Latin America Round Up

Photo Credit: Local woman near Las Bambas project, Peru, Xstrata

Fueled by escalating precious and base metal prices, exploration companies around the world earmarked 25% of their 2008 budgets to their sweetheart region: Latin America.

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A full quarter of the estimated $13.2 billion of the global exploration budget, or $3.3 billion, was poured into Latin American countries, with 83% devoted to the traditional big five nations: Mexico, Peru, Chile, Brazil, and Argentina, reveals Jason Goulden, Corporate Exploration Strategies Director at the Nova Scotia-based Metals Economics Group (MEG).

The region has been the most popular destination for exploration since 1994, followed by Canada (19%), Africa (16%), Australia (12%), the U.S. (8%), and only 4% in the Pacific/South Asia, according to the 2007 MEG survey that covers annual budgets from 1,912 companies, which consist of about 95% of worldwide commercially oriented nonferrous expenditures. In comparison with the previous year, Latin America has seen its 2008 exploration budget levels grow by 37.5%, from $2.4 billion to $3.3 billion. Like all cycles, this bonanza reached its peak in 2008, after six years of consecutive annual exploration budget growth, since its bottom in 2002.

But the late 2008 metal prices and exploration downturn could flip back in 2009, when some countries begin to propel their stimulus plans into their economies to avoid recessional pain, which would have a positive impact on the metals arena. Newly installed U.S. president Barack Obama, for instance, announced a $1 trillion infrastructure

Photo credit: Rory Sheldon

program, whilst China's infrastructure package will reportedly reach $586 billion. These ambitious plans will push metal prices up in the second half of 2009, forecasts Christopher Ecclestone, Equities Strategist at New York-based Hallgarten & Co.

Nevertheless, the first semester of 2009 will be challenging for the mining industry, especially for firms struggling with cash flow. "I see a lot mergers going on in the first half of 2009, but not majors buying smaller ones, but amongst peers."

Ecclestone explains that the 2007 financial scenario – where mining firms went to the markets to finance their operations bit by bit – has slammed the door in their faces, leaving a window open for mergers and acquisitions (M&As) as the only way to access capital and keep their operations afloat. He also states that the traditional way of selling the "less sexy" asset to fund their main one won't work in recession times since the companies' market caps would be so depressed. It may be less expensive to buy the whole firm before acquiring a single project (at the proposed price), and in that situation, M&A proposals arise.

On the other hand, HSBC Securities Senior Mining Analyst, Victor Flores, also based in New York, doesn't see vibrant M&A activity in 2009, and instead expects less of these transactions as the world's economy enters into a recession. "At the beginning of 2008, mining companies were waiting for other firms' market capitalisations to go down and then buy them, but then the financial crisis befell us, and now there is even less interest in mergers and acquisitions. To merge, firms need capital, and there is none." He adds, "[2008] has been one of the worst years that the mining industry has seen in a decade, in terms of share prices, companies' growth, market conditions, and prospects for the next year."

To illustrate, Flores cites the Brazilian giant Vale's attempt to acquire Swiss Xstrata, but "Xstrata's shares were overvalued, and they continued on the rise in 2008, and when Vale tried to convince the banks to lend them money, they [Vale] decided not to continue because it was too expensive, and the proposal fell apart." Flores' argument was coincidentally affirmed by Vale's Financial Director Fabio Barbosa, who in a December 16 interview with Reuters assured, "Our sector will see less wonderful days for mergers and acquisitions."

Despite the fact that Latin America leads in attracting global exploration budgets, the region is perceived as one of the riskiest ones in which to conduct mining activities from a political standpoint. The Canadian-based Fraser Institute, who conduct an annual survey of metal and mining exploration companies, ranks the Latin America Policy Potential Index (PPI) for 2008 as the second worst, next to Oceania (Pacific nations), and after Africa. The PPI is a composite index which measures government policies' effects on exploration activities in 68 nations.

Amongst individual countries in the 2008 study, Chile scored in the top-ten, Mexico earned the 28th place, and Peru was positioned 30th. In contrast, Ecuador, Honduras, Bolivia, Panama, and Venezuela were within the bottom 10, with Colombia and Brazil somewhere in the bottom half of the PPI's 68 nations.

"This is a real shame. It means that even in this time of booming commodity prices, Latin American nations are producing fewer jobs and less prosperity from mining than they otherwise could, in a region that desperately needs both jobs and prosperity. It also means that the mining industry struggles more than it should with developments in Latin America," said Fred McMahon, the survey's coordinator, during the LatAm Mining Congress 2008, held in June in Miami.

Latin American M&As

Latin American metallic mineral assets were the only ones in the world to attract the sole major company shopping in 2008. Kinross Gold Corporation first acquired the "gold dinosaur" Fruta del Norte project (FDN), located in southeast Ecuador, in a midyear takeover bid for the Canadian junior firm Aurelian Resources. And most recently, Kinross went to the markets again, announcing their intention to buy the Lobo-Marte gold project in Chile, a transaction expected to conclude in late December 2008.

Fresnillo, headquarted in London and the world's largest silver producer, have offered to buy another, MAG Silver, in a takeover bid, a bid that will likely be responded to in January 2009. The last firm announcing a takeover bid in 2008 was Rusoro Mining, who want to acquire Venezuelan Gold Reserve's assets, as announced on December 15. The next day Canadian junior firm Corriente Resources, rich in Ecuadorian copper, announced they had entered into negotiations with a potential buyer. Without a doubt, December was the most exciting month of the year in terms of Latin American M&As, but far less effervescent than 2007.

So, let's start with the biggest deal of 2008. Kinross poured CDN$1.2 billion into Aurelian Resources and their mega-rich FDN, a high-grade deposit containing a resource of 13.7 million ounces of gold, and 22.4 million ounces of contained silver. The takeover bid resulted in the purchase of one of the largest discoveries made by a junior in the last decade, in an offer that consisted of 0.317 of Kinross common share and 0.1429 of a warrant per Aurelian's stock. And despite vocal opposition from Aurelian's retail investors, who considered the offer lowball, Kinross' offer succeeded, acquiring over 90% of the shares in September.

The acquisition was proposed late July 2008, at a moment of political uncertainty in Ecuador. This was one month prior to Ecuadorians approving their country's 20th constitution through a referendum – and with a new mining law on the way, expected to pass in January 2009. Also, Aurelian Resources' market capitalisation was at record lows since the April 2006 discovery, as a consequence of the Ecuadorian government's mining mandate which halted all industry operations until the new law is enacted. In retrospect, with lower gold prices at the end of 2008, Aurelian may have reached a good deal with Kinross Gold.

At the time of the bid, HSBC analyst Victor Flores speculated that the main reason Aurelian wanted a speedy sale may have been the expected 70% windfall tax to be applied to the mining industry, whilst the tax was still unclear to investors. "A windfall tax of 70% is a very severe one for the mining industry. If they want to apply [a WFT], it should be similar to the 25% income tax, or a 30% WFT," he said in an earlier interview. Ecuadorian Undersecretary of Mines José Serrano confirmed the WFT was to be imposed, in mid-June of 2008 , a few weeks before Kinross expressed their interest in Aurelian's assets. From Kinross' standpoint, however, such an acquisition seems to be a wise one.

"We actually like the company's bold approach, as it reminds us of the time when Barrick acquired a little known junior by the name of Arequipa Resources and eventually developed Pierina, one of Peru's largest and most profitable gold deposits," was the HSBC 2008 Senior Gold Book's flattering comment on the Kinross-Aurelian deal.

The HSBC publication also notes that Kinross has many projects in production or near-term production, such as the Kupol project in Russia, the Brasilia (Paracatú) mine, and the Chilean Maricunga and La Coipa gold mines. "But with Kinross's near-term projects now coming on stream, production

Victor Flores,
Senior Mining Analyst,
HSBC Securities

Artist representation of Adriana Resources Inc. Proposed iron ore port facility, Sepetiba Bay, State of Rio de Janeiro, Brazil

growth, based on our figures will slow, and the market may begin to demand financial returns on the production that is coming on stream during the latter half of 2008 and into 2009." It adds that "companies where growth is well into the future may be able to afford earnings disappointments; companies that are delivering promised production growth cannot, in our view."

Therefore, Kinross needed to ensure their future gold production, starting in 2010 through new acquisitions, making the Aurelian Resources takeover a perfect fit with their "gold dinosaur" FDN project. After only four months, Kinross went shopping again, this time looking more southward into Latin America in the most stable jurisdiction in the region, Chile. On November 25, Kinross announced their intention to acquire Minera Santa Rosa's Lobo-Marte gold project, with indicated resources of 5.4 million ounces of gold, located in the northern Maricunga district, midway between their Maricunga and La Coipa gold mines.

For the Lobo-Marte deal, Kinross announced two separate agreements with Minera Santa Rosa's two owners: Teck Cominco Limited and subsidiaries of Anglo American plc, each with 60% and 40% interest in Minera, respectively. The gold giant offered Teck 5.6 million of Kinross common shares, a cash payment of US$40million, and a 1.75% net smelter return royalty on 60% of future production. Meanwhile, they offered US$140million in cash to Anglo American. The Anglo American portion was completed on December 17, and the remaining 60% purchase of Minera from Teck was expected by the end of 2008.

The third takeover bid was announced last December 1, by Fresnillo Plc, the world's largest primary silver producer and Mexico's second largest gold producer. The firm is interested in acquiring all outstanding MAG Silver common shares directly from stockholders at a price of US$4.54 per share, in cash. Fresnillo wants to double their silver production in 10 years, and currently has a portfolio of three producing mines, two advance development projects, and three exploration prospects, all located in Mexico. Fresnillo and their affiliates already own 19.8% of the outstanding shares of MAG Silver.

The offer was rejected by MAG Chief Executive Dan MacInnis, who called the offer an opportunistic one, based on hammered commodity prices. However, equities analyst Christopher Ecclestone said the Fresnillo offer "is the first bullet in the war. 2009 will have [many] more transactions like that." MAG Silver executives said they will not respond to the offer until January 2009. So far, it seems that January will be an exciting one with MAG Silver's response, and Ecuador's new mining law.

The penultimate takeover bid of 2008 was announced on December 15, with Rusoro Mining intending to acquire Gold Reserve Inc., with assets in Venezuela, offering three Rusoro common shares for each Gold Reserve Class share. The offer values Gold Reserve at CDN$1.08 per share, representing a premium of 140% based on the December 12 closing price for Rusoro and Gold Reserve on the TSX-V and the TSX, respectively, reported Mineweb. The combined company would have 12.2 million ounces of proven and probable gold reserves and measured and indicated resources.

And before this book went to print, Ecuador's Corriente Resources, with their famed Mirador copper-gold exploration project, announced that they have entered into a period of exclusive negotiations with a selected party for a potential sale of the company, in a release circulated on December 16. Off-the-record sources say a Chinese company would be on the other side of the negotiation table. The negotiation period will be extended to March 31.

Despite these last-minute takeover proposals in 2008, 2007 was by far the most exciting for the M&A field. Canadian Yamana Gold bought Meridian Gold and Northern Orion, both of them with main projects in Latin America: Meridian's El Peñón, in Chile, and Northern Orion's Agua Rica, in Argentina.

Kinross also acquired in 2007 the remaining 50% of their Goldcorp interest, who own La Coipa mine, in Chile. Meanwhile, the world's first gold company, Barrick, bought Arizona Star, owner of 51% of the Cerro Casale mine in Chile, who are currently operating in partnership with Kinross. The Canadian Rusoro bought the Venezuelan mine Choco 10, and Brazilian giant Vale attempted to buy Xstrata, but the deal didn't materialise.

Political Environment

Despite Latin America's political risk, the region continues to attract many explorers from around the world: hunters of metallic mineral wealth and low operational costs resulting from currencies weaker vis a vis the U.S. or Canadian dollar.

Also, the governments within the region seem to be steering in the right direction, including the least favoured jurisdictions "who begin to understand that the mining industry is not an ever-milky cow, which they [governments] can milk until it dies. Ecuador and Bolivia, and some difficult Argentine provinces, are now – more than ever – interested in negotiations with companies to develop a responsible industry," says Ecclestone.

Bolivia, in fact, may be a better jurisdiction than it appears. "The Morales regime has not shown itself to

Working late into the night

be aggressive towards foreign miners, and is regarded as pro-mining by those in the know," reveals one of Ecclestone's studies on Latin America. Mining in Bolivia provides about 30,000 jobs, mainly located in the upland areas.

Ecuador, for its part, has leftist president Rafael Correa fighting against the extreme left – once his followers – over development of responsible large-scale mining operations in the only Latin American country that lacks it. "Unfortunately, some people are childish – in quotations – such as the ones opposed to mining.

But what country in the world has rejected mining? The dilemma is not 'no' or 'yes' to mining. It is well-developed mining… Please, we cannot fall into this childish behavior. We are in a country with a high rate of misery," he said, responding to the Confederation of Indigenous Communities' (CONAIE) threats to demonstrate if the new mining law is not tabled by the Congresillo, which is expected to pass the bill in January 2009. In contrast Peru, with many majors already present, has the most promise for large-scale mines in many metals, just after Australia.

However, shareholders' profits are not as high as expected, and were registered at modest levels in comparison with 2007. The HSBC Gold Book reveals that the best-performing gold company amongst ones they covered was Buenaventura, who have a 44% interest in the big gold producer Yanacocha mine in Peru. Buenaventura brought a whopping share price appreciation of 101.7% in 2007, and a modest 15.5% increase in the first half of 2008.

"Since gold and copper prices remain at, or near, their all-times highs, we find it difficult to explain why shares have not recovered, and can only conclude that changing investor sentiment towards the region, or Peru specifically, has become less positive," argued the publication issued last August 2008. HSBC assumes that investors may fear President Alan Garcia's successor (who may be the populist Ollanta Humala) in the midst of Garcia's low popularity levels.

Argentina, for its part, is a mixed bag. Depending on the province, mining operations are easy or extremely difficult. The "no-go zones" are La Pampa, La Rioja, and Mendoza, and the "go zones" are Catamarca, San Juan, Salta, and Santa Cruz, as determined by Hallgarten & Co. Santa Cruz in particular has registered exciting mining activity – up 400% in the last 30 months.

More informally, Inca Kola News, the lively financial blog that covers Latin America, have recently released their qualifications for each country in the region. The site gives Chile the highest grade, 10 out of a possible 10, because "Chileans look after their miners, and welcome foreign direct investment with open arms, giving tax breaks and preferential treatment to foreign miners," says the knowledgeable blogger nicknamed Otto Rock.

Otto crowns Chile number 1 and gives second and third places to Mexico and Peru, with 9 and 7, respectively. Peru scored lower than expected due to its "painful bureaucracy," whilst Colombia "is surprisingly good these days," with a better than expected 6 or 7, but the far-right and far-left terrorists are still a concern, adds the always-insightful blogger.

Brazil, for its part, got a low 4 or 5, because of the bureaucratic initial paperwork, but "once you're up and running, it's a 7 or 8." Consistent with other opinions, Argentina varies depending on the region, from zero to 8, and the poorest scorers are again Bolivia, with a mere 3, and Ecuador another 3, "but once the mining law hits the books [Ecuador] will be a 5 or more." Venezuela earned the poorest score with a resounding zero.

HSBC, in a more formal style, also examines Latin American governments. From their perspective, Peru and Chile continue to pursue policies that are supportive of the mining industry, but the signs of actual or potential resource nationalism emanating from Venezuela, Ecuador, Argentina, and Bolivia are causing concern among investors.

To fight in the resource nationalism war, Corporate Governance Solutions founder Eva Thorne recommends mining companies share profits with new stakeholders, including governments and affected communities.

"The rise of resource nationalism in Latin America should not be cause for foreign companies to pack their bags and seek investments in safer locations. Rather, with better planning, and a more detailed analysis of the nature of state intervention, mining companies will likely find that they can continue to invest in these countries and make significant profits, even as they are required to share more of their profits," she said during the LatAm Mining Congress 2008. Thorne grouped Latin American regimens into three categories: the market-friendly (Brazil, Chile, Mexico, Colombia, and Argentina), the moderate (Peru and Ecuador – which is dangerously moving towards her lowest category), and the radical (Bolivia and Venezuela).

Latin American Exchanges

Listing mining companies on the Latin American exchanges has pros and cons. On the bright side, local investors may have more contacts and knowledge of the industry operating in their countries, giving them the advantage to see opportunities that foreign investors cannot see. Nevertheless, the Latin American stock markets are smaller and less active, states HSBC Victor Flores.

Not all countries in the region have buoyant exchanges, and these are limited once again to the favourite mining nations, excluding Chile, which never developed significant mining-related exchange activity at home. The more active jurisdictions having exchanges are Brazil, Peru, Mexico, Argentina, Mexico, and Colombia, with the Peru exchange being the most influenced by miners.

Peru's Lima Bolsa: Miners Dominate for Better or Worse was the Hallgarten & Co. title for their May 1 report, which features the new Lima Venture Exchange. The largest sector in the Lima Bolsa is clearly mining. The top weighted stock is local zinc/lead/silver miner Volcán with 11.36% of the general index, followed by Cerro Verde, the big copper mine near Arequipa, and then a group of miners and mine service providers that altogether make up 55.07%.

'Your local investor may be your best ally' was the message that Maurizio Levi-Minzi, partner at Debevoise & Plimpton LLP, delivered during the LatAm Mining Congress 2008. He believes that inviting local investors to participate in mining endeavors can also boost the mining companies' influence over local governments. "As the economies of Latin American countries strengthen and their capital markets continue to evolve, financing projects in the region with local capital should become increasingly attractive. Local investors, especially pension funds, are not only able to provide at least part of the funding that mining projects require, but will also serve as a valuable constituency with a stake in the success of the project and the ability to influence the host government and the local communities." Levi-Minzi's interesting idea deserves to be taken into account, especially amongst mining firms that face potential opposition in remote areas where extremist green NGOs have been entrenched for decades. This well-funded international movement has influenced unwary campesinos in the developing world, frustrating industries such as mining that, in the example of Chile and Peru, bring greater development and prosperity to Latin American nations.