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Miners must think outside the box

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If mining companies want to survive nuclear winter in the sector, they should think outside the box.

That was a central theme at a conference Tuesday that brought together Toronto-based mining companies, investment bankers, lawyers and other industry insiders. Speakers at the event, presented by business development firm MineAfrica and focused on the crisis in the sector, discussed everything from innovative financing methods to cash preservation strategies for companies in dire straights.

The mining industry has been devastated by the global financial crisis, which has hammered commodity prices and made it essentially impossible for many companies to raise money, particularly in the junior sector.

"When the banks are worried about their own balance sheets, they're going to be a lot less interested in your balance sheet," Jim Kofman, vice chairman at UBS Securities Canada, told the audience.

His advice to mining companies is that if they need capital and debt or equity financing is available, don't worry if it's dilutive or expensive: just take it right now.

There is no better asset to have right now than cash, and the companies that have it were advised to manage their balance sheets even more closely than usual.

Lee Hodgkinson, global director of mining at KPMG, said that companies should be constantly revisiting cash flow forecasts, examining currency hedges, taking advantage of opportunities to consolidate debt, and pushing suppliers for better terms.

But there are many mining companies that do not have much cash right now and are completely stuck. Traditional financing is impossible because investors do not want to touch them at any price.

Daryl Hodges, head of investment banking at Jennings Capital, said these companies have two options: hunker down and stop spending any cash, or look at non-traditional financing. "The reality is you have to do both," he said.

He pointed out a number of alternative sources of financing that are getting more popular, including high-yield and convertible debt, off-take agreements with strategic investors, royalty deals with companies like Franco-Nevada Corp., and forward sales contracts with customers for resources that are still in the ground. All of these options have helped different mining companies raise some much-needed cash in recent months.

If all else fails, the other option is a takeover. But there was no consensus from the experts on whether M&A will really take off in the next few months.

While a number of speakers said that it is inevitable at these low valuations, Mr. Kofman went against the grain and suggested that there will not be many deals until the bottom of the market is behind us. Quite simply, he thinks that large-cap miners do not want to get caught buying on the way down. Plus, they want to hoard their cash as much as anyone to get through the downturn.

"It is remarkable the annihilation of the large-cap mining companies," he said.