autumn 2012

Favourable long term fundamentals

Undervalued mining sector creating M&A opportunities

The slowdown in the Chinese economy has had a severe impact on the mining sector over the last 12 months after almost a decade of sustained growth. The industry faces some difficult challenges over the next few years including labour and energy cost inflation, production delays, escalating capex costs as well as various geo-political risks.

However, the long-term industrialisation and urbanisation cycle of China and other emerging economies is on-going and will continue to create long-term favourable fundamentals for the industry.

Lower valuations creating attractive M&A opportunities

There were over US$52 billion of M&A deals globally in the first half of 2012 across the value range, with over US$6 billion involving mid-market firms. With corporate balance sheets still strong, lower company valuations, fragmented commodity markets and pressure to address operational as well strategic issues, the conditions for M&A are very positive.

"Many commodity markets are highly fragmented and in need of consolidation. In Russia for example, we expect considerable acquisition activity within the coal industry across the whole of the value chain"

Nick Van Den Brul
Partner, NorthStar Corporate Finance

Consolidation

Marius Kloppers, CEO of BHP Billiton stated that "the trend is always toward consolidation in industries, particularly the mining industry, where we consume the resources every day that constitute the life blood". When asked about future M&A he said "absolutely no doubt" that BHP will do more transactions.

Cross-border acquisitions

Chen Jinghe, Chairman of Zijin Mining Group, one of China's largest gold and copper mining groups announced this year that it would spend 5.5 billion yuan (US$875 million) on acquisitions, the bulk of which will be overseas gold and copper assets. The state-owned group achieved an 18% rise in profits last year and now has assets in Australia, Peru, Russia and central Asia.

Support for commodity prices

Cynthia Carroll, CEO of Anglo American, said that the current subdued sentiment in commodities would pass. "Short-term prospects for the world economy have deteriorated in recent months, yet we see more resilient trends in the medium to longer term. Long term supply constraints across many commodities, combined with continuing industrialisation trends in key growth markets should provide considerable support for prices".

Challenging capital markets encouraging M&A

Opportunities across a maturing commodity cycle

Ongoing industrialisation and underlying commodity inflationary pressures will continue to boost the mining sector despite market instability over the past 18 months.

- China, which is the largest consumer of every major commodity except oil, where it is second, still has some way to go to reach the levels of commodity consumption per capita of the West (See Figure 1).

- In the short to medium term, companies that have significant exposure to mining carbon steel materials will benefit from urbanisation development – China is expected to account for 50% of world steel use in 2012. Longer term demand, in particular for late-cycle commodities such as nickel and platinum, is influencing the current strategies of the major mining companies, including the Chinese.

Few major new discoveries causing resource depletion

- There have been significant reductions in capital expenditure, exploration and development during the last decade. This has led to a relative scarcity in the near-term commissioning of major projects across many minerals and commodities. Production delays as well as a demand driven period of over-exploitation, have also depleted reserves of a number of important minerals such as copper and gold.

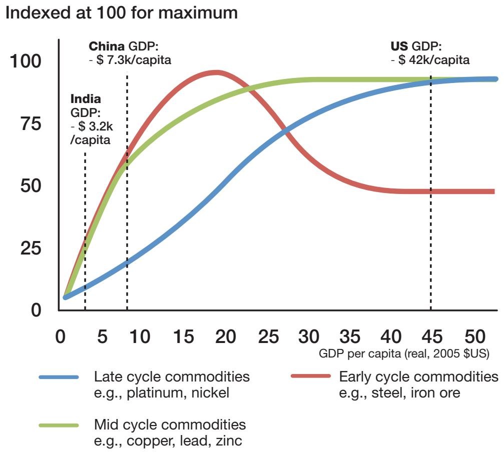
- Given current market pricing for mining stocks relative to the capital costs of construction, which have significantly increased of late, there is a preference now to acquire productive assets.

Alternative capital sources required

- The current capital markets are somewhat challenging for both majors and juniors. Whilst the majors have the benefit of relatively strong cash positions, the juniors/exploration companies are having to manage their exploration spend and capital burn very tightly as their ability to access capital on reasonable terms is limited.

- The scarcity of both equity capital and bank project finance has created a trend toward alternative capital sources (e.g. royalty companies, private equity, sovereign wealth funds) and helped create a more attractive environment for M&A, with more opportunities.

Figure 1: **Commodity intensity**



Source: Xstrata

Figure 2: **Late-cycle commodity price development**

Source: Capital IQ

M&A is an integral part of mining strategies

Whether domestic consolidation or cross-border acquisitions, 2011 came close to equalling the record year set in 2006, despite the depressed share prices of some of the top mining companies.

The past six months has seen over 1,000 deals take place (see Figure 3). driven by supply side issues, including diminishing productive mining assets and rising costs, funded by large cash reserves of the buyers.

- Whilst the proposed mega-merger of Glencore and Xstrata looks more and more unlikely, 2012 witnessed an array of successful deals both in the developed economies (Minefinders/Pan American Silver) and the emerging economies (Sterlite Industries/Sesa Goa).
- Historically the rationale behind acquisitions has differed from region to region. For example, in China the main driver has been to secure raw materials whilst in the West it has been to gain market share, achieve economies of scale and cost efficiencies, and gain intangible assets.

Figure 3: Selected mining sector deals

Announced	Target	Target Country	Target Activities	Acquirer	Acquirer Country	Deal Value (US$) Million
Pending	African Barrick Gold	UK/South Africa	Gold mining in Africa	China National Gold Group Corp.	China	3,900
July 2012	Markray Corp	USA/Russia	Gold, silver and platinum mining	ZAO GRK Zapadnaya	Russia	175
July 2012	Satbor LLP	Kazakhstan	Mining potash and borate	Sprint Capital Partners	Hong Kong	ND
June 2012	Ekaterinburg Non-Ferrous Metal Processing Plant	Russia	Engages in mining of precious metals	Renova Group	Russia	16
June 2012	Bakalskoye Mining Department	Russia	Engages in iron mining	Atop International Group	British Virgin Islands	ND
June 2012	Allied Gold Mining PLC	Australia	Gold mining	ST Barbara Limited	Australia	619
May 2012	Wesizwe	South Africa	Platinum mining	Jinchuan Group + China Africa Development Fund	China	227
May 2012	Hebei Hua' Ao Mining Development	China	Gold-zinc mining	Griffin Mining Limited	UK	111
April 2012	Norton Gold Fields	Australia	Gold mining	Zijin Mining Group	China	220
Feb 2012	Sterlite Industries (India)	India	Non-ferrous metals and mining	Sesa Goa	India	14,829
Jan 2012	Minefinders Corp	Canada	Mining of precious and base metal properties	Pan American Silver Corp.	Canada	1,431
Dec 2011	Quadra FNX Mining Ltd	Canada	Copper mining services	KGHM Polska Miedz Spolka Akcyjna	Poland	2,960
Nov 2011	The De Beers Group	Luxembourg	Mining and marketing of diamonds	Anglo American PLC	UK	5,183
Nov 2011	Polymetal OAO	Russia	Leading Russian gold and silver producer	Polymetal International	Channel Islands	6,214
Aug 2011	HWE Mining	Australia	Mining services	BHP Billiton	Australia	1,193
July 2011	Metorex Limited	South Africa	Copper and cobalt mining	Jinchuan Group	China	1,485
July 2011	MacArthur Coal Ltd	Australia	Mining of metallurgical coal	Peabody Energy	USA	5,163
July 2011	PetroHawk Energy Corporation	USA	Natural gas producer	BHP Billiton	Australia	15,708
April 2011	Walbrzyskie Zaklady Koksownicze Victoria S.A.	Poland	Production/sales of coke and carbon derivative products	Jastrzebska Spolka Weglowa Spolka Akcyjna	Poland	143
April 2011	Equinox Minerals Limited	Australia	Mining and exploration of mineral (gold, copper)	Barrick Gold	Canada	7,296
Feb 2011	Chespeake Energy Corporation	USA	Natural gas and oil properties in the US	BHP Billiton	Australia	4,771

***Source:** Capital IQ, Mergermarket*

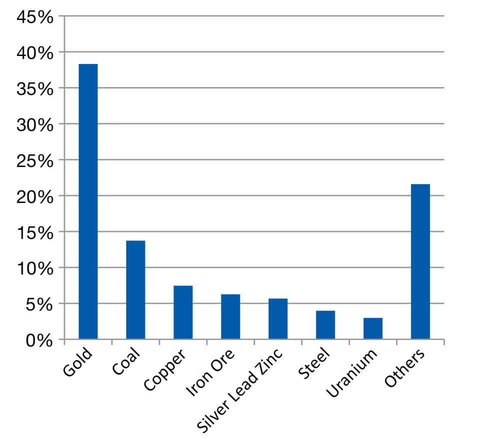
Rationale for acquisitions broadens

- Companies are now however increasing their diversification strategies. Both private and state-owned entities are targeting vertical businesses that operate within a specific sub-sector in an attempt to control most, if not all, of the value chain - from raw material mining and refining to services all the way up to power distribution.

- Mining companies are also restructuring their operations to address unproductive and loss-making mines. Barrick recently announced that it is in discussions with China National Gold Group to buy African Barrick Gold, which experienced a drop in production last year despite mining 509,000 ounces of gold.

- The disparity between company share values and metal prices helped gold to be the most targeted segment - over a third of all transactions in the past 18 months. Activity was principally driven by the majors seeking to solidify their market share and wanting to use cash that has built up in their treasuries. We have also seen juniors looking to capture resources and Chinese companies addressing demand/supply differences in China.

Figure 4: **Breakdown of deals by commodity %**



Source: *Capital IQ*

- The second most targeted segment was coal. Large players in Russia, India and Australia all looked to strengthen their positions by consolidating. Notable deals included India based Adani's acquisition of Linc Energy's Galilee Basin Coal Assets (Australia) for a total lifetime consideration of US$2.7 billion and Peabody Energy's (USA) acquisition of MacArthur Coal Limited (Australia) for US$5.2 billion.

Spotlight on platinum - precious metal

The two-speed nature of global growth indicates that in the medium to long-term, demand for metals such as nickel and platinum will increase significantly.

Companies with a diverse commodity mix or those with a particular focus in the late cycle materials should benefit.

Recently however investors have grown increasingly pessimistic about platinum. Neither mine closures nor other supply risks are doing much to generate support for the metal. Inflationary pressure and this market uncertainty has led to gold becoming intermittently costlier than platinum.

Although the scarcity of the two precious metals is similar, the extraction of platinum tends to be costlier, as deposits are usually more diffuse. Around two thirds of annual output is utilised in industry such as in car production, while for gold as much as 85% is used for adornment or 'store of value'.

Changes at the majors

Anglo American Platinum, the world's largest platinum group metals (PGM) producer and accounting for circa 40% of the newly mined platinum globally, has recently had a management reshuffle after its CEO resigned to pursue other interests. Lonmin has had to close its main mine in South Africa due to strikes and disorder. Aquarius Platinum has announced the closure of two South African mines.

Active M&A market

Despite these difficulties, there are still deals being done. Reflecting China's rapid ascendancy in the commodity cycle chain, Chinese businesses have been looking to secure long term supply by acquiring platinum businesses overseas. Jinchuan Group acquired Wesizwe in June (see Spotlight on South Africa), which given the high cost structure of many South African platinum mines as well as the labour situation seems like a gamble to many.

Figure 5: **Gold vs Platinum US$/oz**

Source: *BullionVault*

Acquisitions by the majors have tended to be targeted in the mid-market as they look to acquire resource assets and mining capabilities. Bermuda-headquartered Aquarius Platinum acquired mid-market assets including UK based Ridge Mining (US$133 million) and South Africa based Afarak Platinum (US$109 million). Anglo American Platinum recently acquired the Boikgantsho Project and the eastern section of the Ga-Phasha Project from Bokoni Platinum Mines in South Africa for a combined consideration of US$230 million.

Industry dominated by the majors

Diversified mining groups dominate the industry (see Figure 6). Recent trading announcements by Anglo American and BHP Billiton underline the short term difficulties the industry is facing, however EBITDA margins are still high (>40%).

Whilst a number of development projects have been shelved until the global macroeconomic environment stabilises, M&A is still on the agenda of most.

"There's a lot of opportunity for M&A out there. The seniors and the intermediates have watched higher metal prices cause their treasuries to fill up and that's going to burn a hole in their pocket"

Rob McEwen CEO, Goldcorp Inc.
Source: Bloomberg

Majors will use cash reserves to acquire productive assets

Figure 6: Major mining companies

Company Name	Country HQ	Market Cap ($ bil)	Revenue ($ bil)	EBITDA ($ bil)	TEV / EBITDA	Revenue 3 Yr CAGR %	EBITDA margin %	Primary Geographies (Revenue)	Primary Commodities	Comments
BHP Billiton	Australia	184.6	75.5	39.5	5.1x	5.7%	52.4%	China, North America, Australia	Iron Ore, Metallurgical Coal, Base Metals	The acquisition of Houston oil and gas explorer Petrohawk Energy Corp for US$15.8 billion elevated BHP into the top 10 natural gas producers globally.
Rio Tinto	Australia	100.2	56.8	22.2	5.5x	7.4%	39.1%	China, Japan, North America	Iron Ore, Aluminium Copper	Has made diversified acquisitions: Aluminium (Alcan), Coal (Riversdale), Copper (Ivanhoe).
Vale S.A.	Brazil	87.9	49.4	25.2	4.6x	17.6%	50.9%	China, Brazil, North America	Bulk Metals, Basic Metals, Fertilizers	Recent major mining acquisitions include Simandou and Vale Fertilizantes.
China Shenhua Energy Co	China	69.8	34.9	13.5	5.6x	25.8%	38.6%	China	Coal, Diversified Power	Most of its acquisitions have been localised and outside of the mining space.
Suncor	Canada	48.7	39.6	12.0	4.5x	17.7%	30.3%	Canada	Oil Sands, Diversified Energy	Has been relatively inactive in M&A. Acquired Petro-Canada in 2009 for US$19.5 billion.
Xstrata	Switzerland	43.5	32.7	9.7	6.3x	15.1%	29.7%	Australasia, South America	Copper, Coal - Thermal, Zinc Lead	The proposed merger with Glencore is still in the balance due to disagreements over terms.
Anglo American	United Kingdom	42.9	29.0	9.1	5.11x	11.3%	31.2%	South Africa, Chile, Brazil	Platinum, Iron, Manganese, Copper	Has been making acquisitions across the cycle chain. From iron (Kumba, Minas Rio) to diamonds (De Beers).
Glencore	Switzerland	40.2	202.0	4.0	11.7x	22.0%	2.0%	Europe, Asia	Diversified Metals, Minerals and Energy	Its largest deal has been its US$7.6 billion acquisition of Viterra. Its US$53 billion deal with Xstrata has yet to be completed.
Potash Corp. of Saskatchewan	Canada	35.6	7.9	4.1	9.0x	7.3%	51.4%	North America, Trinidad	Potash, Nitrogen, Phosphate	Its last major acquisition was its incremental stake increase of Chemical & Mining Co. of Chile in 2006.
Barrick Gold Corporation	Canada	38.2	14.7	7.9	6.3x	25.6%	53.5%	North America, Australia Pacific	Gold, Copper	Has been highly acquisitive. Recent high value transactions include Equinox Minerals and Compañía Minera Casale.
Freeport-McMoRan Copper & Gold Inc.	United States	34.9	18.4	7.7	4.78x	12.4%	41.9%	United States, Japan, Indonesia	Copper, Gold, Molybdenum	Has been relatively quiet in M&A since its US$28 billion acquisition of Phelps Dodge Corporation in 2006.
Goldcorp Inc.	Canada	32.5	5.3	3.0	10.8x	29.8%	57.6%	North America	Gold, Silver, Copper	Has made nine acquisitions since 2008, including the US$3.3 billion acquisition of Andean Resources Limited.
Norilsk Nickel	Russia	25.2	14.1	7.2	4.0x	0.3%	50.8%	Europe, Asia, North America	Diversified, Energy	Last major mining acquisition was of LionOre Mining International (Canada) in 2007.
ArcelorMittal	Luxembourg	23.1	91.8	9.5	5.0x	1.6%	10.3%	North America Brazil, Germany	Iron Ore, Coal	Recently acquired Kalagadi Manganese (South Africa), Baffinland Iron Mines (Canada) and mining service company ATIC Services (France).

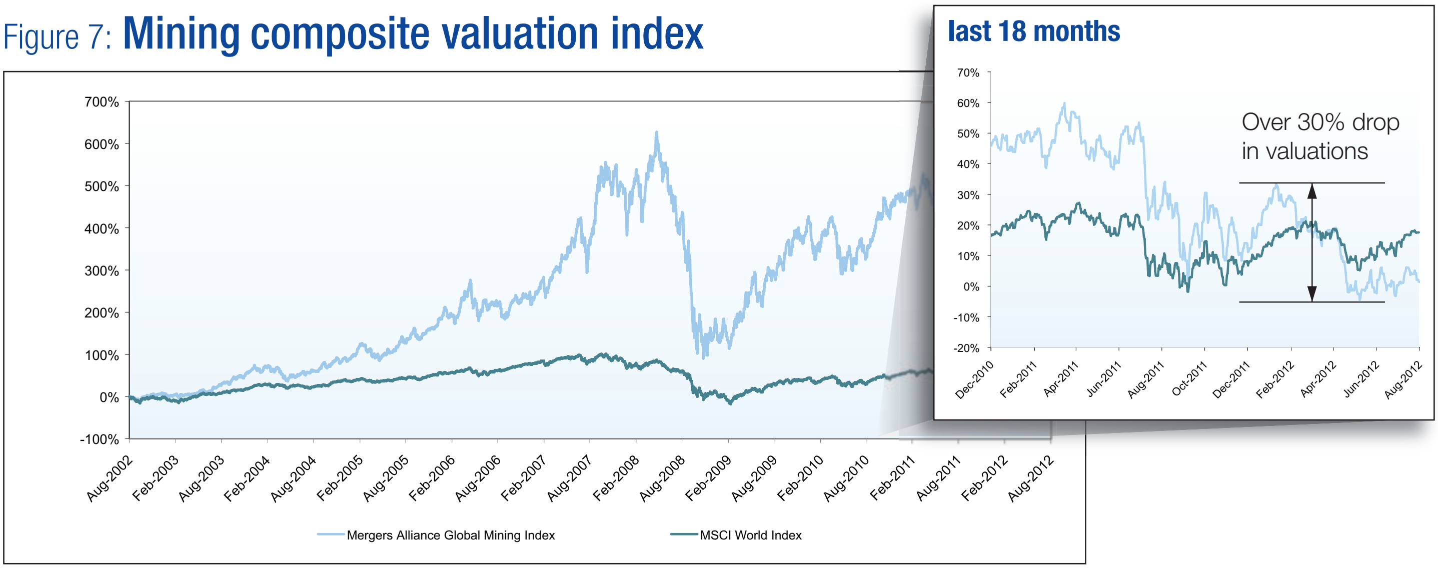
Source: *Capital IQ*

Opportunity for acquirer to arbitrage gap between commodity and equity markets

Valuations more attractive for acquirors

The Mergers Alliance Global Mining Index shows a sharp drop since mid 2011 compared to the broader markets. Although certain commodity prices fell, they remain high in historic terms indicating a widening disconnect. Another dynamic weighing on mining stocks is the sector's susceptibility to external economic shocks; shareholders tend to flee mining stocks faster than other equities.

Figure 7: **Mining composite valuation index**



Source: *Capital IQ*

Spotlight on Russia – mining heavyweight

With the largest iron ore reserves in the world and the second largest recoverable coal reserves, it is of little surprise that Russia accounts for a seventh of total global mineral extraction.

Mineral rich

It is the leading producer of iron ore (15% of global supply), and of nickel, platinum, palladium and rhodium and a major producer of aluminium, lead, zinc and copper amongst others. It is also a significant producer of gold and silver and industrial and gem-quality diamonds.

Private sector thriving

Unlike the oil and gas sector where the Russian State plays a significant role, metals and mining are predominantly private sector activities subject to normal corporate governance and taxation.

Several private companies operate in the sector including Metalloinvest, which possesses the world's largest iron ore deposits and sixth largest gold mining assets and Norilsk Nickel the world's largest nickel and palladium producer and a major player on the copper, cobalt and platinum markets.

Since the collapse of the former Soviet Union, a number a major integrated steel companies have emerged such as Severstal, Evraz, Mechel and Magnitogorsk. Severstal has also expanded beyond Russia buying businesses in the USA and Italy.

M&A across the industry

M&A in Russia has been dominated by local players, however majors such as BHP Billiton are beginning to explore opportunities. It was announced in July that BHP was looking at a JV with Millhouse Group, controlled by Russian billionaire businessman Roman Abramovich, on the development of the gold and copper rich Baimskaya area in Russia's Chukotka Autonomous District.

The gold sector in particular has attracted investment with Polyus Gold, Polymetal and Petropavlovsk (a successful example of foreign investment by Peter Hambro Mining) playing leading roles. Other overseas investors include Kinross Gold of Canada, which has invested in North Eastern Russia and Highland Gold, where

the Fleming family have been significant investors with three mines located within the Khabarovsk and Zabaikalsky regions.

Coal attractive

The Russian coal industry remains highly fragmented, despite considerable consolidation efforts by SUEK (part of the MDM bank group), Mechel, and Kolmar over the past decade. The industry is gradually upgrading extraction and processing equipment and transport infrastructure. In many cases, management strength is an issue, especially for export-oriented production. We expect attractive investment opportunities in the coal sector and processing over the next few years.

Prospects for M&A

The global macroeconomic environment is expected to stabilise before improving in 2013. Longer term, demand for commodities will be driven by emerging market industrialisation and with further interventionalist policies expected in the Eurozone and the US in the form of monetary stimulus, we expect commodity prices to rise. M&A activity will continue to be robust for all the factors outlined above.

- Majors to spend their significant cash reserves on acquisitions, having largely held back on exploration, recognising that it is cheaper to acquire productive assets.
- Acquisitions of mid-market listed businesses, which have significantly lower share valuations than 18 months ago and have limited access to capital. The gap between juniors and majors is larger than it has ever been and consolidation activity is necessary for economies of scale.
- Increase in divestments of non-core businesses (second or third tier assets) by the mining majors as they attempt to address capex and cost inflation at unproductive mines.
- Demand across all the resource sectors, with an especially near term focus on early cycle commodities. Traditional miners, as well as steelmakers and other industrial verticals will increasingly seek out acquisitions in light of continued challenges with supply.
- China to continue to acquire mid and late-cycle operations worldwide, especially copper, gold and platinum in order to secure supply.

Mid-market acquisitions and disposals of non-core assets to boost M&A

Spotlight on South Africa – mining at a cross roads

The South African mining market remains attractive despite decreasing output.

Difficult back drop
On 16 August 2012, South African police killed 34 striking workers at Lonmin Plc's Marikana platinum-mining complex, the worst death toll in police action since the end of apartheid. This tragedy, sparked by pay disputes, follows news that South Africa had its lowest mining output in 52 years.

A number of factors contributed to this output drop including labour cost pressures and energy security and shortages. Slowing global demand has had a significant impact; iron ore and coal to China and India have slowed markedly and platinum demand has dropped as a result of the economic woes in Europe and the USA. Whilst mining contribution to South African GDP is now less than 10% (peaking in the 1980's at 25%) mining exports still contribute to 61% of South Africa's total exports and the country remains in the top five mining and mineral producers worldwide.

Regulatory uncertainty
Political pressure to allow broader participation amongst previously disadvantaged South Africans continues to dominate the debate. However the single biggest issue remains the African National Congress' (ANC) discussions on nationalisation, which means a lot of investors are still unsure whether its current position (against) will be sustainable.

Commodity security driving investment
South Africa still remains an important mining investment destination especially for Chinese buyers. One of the most high-profile deals in the past 12 months was the acquisition of Johannesburg based Metorex for US$1.2 billion by China's Jinchuan Group, after outbidding Brazilian mining giant Vale. Metorex is focused on copper and cobalt opportunities in both SA and Zambia.

In June 2012, Jinchuan also acquired 45% of platinum specialist Wesizwe for US$227 million along with China Africa Development Fund. Together they have pledged to invest another US$887 million in developing a greenfield platinum mine in the Northwest.

M&A activity has been largely focussed off-shore as the major's battle the twin threats of legislation and operating costs (driven largely by wage increases and electricity prices) coupled with weak global demand.

Contacts

Specialist advice on call…

For information on sector trends and M&A in mining

Paul Vanstone
Director, United Kingdom

Telephone: +44 20 7881 2990
Email: paulvanstone@catalystcf.co.uk

Bart Jonkman
Managing Partner, Benelux

Telephone: +31 73 623 8774
Email: bart.jonkman@bluemind.nl

Michel Degryck
Partner, France

Telephone: +33 148 246 300
Email: m.degryck@capital-partner.com

Stefan Constanin
Managing Partner, Germany

Telephone: +49 69 97 40 30 0
Email: s.constantin@chrcf.com

Nuccia Cavalieri
Partner, Italy

Telephone: +39 02 92 88 04 00
Email: nuccia.cavalieri@ethicacf.com

Piotr Olejniczak
Director, Poland

Telephone: +48 22 236 9200
Email: piotr.olejniczak@ipopema.pl

Nick Van Den Brul
Partner, Russia

Telephone: +7 495 721 1370
Email: nick.vandenbrul@northstarcorporatefinance.com

Pieter Veldtman
Director, South Africa

Telephone: +27 11 268 6231
Email: pveldtman@bridgecapital.co.za

Omkar Biradar
Vice President, India

Telephone: +91 22 61496666
Email: omkar@singhi.com

Peter Gray
Managing Director, United States

Telephone: +1 914 263 9428
Email: pgray@headwatersmb.com

Luis Garcia Diaz
Senior Partner, Mexico

Telephone: +52 55 2167 1810
Email: lgarcia@sinergiacapital.com.mx

Leonardo Antunes
Managing Director, Brazil

Telephone: +55 21 2543 5409
Email: lantunes@brocap.com

Join in the mergers and acquisitions discussion

With a mining sector team, the Mergers Alliance partners are expertly placed to offer advice.

In particular, we offer:

- Advice on structuring and completing deals in the mining market.
- Identifying acquisition opportunities in emerging markets.
- Information on sector trends and valuations.
- Access to corporate decision-makers and owners.

Contact Us…

Mergers Alliance

Stas Michael
Business Manager

Direct Line: +44 (0) 20 7881 2990
E: stasmichael@mergers-alliance.com

Andre Johnston
Research Manager

Direct Line: +44 (0) 20 7881 2967
E: andrejohnston@mergers-alliance.com

www.mergers-alliance.com