Current Themes in Mining Restructurings

FEBRUARY 2015

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Executive summary

- 2015 will be a year in which the trend of mining companies being restructured, going into administration or even bankruptcy will continue
- With mining companies under-performing due to growing surpluses in key commodities the majors are scaling back capital expenditure
- The capacity of junior mining companies to raise capital in recent years has fallen dramatically with capital raised for working capital, capital expenditure and exploration decreasing dramatically year-on-year. Companies are therefore finding the refinancing market a much tougher one to navigate
- This has caused a significant increase in restructurings in the sector
  - These generally come too late to preserve sufficient upside for the shareholders which in turn is putting off equity investors
- A deep pocketed and supportive shareholder base will often back a strong management team and can extract a lot of value in doing so via various instruments
- In situations where substantial amounts of new capital is required following a restructuring, companies are likely to find financing difficult given the lack of upside seen in the commodity markets
- Certain types of secured bridge financing are becoming more frequent but if nothing can be achieved we have seen some companies go into administration or even bankruptcy
- For investors, purchasing the debt is a way in which to gain significant exposure to the upside or potentially control positions

1. Where we are in the cycle
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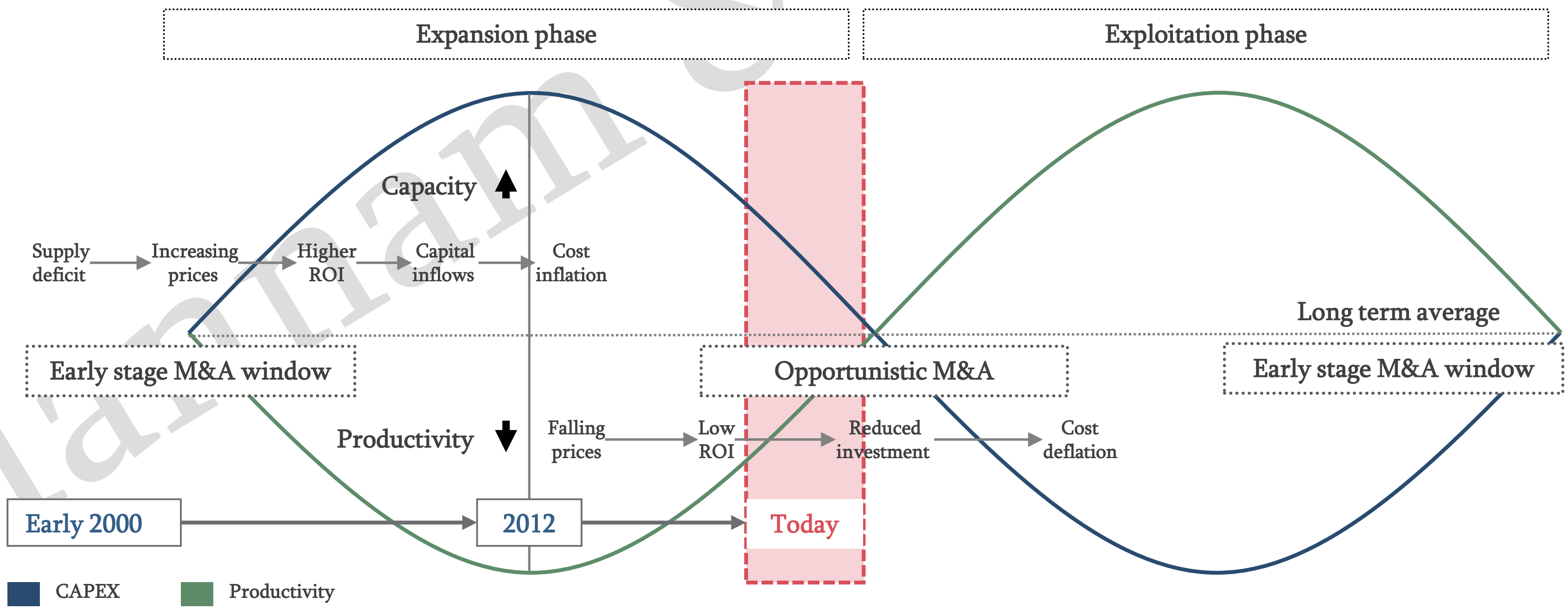
After years of expansion, the mining industry has been forced to focus on productivity improvements and strict value management

- It takes years to effectively add capacity in response to demand spike
- Prices rise, capital returns increase, capital in-flows are high and mining specific cost inflation is above average
- A pronounced "expansion" phase results in a material increase of the capital stock (capacity) and the destruction of productivity
- Before capital expenditure peaks, prices start to fall which pulls the industry into a downturn where surviving players focus on regaining productivity
- Funding will only be available for the best projects in the industry

Cycles of "expansion" and "exploitation" can take a considerable time in mining



The mining sector outperformed the wider market over the last decade…

- The emergence of BRIC nations redefined the mining landscape over the last decade
- A period of unprecedented returns and capital inflows followed
- The quick recovery after the 2008 global financial crisis indicated to many that the growth story was intact
- From 2011, the mining industry has fallen victim to its own supply additions, leading to falling prices and consequently lower returns
- Today, the industry is struggling with low productivity and an expanding capital base at times of moderating demand growth

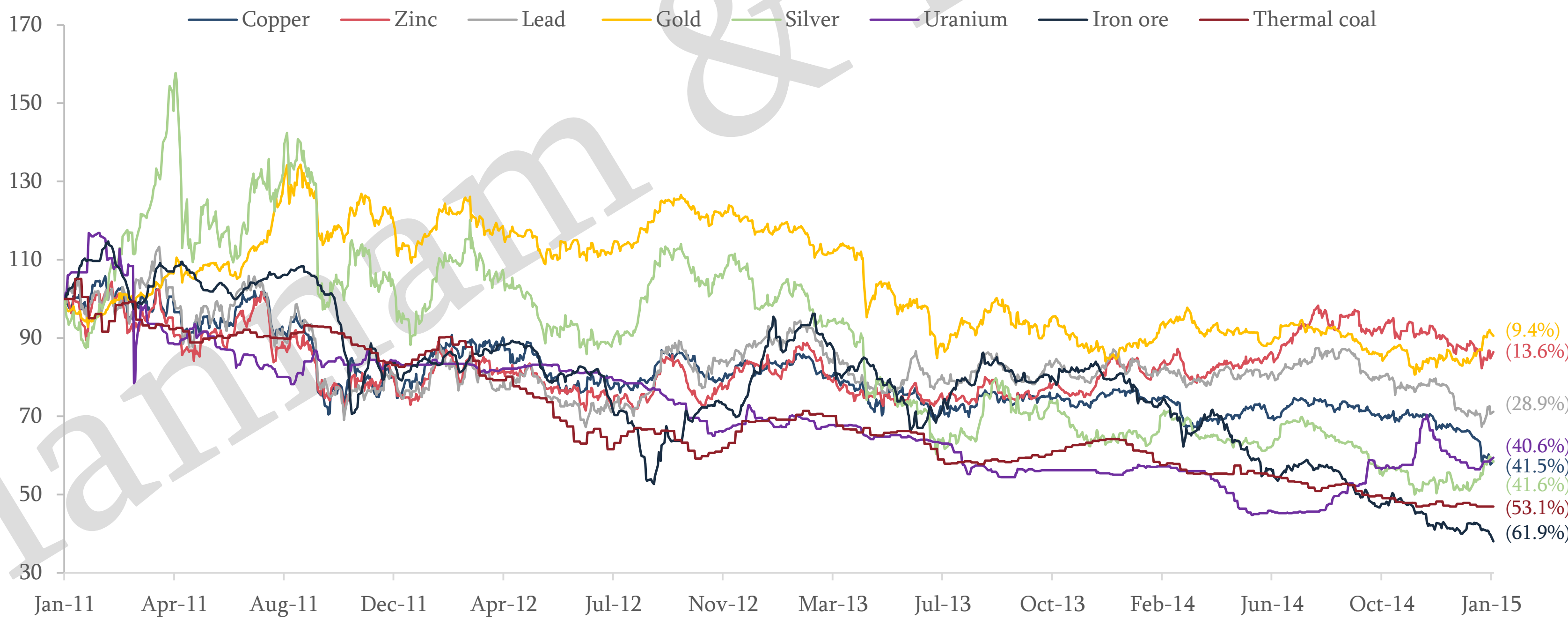
Global mining beat the market during the last decade but is entering a new non-expansionary phase

Source: Capital IQ as of January 27th, 2015
Note: Indices rebased to 100

…but in the last four years, metal prices have fallen on the back of large capacity additions and a moderation of demand across the world…

- Emerging markets were the drivers for demand growth over the last decade
- A slowdown in the economic growth in emerging markets forced commodity prices downward from record highs
- Early stage commodities (such as iron ore), by and large, have seen fast falling prices in recent months
- Most markets are well supplied and low prices are unlikely to stimulate demand
- Many companies had to react by closing down loss-making operations and cancelling expansion projects

The price performance of all major metals was negative over the last three years

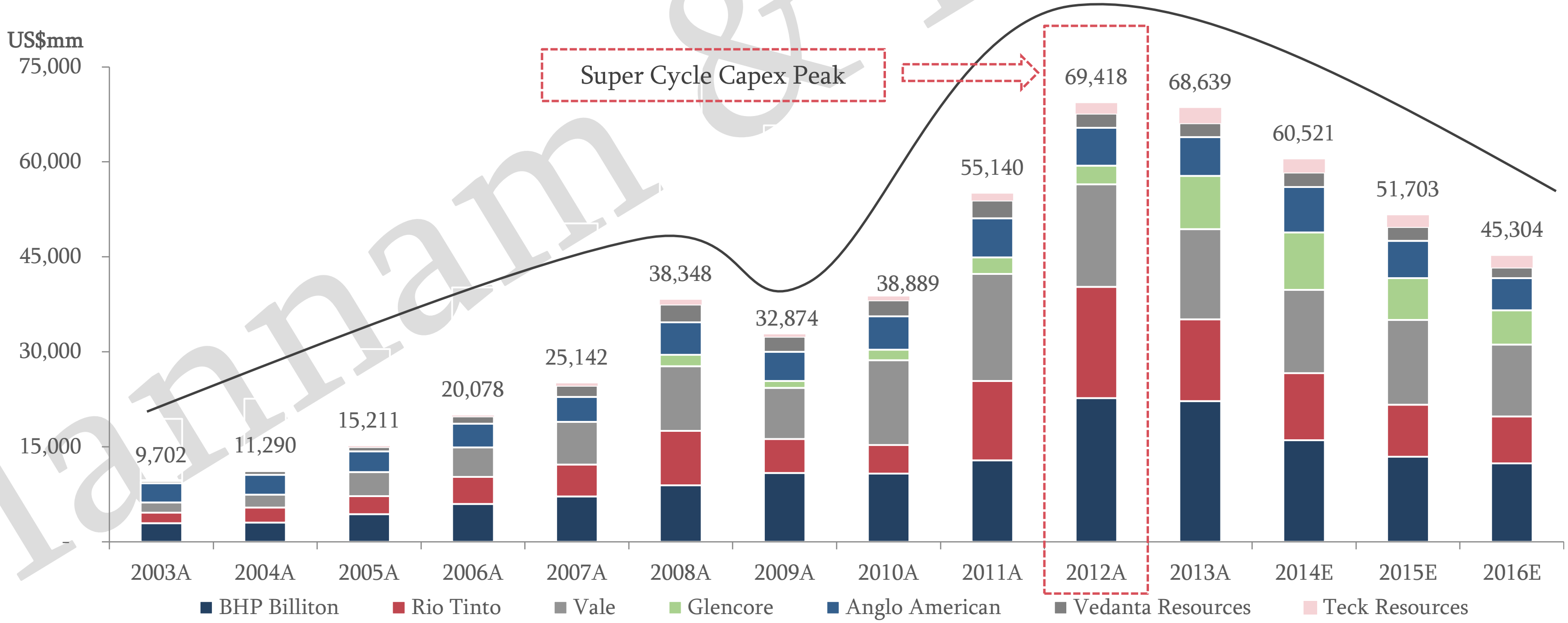


Source: Capital IQ as of January 27th, 2015
Note: Commodity prices rebased to 100

…with the state of the mining cycle easily observed by the capex profile of majors…

- The "Expansion" phase peaked in 2012, a year after the post crisis commodity prices peaked
- Majors tried to stop projects, but most projects that had already started looked attractive ignoring sunk costs and continued
- We expect a prolonged period of reducing capital expenditure and a focus on exploiting the existing asset based
- The thermal coal industry is a good example, where based on record low prices, shut downs of operating mines have started and companies are focussing on regaining productivity
- Shareholders force boards to be conservative resulting in limited M&A driven by synergistic consolidation

Capital expenditure by global diversified miners from the start of the "Super Cycle"



Source: Company filings and Capital IQ as of January 27th, 2015

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…resulting in significant underperformance of mining stocks

- The market moved away from mining and focused on industries with higher returns and lower risks
- Producing companies were able to weather the storm better
- Overall, market values plummeted, with $280 billion of market capitalisation lost in 2013 alone
- Three years of falling prices led to record impairments of $57 billion in 2013

The industry had to realigning expectations and focus on productivity improvements and cash conservation

Source: Capital IQ as of January 27th, 2015
Note: Diversified miners index includes BHP Billiton, Rio Tinto, Vale SA, Glencore, Anglo American, Vedanta and Teck Resources
Base miners index includes Freeport, First Quantum, Boliden, Lundin, Nyrstar, Southern Copper, and KGHM
Junior miners index includes Coalspur, Resource Generation, Prairie Downs, Ncondezi, Waratah, Bellzone, Beowulf Mining, Sundance Resource, Flinders Mines, Equitorial, Cape Lambert, Augusta Resource, GEx Resources, Lumina Copper, Nevada Copper, Copper Fox Metals, Western Copper and Gold, Northern Dynasty Minerals, Ascot Resources, Pacific Booker Minerals, Curis Resources, NovaCopper, Newport Exploration, Independence Group, Cudeco, Nautilus Minerals, Indophil Resources, Avanco Resources, Finders Resources, Hot Chili, Panoro Minerals, Los Andes Copper
Note: Prices rebased to 100

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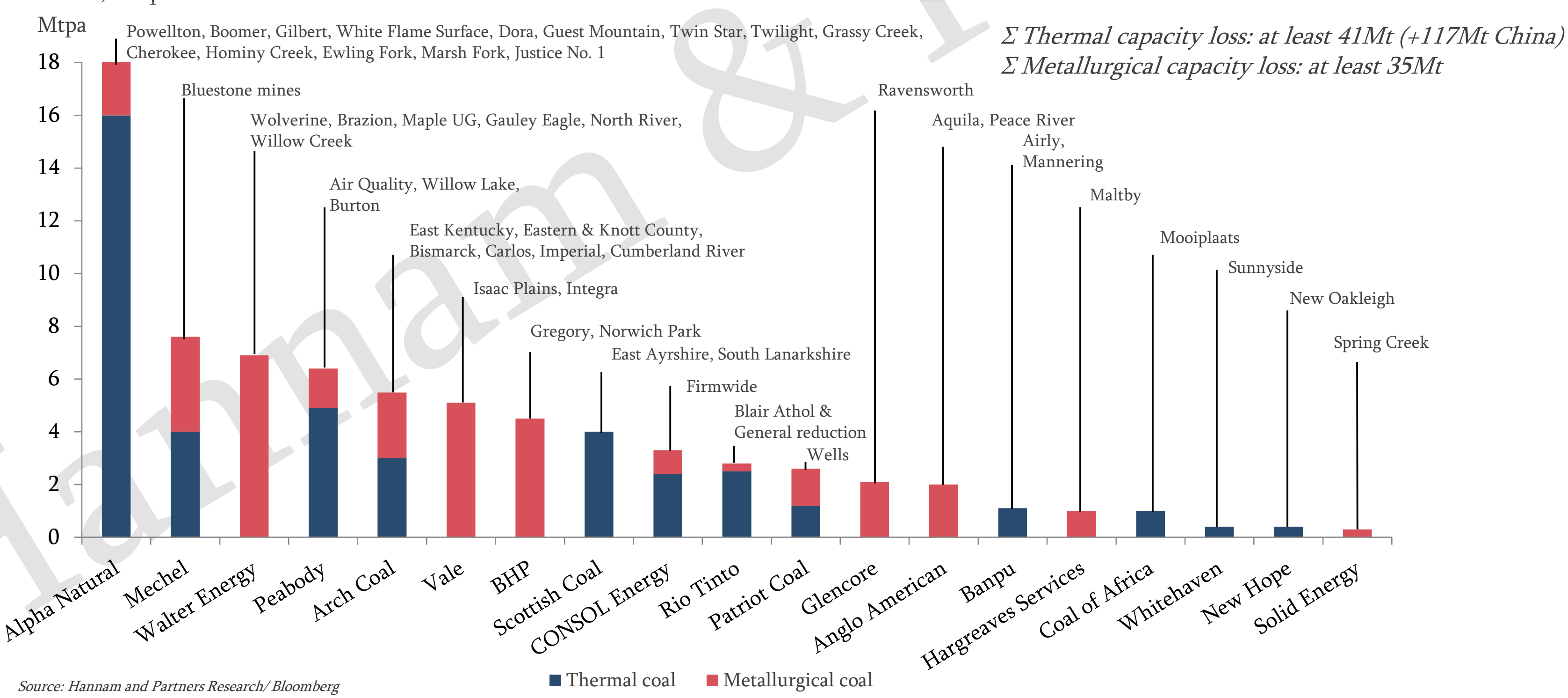
Coal as one of the weakest market performers has seen many closures and suspensions

Mine closure since 2012 (high profile mines)

- At least 41Mt thermal and 35Mt metallurgical coal capacity has been removed since 2012
- Australian mine closures were the result of an increasing cost base
- In the USA, where local prices are significantly below seaborne prices, capacity that did not find its way into export markets had to be closed
- Glencore announced in Nov 2014 that it would close 11 Australian operations for 3 weeks over Christmas to reduce output by 5Mt (TC & MC combined)
- The China National Energy Administration has also disclosed is will remove 117Mt of thermal production by the end of 2014 by closing all mines <90,000tpa

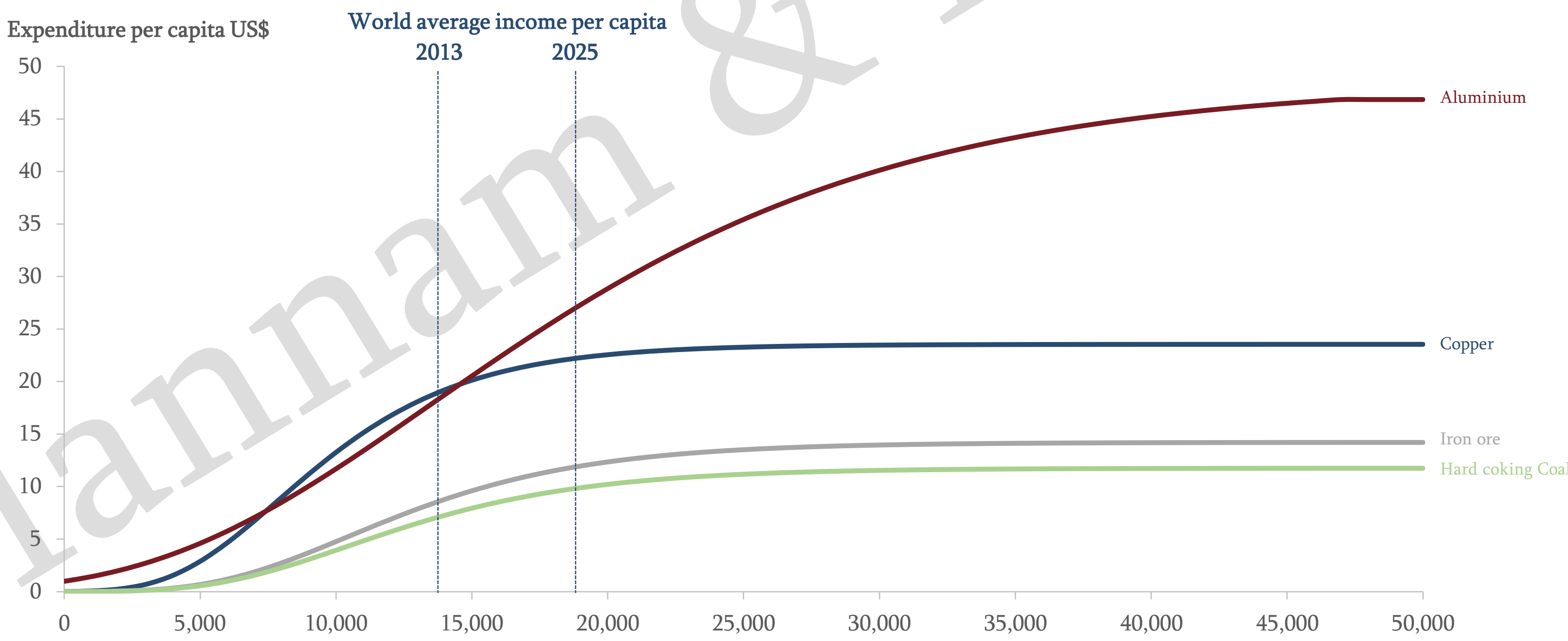


Source: Hannam and Partners Research/ Bloomberg

The question of where to put scarce resources is best answered by looking at the demand dynamics relative to the economic development of the world economy

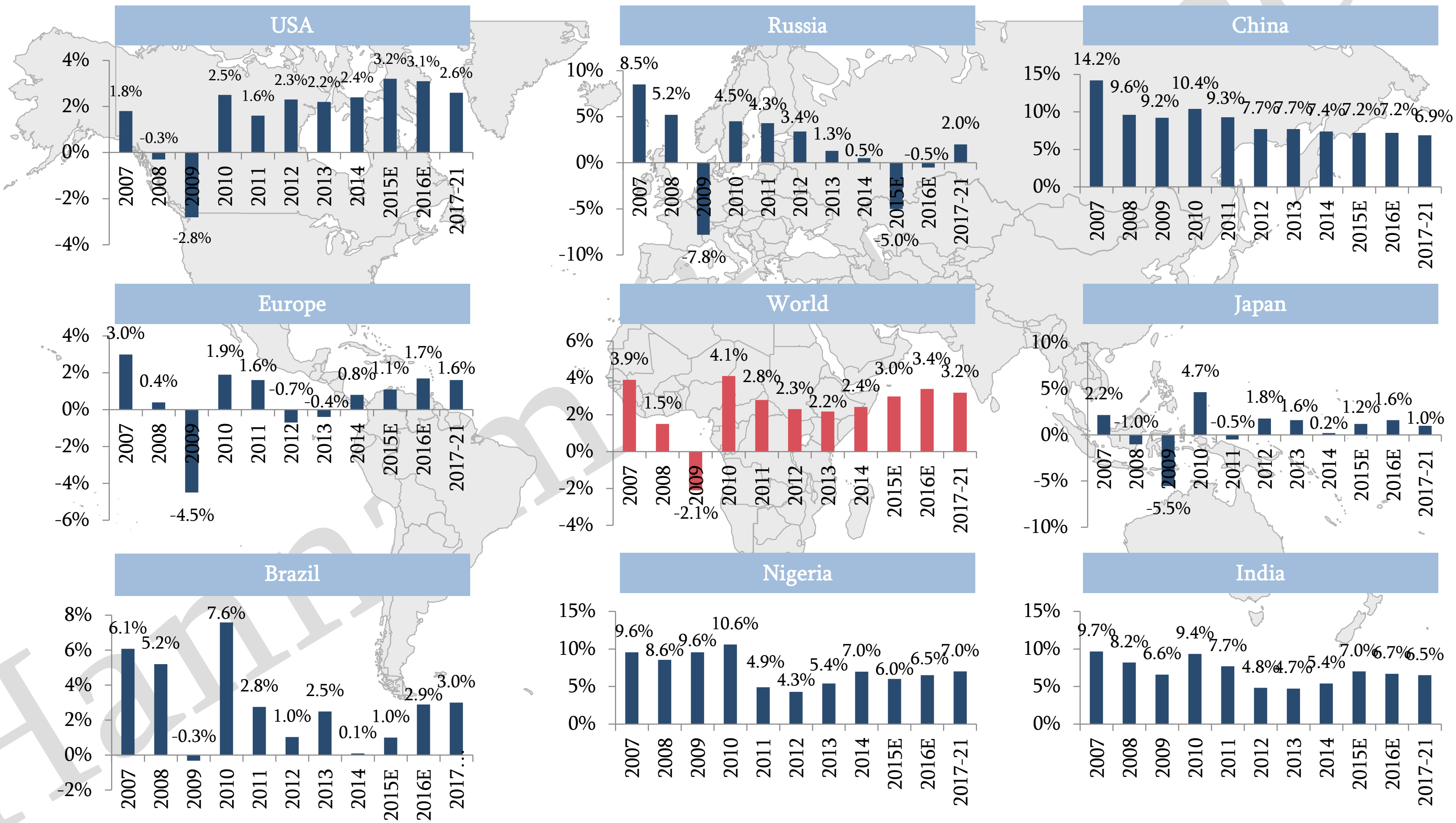
- The global economic development and the demand growth for commodities is driven by large emerging nations, in particular China
- Commodity usage changes relative to the economic strength of an economy, with demand not linear to growth – every stage in the economic development has particular commodity demand requirements
- Early stage: driven by infrastructure developments carbon steel input materials see the highest growth (Fe & coking coal)
- Mid stage: disposable income increases and individual spending accelerates resulting in fast growth for base metals
- Late stage: consumption is driven by high performance applications, i.e. air travel, automobiles and packaging, driving demand of aluminium and specialised alloys

Consumption behaviour is driven by the development state of the economy



Source: Rio Tinto and US Geological Survey

Consistent global GDP growth is forecast but when will the next downturn come?



Source: Bloomberg / PwC
Note: values in real terms

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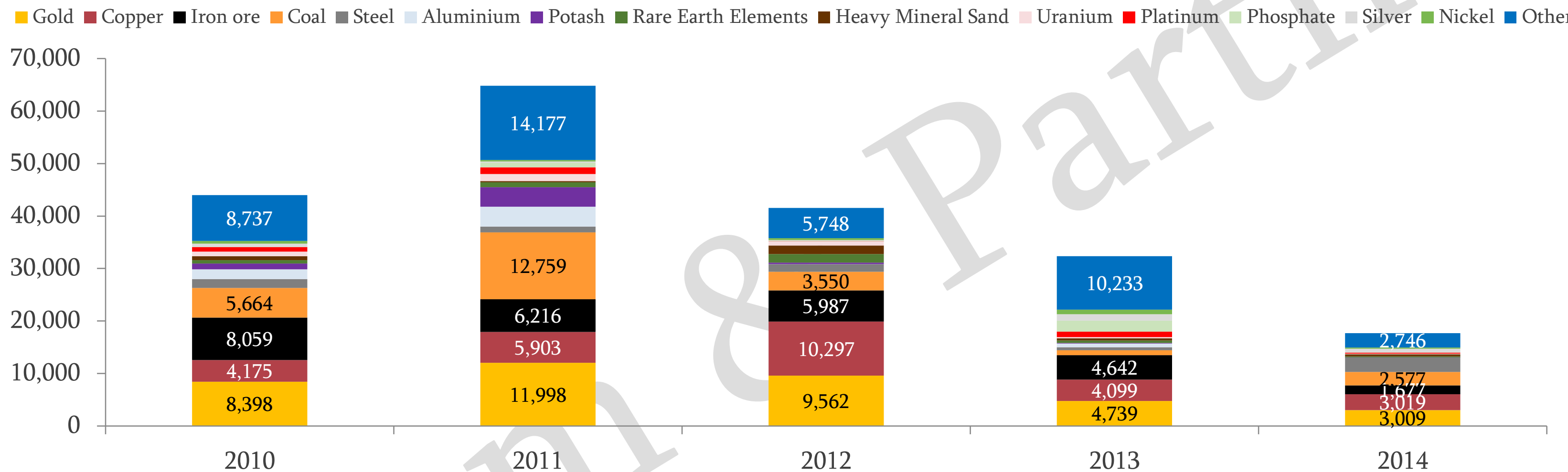
Capital raised by commodity as a percentage of total value raised

By commodity, excluding capital raised by debt reduction/ rollover



	2010		2011		2012		2013		2014		Total
Gold	8,398	19.09%	11,998	18.50%	9,562	23.03%	4,739	14.64%	3,009	17.01%	**37,706**
Copper	4,175	9.49%	5,903	9.10%	10,297	24.80%	4,099	12.66%	3,019	17.06%	**27,492**
Iron ore	8,059	18.32%	6,216	9.59%	5,987	14.42%	4,642	14.34%	1,677	9.48%	**26,581**
Coal	5,664	12.88%	12,759	19.68%	3,550	8.55%	913	2.82%	2,577	14.56%	**25,464**
Steel	1,671	3.80%	1,131	1.74%	1,437	3.46%	600	1.85%	2,766	15.63%	**7,605**
Aluminium	1,899	4.32%	3,750	5.78%	25	0.06%	692	2.14%	0	0.00%	**6,366**
Potash	1,076	2.45%	3,734	5.76%	290	0.70%	103	0.32%	44	0.25%	**5,249**
Rare Earth Elements	641	1.46%	932	1.44%	1,601	3.86%	458	1.42%	133	0.75%	**3,764**
Heavy Mineral Sand	767	1.74%	254	0.39%	1,621	3.90%	455	1.41%	438	2.48%	**3,536**
Uranium	883	2.01%	1,338	2.06%	842	2.03%	203	0.63%	98	0.55%	**3,363**
Platinum	868	1.97%	1,253	1.93%	5	0.01%	1,054	3.26%	173	0.98%	**3,353**
Phosphate	23	0.05%	896	1.38%	97	0.23%	2,074	6.41%	45	0.25%	**3,136**
Silver	639	1.45%	222	0.34%	105	0.25%	1,235	3.81%	713	4.03%	**2,913**
Nickel	482	1.10%	273	0.42%	357	0.86%	864	2.67%	257	1.45%	**2,232**
Other	8,737	19.87%	14,177	21.87%	5,748	13.84%	10,233	31.62%	2,746	15.52%	**41,641**
Total/ year on year change	**43,980**	-	**64,838**	**48%**	**41,525**	**(36%)**	**32,365**	**(22%)**	**17,693**	**(55%)**	**200,400**

Source: SNL

A trend of decreasing capital flows into mining has had dramatic effects for juniors

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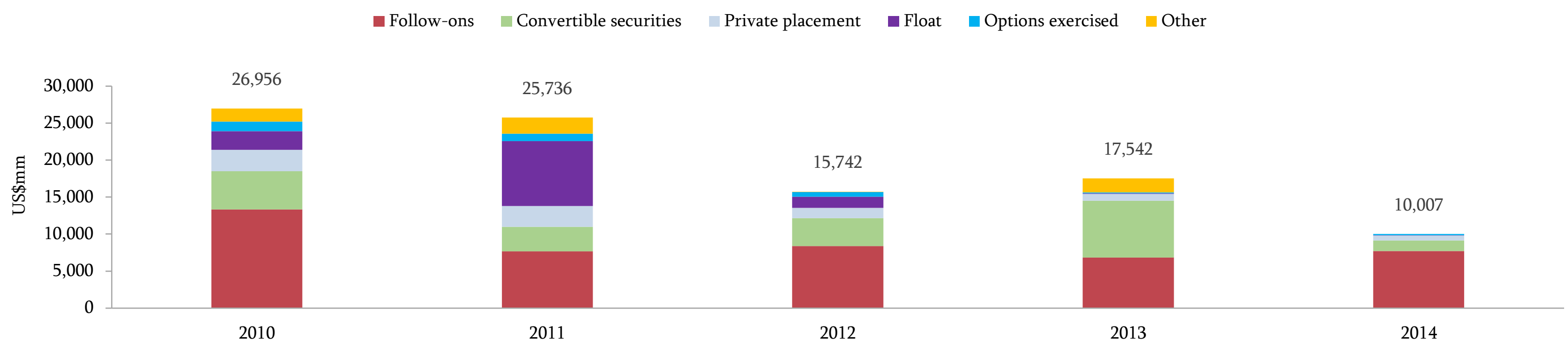
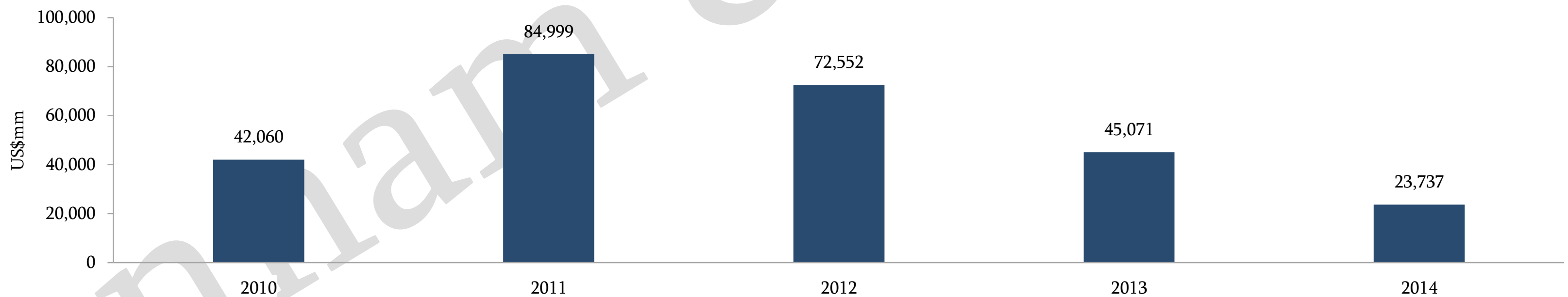
Sources of primary capital in mining since 2010

Sources

Equity or convertible bond



Credit facility or loan



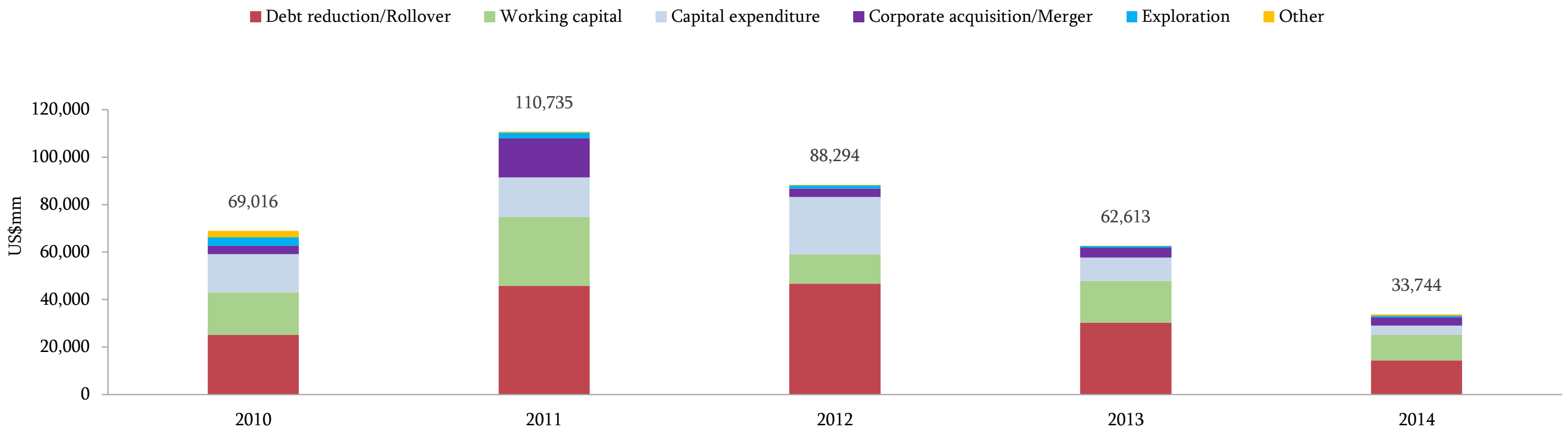
Proportion of totals

	2010	2011	2012	2013	2014	Total US$mm
Credit facility or loan	60.94%	76.76%	82.17%	71.98%	70.34%	268,420
Follow-ons	19.30%	6.92%	9.48%	10.93%	22.82%	43,901
Convertible securities	7.48%	3.01%	4.29%	12.22%	4.25%	21,370
Float	4.19%	2.51%	1.56%	1.48%	1.98%	12,930
Private placement	3.65%	7.94%	1.71%	0.12%	0.09%	8,639
Other	1.89%	0.90%	0.75%	0.24%	0.51%	5,858
Option exercised	2.54%	1.95%	0.05%	3.03%	0.00%	3,284

Source: SNL.

Uses of primary capital in mining since 2010

Uses



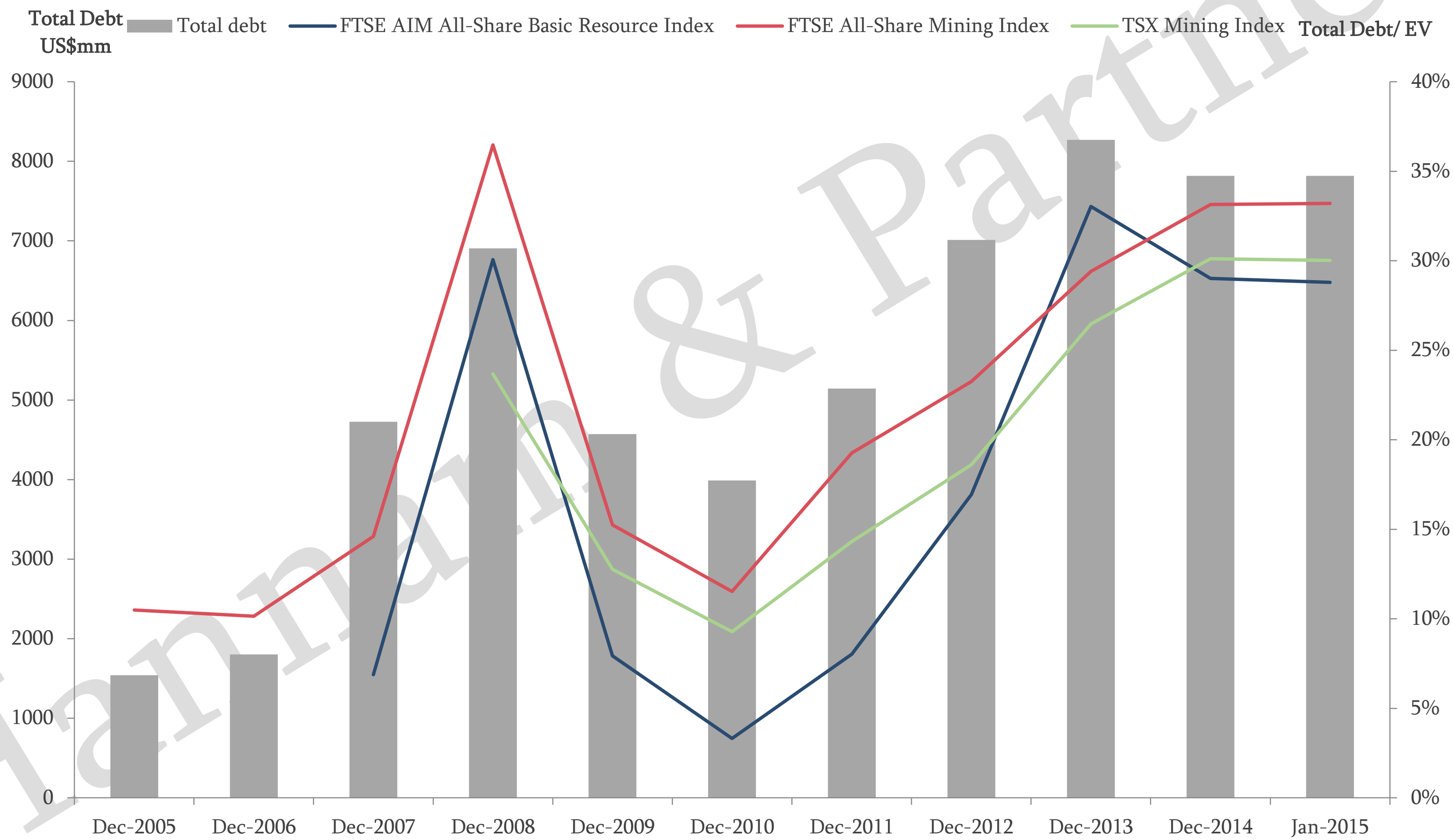
Proportion of totals

	2010	2011	2012	2013	2014	Total US$mm
Debt reduction/rollover	36.43%	41.30%	52.89%	48.27%	42.80%	**162,244**
Working capital	25.97%	26.23%	13.92%	28.24%	31.76%	**87,662**
Capital expenditure	23.26%	15.05%	27.52%	15.59%	11.67%	**70,722**
Corporate acquisition/merger	5.20%	14.88%	3.98%	6.79%	10.43%	**31,351**
Exploration	4.98%	2.12%	1.45%	1.03%	1.72%	**8,295**
Other	4.15%	0.41%	0.24%	0.08%	1.61%	**4,128**
Year on year change	--	**60%**	**(20%)**	**(29%)**	**(46%)**	

Debt reduction and working capital funding has increased proportionally whereas capex and exploration has fallen

Source: SNL, matrix of data available at back of end of Appendix

Total debt in the capital structure and in absolute terms has increased



A function of falling market caps and rising debt increased the proportion of debt in mining companies to unsustainable levels in some cases

Source: Bloomberg as of 6th Jan 2015

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The implications…

- All situations are unique but are generally the results of decisions made in years prior under more optimistic market conditions
- There are clear differences in negotiation leverage in these examples between companies requiring primary development capital, working capital and those trying to refinance
- Early recognition of potential problems, whether expected adverse operational performance or market conditions, can allow far less pressurised conversations with key stakeholder or potential investors
- A strong understanding of what is available and its value is key and Boards need to take a view on what they are willing to offer
  - Marketing rights
  - Off-take
  - Security / Guarantees
  - Warrants
- Optionality is essential – the more options available, the stronger the negotiating position
  - An advisor with a deep network can help here
- Loan and bondholders have been shown to take negotiated positions, with genuine appetite to engineer solutions
  - Existing shareholder willingness to engage and negotiate a resolution early is key
    - Assess their position in previous negotiations
    - Gain a thorough understanding of capital structures, inter-creditor arrangements and any cross-default positions
- Capital structures need to be tailored for future market conditions
- **For companies, early engagement is key and having a strong financial advisor with deep relationships is crucial**
- **For investors, understanding the structure of the debt, the other creditors, the veil of incorporation and the rule of law is key to taking positions with significant upside exposure or potentially controlling positions**
  - We may see many companies like Alpha Natural Resources, Walter Energy and Berau with bonds trading <65 cents on the dollar
  - Investors may want to take short positions in equities early if the debt burden points towards a certain restructuring and a resultant large equity raise or debt-for-equity exchange

…Why Hannam & Partners are experts in distressed situations

- We provide independent advice, are not product led and have the experience and reputation in the market to achieve the best possible solution for all involved across the capital structure
- As advisors to either the Company, major shareholders or major creditors, we aid negotiations based on the individual circumstances of the situations with a look-across to market precedents
- We firmly believe in early engagement and an open dialogue, normally advisor led initially, between all key stakeholders
  - A strong Board is often a key requirement to success as it is the Board who can determine the pace and direction of certain elements of the negotiations
- Our experience tells us that the strongest negotiation tool in distressed situations is keeping full optionality available including potential white knights, other lenders or alternative sources of finance
  - Hannam & Partners' deep network has ensured that multiple options have been available to our clients
- We have worked with corporates but also with investors and lenders alike and therefore understand the demands from all stakeholders and how to best negotiate with each "hat" on

Hannam and Partners' experience and network will strongly benefit clients navigating complicated restructurings

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Matrix of capital raised by use and source (US$mm)

Working capital

	2010	2011	2012	2013	2014
Credit facility or loan	14,161	18,579	11,557	13,910	8,888
Follow-ons	2,688	1,548	216	339	1,704
Convertible securities	676	528	192	1,365	61
Private placement	115	34	12	85	35
Float	0	7,900	0	0	0
Option exercised	251	325	298	83	31
Other	34	135	15	1,900	0
TOTALS	**17,925**	**29,049**	**12,289**	**17,681**	**10,718**
Year on year change	**--**	**62%**	**(57%)**	**44%**	**(39%)**

Capital expenditure/ development

	2010	2011	2012	2013	2014
Credit facility or loan	6,605	9,306	15,097	6,170	1,206
Follow-ons	4,587	4,461	5,867	2,395	1,508
Convertible securities	1,253	435	1,820	649	722
Private placement	1,236	1,538	850	503	463
Float	1,456	294	372	23	19
Option exercised	767	421	288	23	19
Other	152	215	2	0	0
TOTALS	**16,056**	**16,669**	**24,296**	**9,764**	**3,938**
Year on year change	**--**	**4%**	**46%**	**(60%)**	**(60%)**

Corporate & asset acquisition/ merger

	2010	2011	2012	2013	2014
Credit facility or loan	1,287	15,129	2,137	3,895	2,653
Follow-ons	1,723	813	338	151	787
Convertible securities	5	12	60	126	6
Private placement	229	467	69	78	70
Float	340	34	910	2	4
Option exercised	0	14	0	0	0
Other	5	7	0	0	0
TOTALS	**3,589**	**16,476**	**3,514**	**4,252**	**3,520**
Year on year change	**--**	**359%**	**(79%)**	**21%**	**(17%)**

Exploration

	2010	2011	2012	2013	2014
Credit facility or loan	67	31	53	34	48
Follow-ons	1,652	603	471	289	305
Convertible securities	9	142	25	30	29
Private placement	1,040	686	418	199	99
Float	571	569	228	48	8
Option exercised	75	81	65	43	92
Other	26	235	23	0	0
TOTALS	**3,439**	**2,348**	**1,283**	**644**	**581**
Year on year change	**--**	**(32%)**	**(45%)**	**(50%)**	**(10%)**

Source: SNL as of 23rd December 2014