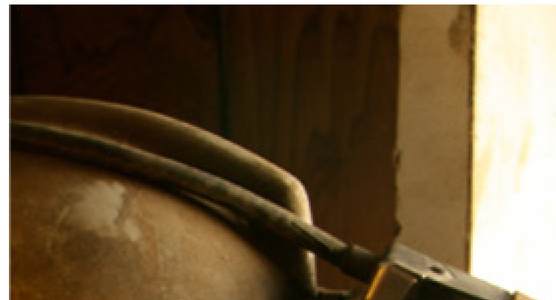

Financing arrangements, derivative transactions, and risk management

Bogotá, Colombia

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France M. Tenaille,
Partner and Co-Director of the Latin American Initiative

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Lawyers • Patent and Trade-mark Agents

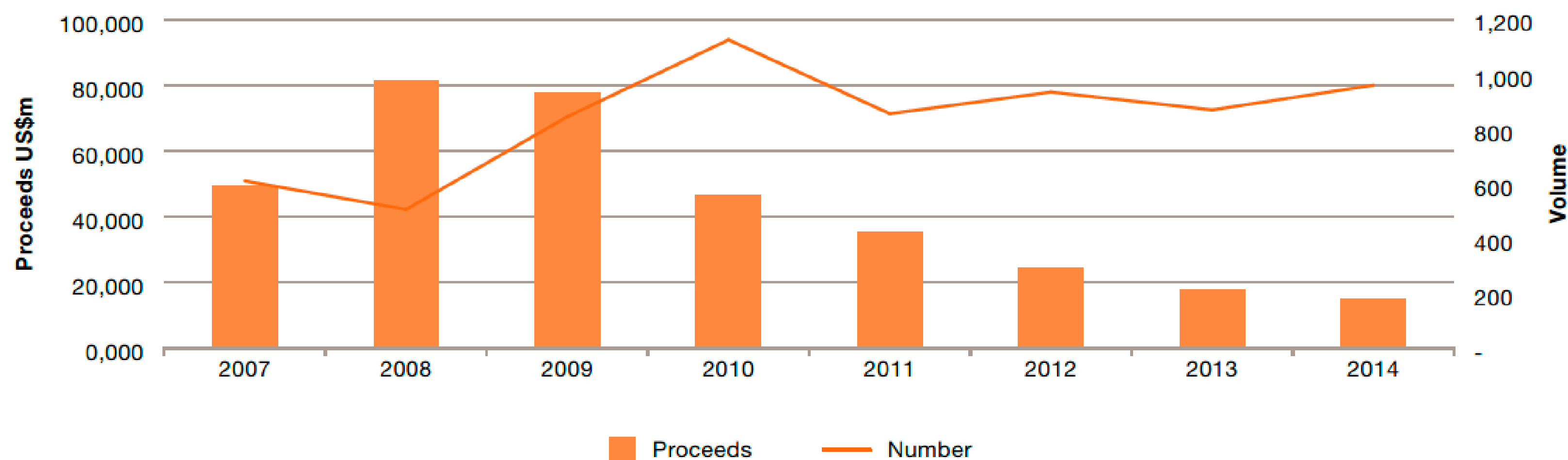
"Access to new capital proved more difficult in 2014; investors diverted away from the mining sector"

> *"Traditional sources of capital are exiting the sector, as stakeholders lose confidence in the ability of miners to deliver adequate returns. The investment environment is poised for alternative capital providers to fill the void left by traditional sources."*

Mine 2015, The gloves are off, PwC

"The value of new equity raised has steadily decreased since 2008..."

Mine 2015, The gloves are off, PwC



Source: Thomson Reuters

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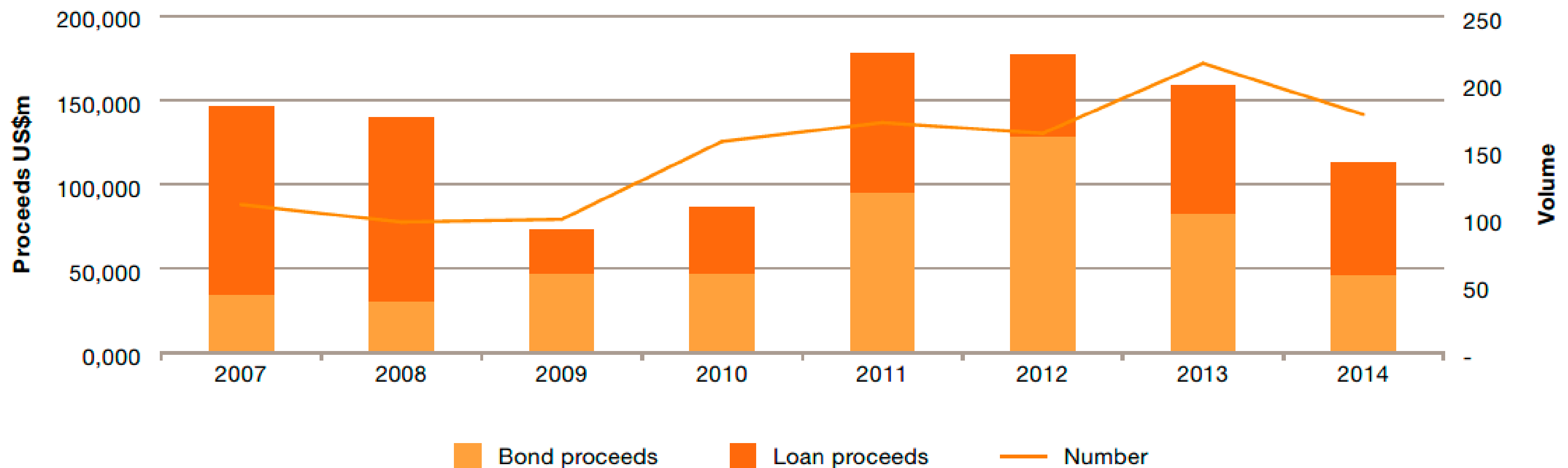
"Debt markets have shown a similar trend since 2012, as investment in major projects was curtailed."

Mine 2015, The gloves are off, PwC



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Agenda

- **Introduction**
- **Overview of financing models**
  - Traditional forms of financing
  - Alternative forms of financing
- **Comparison of financing models**
- **Risk management**
- **Tax issues**
- **Conclusion**

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Forms of Financing

- Traditional forms of financing
  - Debt financing
  - Equity financing
    - Capital markets – IPO/Reverse Acquisitions
    - Private Placements
- Alternative forms of financing
  - "Streaming" transactions
  - Royalty transactions
  - Other forms

Debt Financing

- Creditors extend credit in exchange for interest payments
- Various forms – senior/junior debt, mezzanine debt, convertible debt, bonds, etc.
- Banks and non-financial institutions

Debt financing

- Benefits
  - Widely accepted
  - Available from many sources
  - Finite duration
  - Does not dilute shareholder's equity base
  - Attractive when interest rates are low
- Disadvantages
  - Inflexible and restrictive agreements
  - May affect the project's NPV and cash flow – payment of the debt may begin during or prior to commercial production
  - Not available for exploration projects
  - Significant cost of money

Equity Financing

- Securities (generally shares) sold to investors (private placements) or to the public (IPO/reverse acquisitions)
- Benefits
  - Generally does not require future payment or other obligations
- Disadvantages
  - Subject to commercial and securities regulations
  - Dilutes the shareholder base
  - Private placements– a discount is generally applied to the market price

"Streaming" transactions

- Buying and selling transaction
- Percentage or fixed amount of mining output
- Payment upfront (deposit) – financing for the mining company
- Purchase price- fixed price per ounce
  - Generally, the lesser of (1) the market price at the time of purchase or (2) a fixed price below the market price in effect at the time of the transaction
- The difference between payment for output and market price at the time of payment reduces the amount of the upfront deposit.
- In general, for basic metal byproducts

"Streaming" transactions

Availability of "Streaming"

- Status of the Project
  - Development of the mine
  - Expansion of the mine
- More recent
  - Debt refinancing
  - Financing of acquisitions
- Timing of the upfront payment
  - Total (subject to certain conditions being met)
  - Progress payments (project targets)

"Streaming" transactions

Other relevant terms

- For the life of the mine unless there is a fixed cap or term
  - No cap, potential increase for the investor if the project generates more income than expected and vice versa
- Operating agreements: usually, at the discretion of the mining company
- Restrictions on the transfer of mining properties
- Reporting requirements
- Consequences of non-compliance
- Guarantees

Benefits of "Streaming" Transactions

- No pre-production payments required. Once output starts, payments are based only on minerals actually produced.
- Does not dilute shareholders' percentage of stock.
- Establishes a firm value of the metal being traded
- Lower discount applied to the current value of the mine
- Normally does not require delivery of set amounts of mineral
- Ownership and control of the mine are retained
- No financial commitments
- Flexibility to issue equity and debt maintained
- Increased investor confidence

Royalties transactions

- Purchase of a percentage of a property's future yields
- Paid up front – source of financing
  - Historically, designed to provide the seller of a mining property ongoing access to upturns in the future development of the mining property
- Percentage of income calculated after deducting agreed upon amounts generated by a specific property
- The party financing the transaction receives cash instead of metal
- In certain cases, payment in kind is permitted
- Canada/United States – a claim on the land is created which is maintained after the mine is sold

Royalties transactions

- Mine construction, development and expansion
- For the life of the mine unless there is a fixed cap or term
  - No cap, potential increase for the investor if the project generates more income than expected and vice versa
- Royalties agreements
  - Gross smelter royalty (GSR)
  - Net profits interest (NPI) royalty
  - Net smelter return (NSR) royalty
- NSR royalties tend to be more common

Benefits of Royalty Agreements

- Normally they do not affect a mining company's financial statements and slightly dilute profits
- No payments required until production starts
- Based on minerals produced
- Does not dilute shareholder's equity base
- The owner/operator maintains control over mining operations
- Generally speaking, there are no guarantees
- No financial commitments

Disadvantages of "Streaming" and Royalties Transactions

- Payment obligations usually continue throughout the life of the mine
- Reimbursement of upfront payment under certain circumstances
- Guarantees – may create subordination and deferral problems if debt financing is used in the same project
- Protection agreements – requirements with respect to information, maintenance of the project's assets, audits and inspection rights

Comparison of Financing Models

"Streaming" transactions – commercial advantages

Versus Equity	Versus Debt
Less dilutive since the "stream" is applied to a single asset only	Long payment period
Attractive when shares are being quoted on the stock exchange at lower prices than the net value of the assets	No fixed obligations in dollars, so less risk during raw materials crises
Reduces equity projection and discount financing	There are no restrictive coverage or remaining cash clauses
No additional costs– no brokerage or market discount fees are paid	No commitment, advisor, waiting time, or syndication fees
Helps validate the project	A single source of financing versus investment banks and syndicated loans
Can be done when the licensing and financing risks are reflected in stock valuations	A "stream" commitment can be made prior to completion of licensing and financing
Helps validate due diligence	Due diligence and documentation is quicker than with project financing
	"Stream" financing affects the borrowing base, so it should be taken into account in bank financing.

Comparison of Financing Models

Legal advantages

	Debt	Royalty	"Stream"
Ownership / Control	Keeps total ownership, but may restrict options	Transfers interest in the land and increased exploration	Ownership interest aligned but transfers exploration upturn
Agreements	Strict financial and negative pledge agreements	Selected reporting obligations	Limited operational agreements
Transfer restrictions	Limits on transfers of assets	Limited restrictions	Strict limits on asset transfers and change of control
Transaction mechanism	Complex and laborious	Relatively straightforward	Efficient time and cost structure (unless a bank syndicate is involved)

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Risk Allocation

- The "streaming" enterprise will assume:
  - Production Risk
    - Traditionally, no min/max. delivery requirement
    - No obligation to operate
  - Price Risk
- Consequence
  - If actual output/price is lower than the output/price implicit in the original transaction, the mining enterprise does better
  - If actual output/price is higher than the output/price implicit in the original transaction, the "streaming" enterprise does better

Risk Management

- Generally speaking, a "streaming" enterprise will not have to assume:
  - Operating cost or cost of capital risk
  - Construction risk
  - Financial default risk
  - Political/expropriation risk
  - Risk of taxes levied in the country in which the mine is located
  - Risk of losing concentrate/product
- It can turn to the parent corporation for more guarantees
- If there is greater financial capacity
  - Investment grade guarantee
  - Significant guarantee package
  - There is a possibility of making a more significant initial deposit

Tax Issues

"Streaming" Transactions

- Payment of the Purchase Price
  - The funds are paid upfront in the form of a deposit
  - The metal delivered is sold at market price, paid in part as a credit against the deposit and in part as a fixed payment in cash
  - Once the deposit is fully credited, the purchase price is just a fixed cash payment, which is generally heavily discounted from the market price

Fiscal Consequences – Canadian Tax

Mining Company – Reserve Mechanism

- Upfront payment or deposit is included as income
- The company claims a reserve in respect of the metal to be delivered in future years
- The reserve claimed in previous years is included as income for the following year (Year 2)
- Claims another reserve in Year 2 (and subsequent years in respect of that part of the upfront payment that has not been earned (that is to say, metal not yet delivered)
- Allows the mining company to recognize the deposit as income when the metal is actually delivered, despite its having been paid upfront.

Fiscal Consequences – Canadian Tax

The "Streaming" Enterprise

- The cost of each unit of metals received is equal to the sum of money paid in cash upon delivery, plus the share of the deposit credited upon delivery

Net result: the mining company has income and the "streaming" enterprise has costs in respect of the buying and selling of metals.

Fiscal Consequences – Canadian Tax

Royalties transactions

- If the royalty is in respect of a property of a Canadian mining company, the upfront payment will be deducted from its resources fund
- When the mining funds become negative, income will be included (but may be exempt from taxes due to other tax attributes, if available)
- As the royalty payments are made, the mining company may deduct those payments
- The beneficiary, if Canadian, includes those payments in its/his income.
- If the beneficiary is not Canadian, the payments are subject to withholding.

Conclusions

"Streaming" and royalty transactions

- True financing structures
- It is not a fiscal planning mechanism
- A "life saver" for junior mining companies that have no other means of financing
- Capital optimization mechanisms for high-level producers

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Thank You

France M. Tenaille
Telephone: 416-369-7398
Email: france.tenaille@gowlings.com

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Lawyers • Patent and Trade-mark Agents