Insto Tips

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In each issue of Fortbridge ***Insto Tips*** we bring you advice — from a resource-industry-focused analyst, broker, fund manager or adviser — on how publicly listed mining and energy companies can encourage investment.

In this issue we talk with Bhagyesh Dash, Founding Partner of Singapore based fund Bromius Capital on the changing paradigm of the Chinese investment market in light of the junior resources sector.

Bromius Capital on the 'Chinese Investor'

How has the profile of the Chinese investor changes over the decade?

Yes, most certainly the profile of the Chinese investor has changed quite a bit. What we are seeing now is increasing proliferation and involvement of private groups – business conglomerates diversifying away from core businesses such as the property sector and entering the resources sector for several reasons. First, for diversification reasons and second, as the Chinese economy in general slows down and the property sector in particular slows down even further, these businesses need to find a new home for surplus cash flows. And, these groups are following the lead of the Stated Owned Enterprises (SOEs) and the dictate of the government to "go global" and secure natural resources for China Inc. by looking to invest in and acquire mining and oil and gas assets overseas which they may ultimately sell to the SOEs.

We are also seeing a new generation of private equity style groups backed by high net worth Chinese businessmen looking to deploy their investor's wealth in the resources sector. More and more of these private equity groups are mushrooming in Beijing, Tianjin, Shanghai, Guangzhou and other flourishing cities of China.

In many cases, we find that there is either a formal or informal partnership between private groups and SOEs – the basic principles being that the private groups will seek to act as the "front runner" by investing in earlier stage companies and once these companies are de-risked, the SOEs will step in to buy out the private companies. This way, the SOEs can avoid earlier stage risk and also can leverage off the nimbleness and less bureaucratic nature of

decision making of the private company. The backing of the SOE also provides the private group with credibility & backing to enable them to convince the investee company of its merits and ultimately provides a well-defined exit path.

Are we seeing new types of investor groups emerge, or is it still the SOE that dominates this group?

In terms of big deals and big investment amounts, the SOEs are clearly still dominant. But, for smaller deals, the private groups are certainly getting more and more active. As mentioned above, there are some fairly sizeable private groups with cash generated from other businesses seeking to deploy this capital into the resources sector and capable of looking at bigger with or without partnering with the SOEs. A good example of this is the recent Cathay Fortune bid for Discovery Metals in an $880 million deal which was in partnership with the China Africa Development Fund and financed by the state owned China Development Bank. Ultimately the bid did not proceed, but it demonstrated private sector capacity for large deals and in partnership with government related entities. Similarly, a consortium that included state owned Hebei Steel and privately owned Chinese commodity trader, General Nice, recently acquired a 57% stake in Palabora Mining in South Africa from Rio Tinto in a $476 million deal.

This goes back to the point made in response to the earlier question of the emergence of a new breed of private investors – cashed up and looking to diversify and therefore deploy funds into resource sector investments.

In this respect it is important to appreciate the growing role of Hong Kong as a source of mainland Chinese capital for mining projects. According to estimates, in mid-2012 Hong Kong banks held US$87 billion in renminbi deposits demonstrating that it is **the** pre-eminent offshore renminbi centre in the world. US$87 billion is a lot of money and Hong Kong is the logical place for these funds – free capital flow, stable currency (albeit pegged to the US dollar), proximity to China and low taxation which provides a platform to maximise shareholders value. Hong Kong also offers a familiar and well developed legal and regulatory infrastructure which is another reason for Hong Kong attracting a growing number of mainland Chinese institutional and retail investors.

Therefore, we believe that you will see a growing number of private groups based in Hong Kong actively investing in the resources sector. Recent funding deals announced by TSX listed junior miners – Axmin Resources and Colt Resources with Hong Kong based investor groups are examples of this. We have also recently seen a Hong Kong listed company, controlled by a mainland Chinese entrepreneur, express an interest in acquiring ASX listed Elemental Minerals, which owns a potash project in Africa, in a A$190 million deal, which is another example of mainland Chinese capital being routed through Hong Kong.

Today, what are SOEs are looking for in an investment?

Securing supply of strategic commodities (oil and gas, copper, coking coal, select base metals and recently gold are the favourites), advanced stage projects, size of investments

and increasing emphasis on return on investment. The return on investment is becoming very important to the SOEs as a number of past investments have not exactly been stellar successes. Also, something that is becoming an important investment criterion is project location and the that it is in a stable, safe political jurisdiction. Australia and Canada are top of the list in terms of preferred investment destinations. The other important criteria is that they are seeking projects that are either already in production or at BFS stage and so in that sense considerably de-risked. Finally, size of resource is important – projects need to be of a certain minimum size to be of interest to Chinese groups.

How important is the issue of absolute control or 100% ownership to SOEs?

For the SOEs this is certainly something important and almost a necessity when it comes to mining deals as this helps procure bank debt funding which is crucial for large capex projects. Without demonstrating management and equity control, it is not possible to raise the bank funding in most cases. So, for SOEs this is still an important issue. But, we are seeing a slow relaxation of this requirement as SOEs are recognising need to maintain existing management teams and not lose that expertise on day one. So, on a case by case basis it is possible to negotiate more of a partnership type deal as opposed to an outright or majority buyout. Also, private investor groups are looking for cornerstone equity positions in projects and companies rather than majority or outright ownerships.

Are we seeing any evidence of SOEs getting involved either earlier in the development stage or with junior miners?

Yes, there have been such deals such as Shandong Gold's investment in Focus Minerals, Zijin buying Norton Goldfields being two recent examples. They recognise that they need to look at juniors with promising prospects on a case by case basis. But, at this current moment in time given market conditions there is less interest in juniors simply because the larger companies and projects have become quite attractive from a valuation perspective and many of the larger mining companies are in need of financial assistance – case in point the discussions African Barrick were having with China National Gold. We believe there is going to be more interaction between Chinese SOEs and the larger mining groups in relation to assets the larger mining groups own and that they are having difficulty funding in these markets.

We are also seeing geological bureaus of provincial governments getting involved in very early stage projects but having said that, in this market, they also understand that the values of more established, larger projects and companies have become very attractive so the current focus remains on the larger more advanced projects.

What are SOEs doing when they take minority stakes in smaller companies?

They are using the minority stakes to "test the waters" by understanding the projects, the management, social and environmental issues better. Once the project is de-risked, they then typically look to consolidate their ownership over the projects just as Zijin did with Norton Goldfields and Yunnan Chihong did with TSX listed Selwyn Resources' zinc project in Canada recently. However, again in this environment the majority of the SOEs have a strong

preference and requirement for majority control positions or outright purchases of companies and projects.

How do the SOEs actually transact and deal with the juniors, directly or through affiliates or "advance private investors"?

SOEs are dealing with juniors through all - of the above – directly in some cases or in a majority of cases through offshore listed subsidiaries – China National Gold has a Toronto Stock Exchange (TSX) listed subsidiary which is being used to look for projects listed on the TSX, China Minmetals Corporation has its 71% owned Hong Kong listed subsidiary MMG Limited which again is managed separately and looking at investment targets separate to Minmetals.

In some cases, as mentioned earlier SOEs are also in partnerships (either formally but in most cases informally) with private groups to invest in smaller, earlier stage overseas projects.

How does the activity of private groups on the mainland moving into mining investment differ from the above profile?

The modus operandi of the private groups in most cases is to act as a front runner for the larger SOE. They are more flexible in terms of decision taking and size of investments so can make quicker decisions. However, for investment sizes above a certain limit, Chinese government or NDRC (National Development & Reform Commission) approval is required for investments in the resources sector above $300 million, which can often trip up a number of private groups. This is where companies need to be very careful in selecting the right private group as an investment partner as it is important the private group has the credibility and nous to be able to secure the NDRC approval and other required approvals such as MOFCOM (Ministry of Commerce) and SAFE (State Administration of Foreign Exchange) approvals as appropriate.

There are some private groups that are sizeable in their own right and so look to make investments for their own account but in most part, we have found there is a relationship of some shape or form with an SOE.

If a private Chinese group get involved with a project through an equity investment, typically it will look to provide what they call a "**packaged funding solution**". This applies to projects that are at development stage and need project or construction financing to bring the project into commercial production. First, the Chinese equity investor comes in to invest at the company and/or project level. This investor will then help market the project in China to the banks and Engineering Procurement & Construction (EPC) firms to secure a) EPC services and b) bank funding for the project.

The benefits to the company are that once it has decided to go down the Chinese funding route and provided, and this is something all companies must diligence carefully, that they have selected the right Chinese equity partner, the Chinese partner will help procure the

remaining pieces of the puzzle far more effectively than the company might have been able to do on its own.

For the Chinese, this is an effective way to capture the entire value and keep it onshore with the resulting benefits that such a strategy spawns. It is also a cheap alternate way to diversify its foreign exchange reserves away from US dollars compared with simply buying gold bullion. It is what we call the "**killing several birds with one stone"** strategy. It is all about China Inc. working in unison to achieve macro-economic objectives.

Provincial level mining geological bureaus seem to be increasingly active, what type of investor group do they represent and how do they operate as investors?

As the name suggests, they are essentially the geological arms of the provincial governments and are provided with investment budgets and the mandate to invest in exploration projects overseas. These bureaus are prepared to enter into farm-in style arrangements to earn their equity in the project so something for many junior companies with multiple exploration projects to seriously consider especially in these markets. We saw the geological arm of Jiangsu province do a deal with a junior ASX listed gold explorer in November 2012 in a deal involving A$11 million in return for farming in for 30% equity. The motivation for such deal seems to be to a) deploy surplus funds b) take on earlier stage higher risk projects but hopefully reap greater rewards in the long run and c) develop overseas exploration expertise and provide employment opportunities for staff.

Finally, what's the best way for junior mining and energy stocks to access "Chinese money"?

I think the best way is to simply use reliable mainland Chinese intermediaries that have a strong network across SOEs and private groups. Building direct relationships is another way but you do not get the benefit of understanding the background of some of the private groups as there isn't much information on these groups in the public domain. Also, very often a common complaint from CEOs is that they find that the initial part of a direct communication with Chinese groups is great and the NDA gets signed (which is the easy part as Chinese love signing NDAs!) but after that there is radio silence from the Chinese side. This is where a good, reliable intermediary is very valuable as by having someone on the ground in China, you have someone who can follow up on a regular basis in a common language to make sure there is no miscommunication and nothing slips between the cracks. A good intermediary is also very useful in assisting a company and its Chinese partner navigates the Chinese approval process in securing the necessary approvals such as the NDRC, MOFCOM and SAFE approvals.

Fortbridge's Managing Director Bill Kemmery and China Specialist, Isabella Kou, are in China this week introducing clients to investment partner opportunities in Shanghai and Beijing. To learn more about our services in the market, please contact me on +61 410 987 513 or radha.belapurkar@fortbridge.com .

About Bromius Capital

Bromius Capital is an Investment and Advisory group based in Singapore specialising in the mining & metals and upstream oil & gas sectors. Bromius have a focused investment strategy – building a portfolio of interests in quality natural resource assets in partnership with experienced management teams and strategic capital.

Bhagyesh Dash has 20 years investment banking and corporate advisory experience in the mining and broader natural resources sector across Asia. During his 12 years based in Jakarta Bhagyesh advised the Government of Indonesia on the privatisation of the state owned mining companies as well as on the divestment by international companies of stakes in leading Indonesian coal companies Kaltim Prima Coal, Adaro and Arutmin Coal. Bhagyesh has extensive relationships with mining companies and resource investors globally and has featured numerous times in the media as a leading commentator on the Asian mining sector.

About Fortbridge

Fortbridge is an independent financial communications firm that helps emerging resource sector companies to raise their profile and to grow. With unrivalled experience in the mining and energy sectors and a growing international network of consultants in Sydney, Melbourne, Perth, London, Toronto, Sao Paulo, Hong Kong and Singapore, Fortbridge is uniquely positioned to support the promotion of listed resource stocks to funds, brokers and other financial institutions. In fact, Fortbridge has introduced more than 100 such companies in the past year to investors in key financial centres around the world. Over 150 ASX, TSX, AIM and JSE listed companies also rely on Fortbridge for the distribution of their major announcements and news releases to international mining, energy and finance media.

Best wishes for your endeavours,

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