Industries
Energy, Utilities & Mining

# Mining Deals*

## 2008 Annual Review

Mergers and acquisitions activity
in the mining industry

*connectedthinking

PricewaterhouseCoopers

# Contents



## Methodology

*Mining Deals 2008* is based on published transactions from the Dealogic 'M&A Global' database, December 2008. Analysis encompasses announced deals, including those pending financial and legal closure and those which are completed. Deal values are the consideration value announced or reported including any assumption of debt and liabilities. Figures relate to actual stake purchased and are not multiplied up to 100%. The geographical split of the deals refers to the location of the purchased asset(s). Where this is not clearly identified or relates to multiple geographical regions, the deal region is stated based on the location of the target company. The analysis relates to the extractive mining sector and therefore excludes related sectors such as the steel industry and metals trading sectors. The sector and subsectors analysed include: precious metals (e.g. gold, silver, platinum), base metals (e.g. iron ore, nickel, copper, aluminium), diversified (companies with a wide range of mining activities across subsectors) and other (includes coal, uranium, mineral sands, mining services). Throughout the report, both for 2008 and previous years, we classify the Russian Federation, Kazakhstan, Kyrgyzstan, Uzbekistan, Turkmenistan, Tajikistan and Armenia as 'Russia and the Commonwealth of Independent States (CIS)'. A full list of transactions throughout 2008 is available by visiting the *Mining Deals* website at www.pwc.com/miningdeals.

# Introduction 01

After the rise comes the fall. The mining industry experienced a violent downward tailspin in the last three months of 2008 which has turned much of the deal-making in the sector upside down. After two years of record M&A activity, 2008 turned out to be a year of extremes with the earlier part of the year following a pattern established in previous years before plunging in a sudden and dizzying vortex in the closing months.

*Mining Deals 2008* reviews deal activity in the mining industry. The report is a companion publication to PricewaterhouseCoopers' *Power Deals*, *O&G Deals* and *Renewables Deals* reports. Together the four reports provide a comprehensive analysis of M&A activity across the extractive and power industries worldwide.

We examine both the rationale behind the overall trends and look at the key individual deals. We look at the year under review, the context of the preceding three years, and ahead to the future direction of deal-making in the sector.

We also highlight, in a series of deal dialogues throughout the report, some of the critical issues for companies engaging in deal activity within the sector. Drawing on our global experience as an adviser to mining industry M&A players, our commentary addresses all key markets in the sector.

Looking ahead, we examine the effect of continuing uncertainties on deal-making in the sector. We look at the consequences of the very different environment. We consider the potentially sector-transforming opportunities that will arise and the key role of China in deal-making.

Our conclusion is that, while the short-tem outlook for mining deal activity from western companies is subdued, the constraints and contrasts in the market will create their own impetus for deal momentum. Indeed, those companies that have funds available may well find 2009 to be a year when they can utilise their financial strength and achieve acquisitions at long-term bargain basement prices.

Tim Goldsmith

**Tim Goldsmith**
Global Mining Leader

# 02 Report highlights

## Deal or no deal

As well as being a year of very high deal activity, 2008 was also the year of what might have been. The potentially sector-transforming bid by BHP Billiton grabbed the headlines but there were many other announced transactions that did not complete. Each of the many bids had its own reasons for running aground but, ultimately, the September 2008 bursting of the commodity price bubble and intensification of the financial crisis killed off activity. The deals that were not deals grabbed the 2008 headlines just as much, and in many cases even more, than those that actually reached fruition.

## Before and after the fall

For much of the year, companies continued to maintain faith in the buoyancy of commodity prices. Deal volume in the first half of 2008 was above or comparable with the previous year's level. The third quarter saw some waning of activity but it was the collapse of Lehman Brothers in September 2008 that sounded a shattering and sudden alarm call to the sector, triggered a rapid fall in most key commodity prices and sent deal volumes crashing down 61% in the fourth quarter towards levels last seen in 2005. Many companies that had spent the earlier part of the year doing deals or resisting unwelcome overtures finished the year looking at overstretched balance sheets, preparing for write-downs, and welcoming back potential buyers with open arms.

## Brazil deal value rises fivefold

The most significant surge in deal activity came in Brazil. Total deal value in South America as a whole rose dramatically from US$8.7bn in 2007 to US$22.8bn in 2008. US$17.7bn of the region's deal value was centred on Brazil – up nearly fivefold from the US$3.6bn total Brazilian mining deal value of 2007 – as companies made strategic moves to secure valuable iron ore resources.

## Playing the China card

There was a big increase in deals involving Chinese buyers. The value of such deals rose fourfold, from US$6.7bn in 2007 to US$25.5bn in 2008. As the year drew to a close and the impact of the downturn on the sector intensified, Chinese buyers played an increasingly important role with opportunities available to them which would not otherwise be available in less constrained times. A number of Australian mining companies opened up to Chinese deal- making in late 2008 and early 2009 ahead of the most high profile China move for an increased share of Rio Tinto.

# 04 Deal totals

2008 proved to be a year of extremes. Commodity prices soared to record highs only to fall precipitously as the financial crisis intensified and economic conditions deteriorated. Deal volume trumped 2006 and 2007 boom year levels in the early part of the year only to plunge back towards 2005 levels by the end of 2008. Mining shares went from rising star to falling asteroid status. Many fell to earth intact but some are burning up. Companies that were resisting unwelcome overtures at the beginning of the year were welcoming them with open arms by the year end.

The year began with BHP Billiton bidding for Rio Tinto in a move worth a potential US$150bn plus that would have guaranteed 2008's place in the Mining Deals' record books. It was the super-consolidation deal that never was as BHP Billiton's year-long pursuit finally fell victim to the credit crunch in November. The Competition Commission's requirements and the deterioration in the financial and economic climate carried too much risk for the refinancing requirements of the deal. The contrasting cash and debt positions of BHP Billiton and Rio Tinto were the most high profile examples of a sector characterised by balance sheet contrasts.

Figure 1: **Total mining deals, 2005-2008 (year on year % change in paranthesis)**

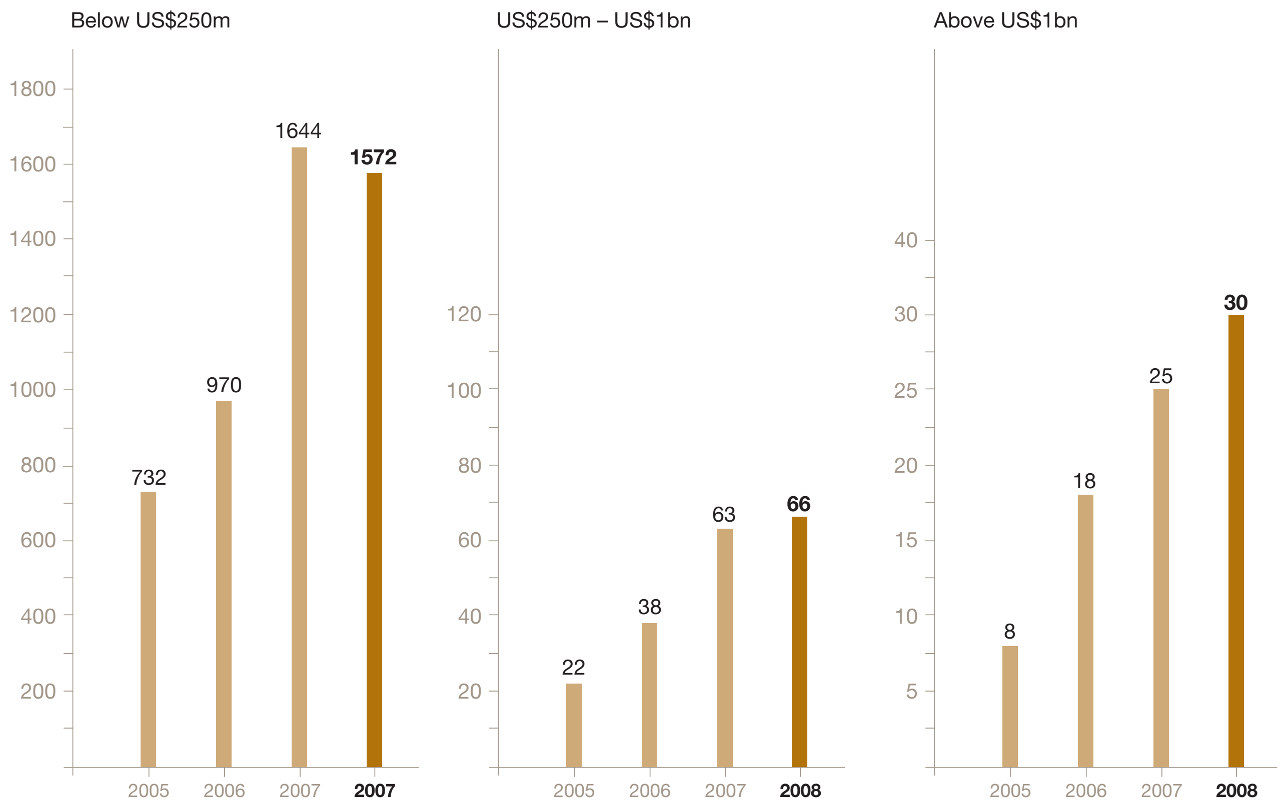
| | 2005 | 2006 | 2007 | **2008** |
|---|---|---|---|---|
| Total number of deals | 762 | 1026 (+35%) | 1732 (+69%) | **1668 (-4%)** |
| Total value of deals | US$69.8bn | US$133.9bn (+92%) | US$158.9bn (+18%) | **US$153.4bn (-4%)** |
| Average value (based on deals where value is reported) | US$125.6m | US$196.6m (+58%) | US$137.5m (-30%) | **US$124.0m (-11%)** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

However, even without such a super-consolidation move, deal volumes in 2008 remained at levels not far below the record highs reached in 2007. Taking the year as a whole, deal numbers and total deal value were 4% down year-on-year (see Figure 1). Indeed, there was an increase in bigger deals with 30 US$1bn plus transactions compared to 25 in 2007 (see Figure 2).

Iron ore was particularly sought after as global steel mills scrambled to secure supplies. The total value of deals for iron ore assets nearly tripled – up from US$7.5bn in 2007 to US$21.4bn in 2008 – and the number of deals rose from 40 to 107. Similarly, demand for energy fuelled a 28% rise in deals for coal and uranium assets (in the 'other' category in Figure 3 overleaf). The total value of such deals rose from US$29.9bn to US$54.2bn year-on-year.

Figure 2: **Size of mining deals by value, 2005-2008**



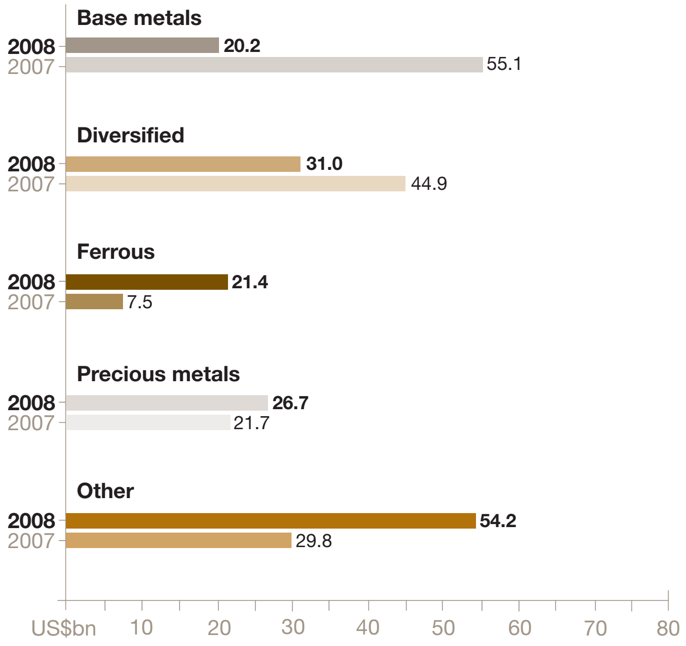

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

# 06 Deal totals

For much of the year, companies continued to maintain faith in the buoyancy of commodity prices. Even though the credit crisis had been constraining the financial and economic outlook since mid-2007, there remained a sentiment that this was a crisis whose effects would be contained and would not fatally compromise the demand from China and India that was the key force behind the boom in the mining sector. With this belief underpinning activity, the quest for world scale, resource acquisition, resource diversification and sector consolidation that had driven 2007 deal-making continued well into 2008. Indeed, for the first half of the year, deal volume was above or comparable with the previous year's level (see Figure 4).

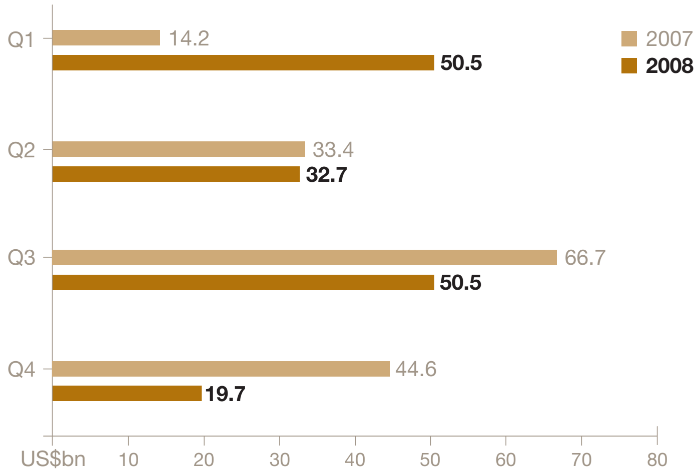
The third quarter saw some waning of activity but it was the collapse of Lehman Brothers in September 2008 that sounded a shattering alarm call to the sector, triggered a rapid fall in most key commodity prices and sent deal volumes crashing in the fourth quarter. The total value of deals in the final three months of 2008 fell 61% sliding down toward the quarterly level last seen in 2005. Average deal value more than halved, falling from US$119 million in Q3 to US$53 million in Q4.

Figure 3: **Analysis of mining sector by value (US$bn), 2007-2008**




**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

Figure 4: **Quarterly tracking of mining deals by value (US$bn) – 2007-2008**




**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

It was as much a year of the deals that might have been as it was of those that were. BHP Billiton's pursuit of Rio Tinto was the one that grabbed the most headlines, but just as transforming would have been Vale's early 2008 rumoured US$90bn pitch for Xstrata. If it had happened, it would have created the world's biggest mining company. Later in 2008, Xstrata returned to the negotiating table with a US$5bn move for Lonmin, the world's third largest platinum miner, but the bid was dropped as market conditions rapidly deteriorated.

These three 'no deals' alone would have potentially added over US$250bn to 2008 deal totals taking deal volume to eye watering, record shattering levels. They were not alone. There were many more, including Murchison Metals' long-running pursuit of Australian iron ore group Midwest and a contest between four different entities for the big Tampakan copper and gold deposits in the Philippines. While the anticipated BHP Billiton and Xstrata super-consolidation plays did not take place, the largest 2008 deal was a key side-move in the fate of the super-consolidation gameplay.

In February 2008, Aluminum Corporation of China (Chinalco) announced that it had partnered with Alcoa to buy Rio Tinto shares in the market. The 'dawn raid' move gave the two companies a 9% stake in Rio Tinto and added a fascinating twist to an absorbing battle as BHP Billiton circled Rio Tinto in an ultimately unsuccessful venture.

Figure 5: **Top Ten – mining deals 2008**

| No. | Value of transaction (US$m) | Date announced | Buyers | Sellers | Sector | Primary continent |
|---|---|---|---|---|---|---|
| 1 | 14,316 | 01 Feb 08 | Aluminum Corp of China; Alcoa Inc | Rio Tinto plc (12%) | Diversified | Europe |
| 2 | 12,651 | 29 Jul 08 | Teck Cominco Ltd | Fording Canadian Coal Trust (60% non-operating interest in the Elk Valley Coal Partnership) | Other | North America |
| 3 | 10,000 | 05 Aug 08 | Interros Holding OAO | Norilsk Nickel OAO (16.7%) | Base | FSU |
| 4 | 4,665 | 31 Mar 08 | Existing Shareholders | Anglo Ferrous Brazil SA | Ferrous | South America |
| 5 | 3,904 | 18 Jan 08 | PT Bakrie & Brothers Tbk | PT Bumi Resources Tbk (35%) | Other | Asia Pacific |
| 6 | 3,730 | 03 Jun 08 | CVC Capital Partners Ltd | Evonik Industries AG (25.1%) | Other | Europe |
| 7 | 3,690 | 03 Mar 08 | Oxiana Ltd | Zinifex Ltd | Diversified | Australasia |
| 8 | 3,120 | 17 Oct 08 | Itochu Corp (16%); Nippon Steel Corp; POSCO Co Ltd; Kobe Steel Ltd; JFE Steel Corp; Nisshin Steel Co Ltd; Sumitomo Metal Industries Ltd | Nacional Minerios SA – NAMISA (40%) | Ferrous | South America |
| 9 | 3,103 | 17 Jan 08 | Anglo American plc | IronX Mineracao SA (63.3%) | Ferrous | South America |
| 10 | 2,798 | 03 Jul 08 | Undisclosed Buyer | Norilsk Nickel OAO (6%) | Diversified | FSU |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review,* based on published transactions from the Dealogic 'M&A Global' database, December 2008

Chinalco's move reflected the growing importance of Chinese and Asian buyers of mining assets, a trend that was to accelerate later in the year as distress became a driver of deal-making (see Asia Pacific section on page 14). The deal was a major factor in the big increase in the total value of deals involving Chinese buyers which rose fourfold, from US$6.7bn in 2007 to US$25.5bn in 2008. In another top ten deal, Japanese general trading company Itochu Corporation and a group that included Japanese and South Korean steelmakers bought a 40% stake in Brazilian iron ore mining firm, Nacional Minerios SA (NAMISA), for US$3.1bn.

With super-consolidation off the table, many of the deals that did take place delivered consolidation below the top tier. Vancouver-based zinc and copper miner Teck Cominco's US$12.7bn purchase of Fording Canadian Coal Trust followed a 20% stake it already owned in Fording. When the deal was announced in July 2008, the rising price of coal had spurred a worldwide consolidation trend with producers of coal used to make steel or to fuel power production seeking to scale up in order to become more competitive and cash in on rising prices. The Fording sale was also triggered by the Trust's response to a Canadian government decision to start taxing income trusts. Later in the year, the debt that came with this deal became a millstone around Teck Cominco's neck.

Ownership share switches in Russian miner Norilsk Nickel lay behind two of the deals in the top ten table (see Russian Federation section on page 16). The remaining top ten deals were in the US$3bn-US$5bn range. A complex deal structure lay behind Anglo American's purchase of iron ore assets belonging to Brazil's Mineracao e Metalicos (MMX) with the move featuring in two of the top ten transactions. Existing MMX shareholders agreed a partial split up as well as the main move by Anglo American (see South America section on page 18).

Private equity made a rare top ten mining deals appearance with CVC's US$3.7bn purchase of a 25.1% stake in German chemicals, energy and property group Evonik. The stake was sold by RAG-Stiftung, a foundation set up to take over the liabilities of the coal industry in the German states of North-Rhine Westphalia and Saarland.

Figure 6: **The five most active bidders, 2008**

| Rank | Company | Number of deals | Total value (US$m) |
|---|---|---|---|
| 1 | Pinetree Capital Ltd | 11 | 5.7 |
| 2 | ArcelorMittel SA | 10 | 2,534.5 |
| 3 | Companhia Vale do Rio Doce – Vale | 7 | 522.0 |
| 4 | Zijin Mining Group Co Ltd | 7 | 195.9 |
| 5 | SeverStal OAO | 6 | 1,058.7 |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review,* based on published transactions from the Dealogic 'M&A Global' database, December 2008

In Australia, there was the seventh largest global deal – the merger of Oxiana with Zinifex to create OZ Minerals, the world's second largest zinc producer. The deal was completed in June 2008 and the combined value was US$10bn. However, by December 2008, shares in the new company had been suspended as it ran into debt refinancing problems which led to a February 2009 bail out by China Minmetals of only US$2bn.

The most active bidders table (see Figure 6) is led by Canadian investment fund Pinetree Capital with a large number of deals for shares in Canadian mining companies but a relatively small US$5.7 million total value. In contrast, steel-maker ArcelorMittel was involved in a similar number of deals but with a total value of US$2.5bn as it sought to secure raw materials supply around the world.

## Mining deal dialogue:

**Deal Origination – the first step is often the most important one**

Identifying the right acquisition targets is key to any successful corporate development programme but this goes much further than researching lists of companies active in a particular sector or geography. As well as the relative quality of the asset and the ability for a transaction to be consummated, it is important to assess the strategic rationale for making the acquisition. This is even more so for mining where a strategic long-term view, tempered with a real-time understanding of current market conditions, is critical for any investment decision.

Developing robust criteria for target selection is an important first step and provides a framework against which to screen acquisition candidates. Next a deep understanding of the operations and also the motivations of all key stakeholders (shareholders, management, employees, governments/regulators and customers) will allow the target population to be further refined.

Once a target has been identified, the first approach is all important. A series of important questions needs to be answered. Who is the key decision maker? What relationships can be brought to bear to present the approach in the best light? Does the target operate in a country where the culture dictates a different strategic approach?

PricewaterhouseCoopers is extremely well placed to assist in deal origination. Our global network of mining industry experts, together with our global network of corporate finance specialists, help our clients develop acquisition criteria and assess the strategic impact of making specific acquisitions.

With a global partner and staff base of over 1,500 mining professionals dedicated to the mining sector and unparalleled research capabilities, we can spread the net wide to find the right targets for your business and advise you on the most effective way to make the first approach. Our corporate finance practice provides lead advisory services from idea generation to deal negotiation, execution and completion around the world.

# 10 Deal places

The largest share of resources targeted by 2008 mining deals continued to be in North America and, in particular, Canada. The region accounted for a total deal value of US$32.8bn in 2008, although this was down sharply from US$77.1bn in 2007. The previous year's total included Rio Tinto's US$43bn purchase of Alcan. As a result, North America's share of assets targeted in deals fell from 49% to 21% of all deals (see Figure 7b). North American deal numbers also fell as did those in Europe and Australasia.

Indeed, North American 2008 mining asset deal value fell below 2005's level of US$36.2bn. However, this was offset by big rises elsewhere, not the least being intense activity for South American, principally Brazilian, assets.
At US$22.8bn, total 2008 deal value in South America was more than 16 times the US$1.4bn total of 2005. Similar increases were seen elsewhere, notably Asia Pacific, the Russian Federation and nearby central Asian states including Kazakhstan. These regions also recorded year-on-year increases in deal value taking total volume higher than in 2007. There was also a big year-on-year increase in deal value in Europe, accounted for by the inclusion of Chinalco and Alcoa's US$14.3bn stake building in Rio Tinto in that territory and CVC's US$3.7bn Evonik purchase from German coal foundation RAG-Stiftung.

Figure 7a: **All mining deals by region, 2005-2008***

| Europe | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| **Value of deals (US$bn)** | 2.2 | 3.8 | 3.0 | **22.4** | **653%** |
| **Number of deals** | 66 | 73 | 70 | **49** | **-29%** |

| North America | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| **Value of deals (US$bn)** | 33.8 | 83.5 | 77.1 | **32.8** | **-57%** |
| **Number of deals** | 225 | 312 | 695 | **596** | **-14%** |

| South America | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| **Value of deals (US$bn)** | 1.4 | 8.6 | 8.7 | **22.8** | **163%** |
| **Number of deals** | 53 | 115 | 174 | **180** | **3%** |

| Russia Federation and CIS | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| **Value of deals (US$bn)** | 5.6 | 16.6 | 20.9 | **25.2** | **21%** |
| **Number of deals** | 50 | 100 | 57 | **77** | **35%** |

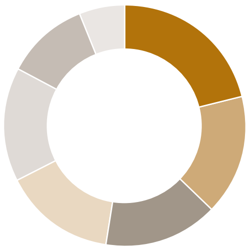
*The geographical split of the deals refers to the location of the purchased asset(s). Where this is not clearly identified or relates to multiple geographical regions, the deal region is stated based on the location of the target company.

Figure 7b: **All transactions by continent by value of transactions, 2007-2008***

2007 (total US$158.9bn)

- North America **49%**
- Russian Federation and CIS **13%**
- Australasia **12%**
- Asia Pacific (excluding Australasia) **10%**
- Africa **8%**
- South America **5%**
- Europe **2%**
- Middle East **0%**

**2008 (total US$153.4bn)**



- North America **21%**
- Russian Federation and CIS **16%**
- Asia Pacific (excluding Australasia) **15%**
- South America **15%**
- Europe **15%**
- Australasia **11%**
- Africa **6%**
- Middle East **0%**

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

| Asia Pacific (excluding Australasia) | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| Value of deals (US$bn) | 2.2 | 3.6 | 16.4 | 22.8 | 39% |
| Number of deals | 96 | 129 | 245 | 267 | 9% |

| Australasia | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| Value of deals (US$bn) | 11.1 | 7.3 | 19.2 | 17.1 | -11% |
| Number of deals | 207 | 237 | 391 | 360 | -8% |

| Africa | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| Value of deals (US$bn) | 9.5 | 9.8 | 13.5 | 9.6 | -28% |
| Number of deals | 59 | 52 | 94 | 131 | 39% |

| Middle East | 2005 | 2006 | 2007 | 2008 | % change |
|---|---|---|---|---|---|
| Value of deals (US$bn) | 0.1 | 0.6 | 0.2 | 0.6 | 221% |
| Number of deals | 6 | 8 | 6 | 8 | 14% |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

# 12 Deal places: North America

The value of deals for assets or companies primarily located in North America fell to US$32.8bn from US$77.1bn in 2007 (see Figure 8), in the absence of deals such as Rio Tinto's 2007 US$43bn purchase of Alcan. However, deal-making by North American mining companies continued at a high level. The value of deals where North American companies were bidders totalled US$33.6bn compared with US$33.9bn in 2007.

Canadian companies or assets accounted for 82% of total of North American target deal value. The vast majority of volume was generated by buyers from within the region with only US$3.2bn coming from purchasers from outside of North America. There were no big foreign purchases to rival deals such as the 2007 US$5.4bn purchase of LionOre by Russia's Norilsk Nickel or the 2006 purchases of Inco and Falconbridge, Canada's largest nickel producers, by Brazil's CVRD (now Vale) and Xstrata respectively. The largest foreign purchase was for US$875 million by Russia's biggest steelmaker, SeverStal OAO, for PBS Coals. The commodity sector collapse led to PBS Coals accepting a US$300 million reduction in the takeover price in order to get the deal done.

The largest North American deal was Teck Cominco's US$12.7bn purchase of Fording Canadian Coal Trust (see page 8). The deal was announced in July 2008 just ahead of the downturn in the commodities market and was partly financed by a subsequent US$2.3bn deal with an unnamed Canadian chartered bank purchasing an 18.56% share of Fording. Despite this, the last few months of 2008 saw Teck Cominco's shares slide to less than a tenth of their pre-Fording purchase value and the company was soon looking for buyers for its gold projects and other non-core assets as part of a forced debt reduction drive. The Teck Cominco developments highlight the contrast between the period before and after the collapse in commodity and equity prices.

Figure 8: **North America mining deals by sector – 2005-2008**

| | 2005 By value (US$bn) | 2006 By value (US$bn) | 2007 By value (US$bn) | **2008** By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 16.8 | 65.8 | 44.4 | **1.6** | **5%** |
| Diversified | 0.9 | 0.9 | 17.7 | **3.3** | **10%** |
| Ferrous | 0.3 | 0.0 | 0.0 | **0.5** | **2%** |
| Precious metals | 14.2 | 15.2 | 8.6 | **8.2** | **25%** |
| Other | 1.6 | 1.7 | 6.4 | **19.3** | **59%** |
| **Total** | **US$33.8bn** | **US$83.5bn** | **US$77.1bn** | **US$32.8bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

Eighty-four per cent of North American mining deal value was in the other (covering resources including coal and uranium) and precious metals sectors (see Figure 8). An increase in the value of coal mining deals boosted activity in this sector. In addition to the Teck Cominco deals, another large coal move saw Canadian mining and energy company Sherritt International complete a US$915 million buyout of coal miner Royal Utilities Income Fund, adding to its existing share and giving it full ownership.

Heading the precious metals' deal list was Barrick Gold's US$1.7bn purchase from Rio Tinto of the remaining 40% it did not already own of the Cortez gold project in Nevada. In a second US$1bn plus deal, Goldcorp completed a friendly US$1.4bn acquisition of its Red Lake neighbour Gold Eagle. Goldcorp is Canada's second largest gold producer and the deal came as it reported an unexpected second-quarter loss, cut its production outlook for the year and boosted its 2008 cost estimates. The two gold deals were both examples of moves by large gold producers to boost their pipelines.

## Mining deal dialogue:

**Total tax contribution – a more complete tax analysis**

Mining companies, their investors, governments and other stakeholders are coming to realise that a proper analysis of a mining company's tax obligations extends far beyond its income taxes. Property taxes, royalties and other non-income taxes typically exceed a mining company's income tax burden. A potential acquirer would see perhaps only half the picture if it only focused on a target company's income tax expense as shown on the P&L statement.

The typical focus on a mining company's income taxes only is understandable; income taxes are the only tax separately stated in any company's financial statements. Reporting those nonincome tax obligations in the financial statements is impractical, as many rates and agreements are negotiated or otherwise confidential.

While a knowledgeable mining executive or investor knows there are significant non-income taxes levied on the industry, historically almost no one focused on the extent of those obligations, even tax directors. Property taxes, royalties, VAT and most other non-income taxes are often calculated and paid by personnel at the mines. Payroll taxes are typically calculated and paid by a central payroll department. Income taxes are usually calculated, paid and actively planned by a headquarters tax function that often has no responsibility for the non-income taxes and related activities at the mines.

PricewaterhouseCoopers' Total Tax Contribution (TTC) study shows that mining companies usually pay more total income and non-income taxes than companies in other industries. This total tax data can be invaluable when a mining company is analysing a potential mine, when an acquirer is evaluating a target, or when a government is contemplating legislation that might lead a mining company to consider switching investment to another country. PwC's TTC group and databank can help a potential acquirer evaluate a company's TTC (if the right information is available) and enable a better informed decision to be made.

# 14 Deal places: Asia Pacific (excluding Australasia)

Asia Pacific deal volume surged in 2008. The total value of deals for assets and companies primarily located in Asia Pacific rose 39%, from US$16.4bn in 2007 to US$22.8bn in 2008 (see Figure 9). The level of deal-making where Asia Pacific companies were bidders rose even further, buoyed by an increased level of deal-making by Chinese companies for assets outside the region. Chinese bidders accounted for US$25.5bn out of US$48.3bn Asia Pacific total bidder value in 2008. In turn, the US$48.3bn total was more than triple the US$15.6bn level of Asia Pacific bidder activity reached in 2007. US$26.8bn of 2008 Asia Pacific bidder activity was for targets outside the region, of which US$17.5bn was by Chinese companies.

Chinalco's US$14.3bn February 2008 investment in Rio Tinto headed the list of outbound 2008 deals by Chinese companies. Twelve months later, Chinalco is set to increase its stake in Rio Tinto further with the February 2009 announcement of a US$19.5bn cash injection in response to Rio's need to reduce debt. If completed, the latest move will double Chinalco's stake in Rio Tinto from 9% to 18% and be the largest investment ever by a Chinese entity in a foreign company.

In 2008, the other US$1bn plus moves by Asia Pacific bidders for companies outside their region were:

- the US$3.1bn purchase of Brazilian iron ore mining firm, Nacional Minerios by a group of Japanese and South Korean steelmakers (see page 8);
- the US$1.3bn acquisition by Japan's Marubeni Corporation of a 30% stake in Minera Esperanza and Minera El Tesoro located in Chile from UK-based copper miner Antofagasta;
- Xinwen Mining Group of China's in-progress US$1.3bn purchase of coal exploration permits from Australia's Linc Energy.

The vast majority of activity for the US$22.8bn of assets located within the region was mainly in the coal mining sector and, to a lesser extent, the base metals sector (see Figure 9). The highest value deal was a US$3.9bn purchase of a 35% stake in Indonesian coal mining firm PT Bumi Resources by Bakrie & Brothers, the holding company of Indonesia's powerful Bakrie family. However, in the last few months of 2008 following a share price plunge, the Bakries were seeking to sell their stake for US$1.3bn in order to repay debts that had been guaranteed as part of the original purchase. Attempts to strike a deal with a private equity led consortium fell through.

The other US$1bn plus deals for Asia Pacific assets were a divestment of zinc mining assets to Shanghai-listed zinc and germanium manufacturer Yunnan Chihong in a US$1.5bn deal that still remained pending at the end of 2008, and a US$1.4bn purchase by Hong Kong-listed Fushan International Energy Group of various Chinese coking coal assets.

Figure 9: **Asia Pacific (excluding Australasia) mining deals by sector – 2005-2008**

| | 2005<br>By value (US$bn) | 2006<br>By value (US$bn) | 2007<br>By value (US$bn) | **2008**<br>By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 0.0 | 0.9 | 1.4 | **2.6** | **12%** |
| Diversified | 0.2 | 0.8 | 4.3 | **1.0** | **5%** |
| Ferrous | 0.1 | 0.1 | 1.1 | **0.8** | **4%** |
| Precious metals | 0.6 | 0.2 | 1.3 | **2.2** | **10%** |
| Other | 1.4 | 1.6 | 8.2 | **16.1** | **71%** |
| **Total** | **US$2.2bn** | **US$3.6bn** | **US$16.4bn** | **US$22.8bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

Deal volume for Australasian mining resources fell 11%, from a total deal value of US$19.2bn in 2007 to US$17.1bn in 2008. However, total deal value where Australasian entities were buyers rose 12%, from US$9.1bn to US$10.2bn, as Australian companies continued to step up their quest for mining assets worldwide.

The big deals were centred on Australian assets with Oxiana and Zinifex's merger to create OZ Minerals and its subsequent tumble taking the spotlight (see page 9). The second largest, and the only other US$1bn plus deal, saw energy company New Hope selling its New Saraji coal project to BHP Billiton and Japan's Mitsubishi Corporation for US$2.4bn.

The year 2008 saw the continued emergence of Chinese investors in Australian mining resources. Chinese steelmaker Sinosteel gained control of Midwest Corporation. It had faced competition for Midwest from Murchison Metals but emerged victorious in July 2008. The Sinosteel move and the involvement of Chinalco in mining giant Rio Tinto is the most high profile manifestation of a trend that is being echoed through the ranks of more junior mining companies in Australia.

Foreign investments in Australian companies and assets must pass the Foreign Investment Review Board's (FIRB) 'national interest' test. For much of the 2006 and 2007 boom years this was a significant obstacle for Chinese investors. However, towards the end of 2008 and into 2009, the board has given the green light to a series of investments by Chinese companies in response to the difficulties faced by a number of cash-strapped Australian mining companies.

The place where the change of mind is most evident is in many mining company boardrooms. Iron ore producer Mount Gibson, for example, had resisted overtures from China's Shougang Concord. Its resistance had been reinforced by an Australian takeover panel ruling in April 2008. By the end of the year, however, the company was turning to Shougang and another Chinese group, APAC, in a rescue package that will give the two Chinese companies a substantial stake in Mount Gibson.

Other Australian mining companies that have opened up to Chinese investors in late 2008 and early 2009 include zinc miner Perilya and iron ore explorer Centrex Metals through deals with Shenzen Zhongjin and Wuhan Iron and Steel respectively. FIRB approvals, and in particular the appetite for Chinese investment in Australia, will be seriously tested in 2009 by the recently announced Chinalco/Rio Tinto and China Minmetals/OZ Minerals deals.

Figure 10: **Australasia mining deals by sector – 2005-2008**

| | 2005<br>By value (US$bn) | 2006<br>By value (US$bn) | 2007<br>By value (US$bn) | **2008**<br>By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 0.5 | 0.5 | 4.9 | **0.2** | **1%** |
| Diversified | 8.7 | 3.1 | 4.5 | **5.0** | **29%** |
| Ferrous | 0.6 | 0.8 | 2.5 | **2.2** | **13%** |
| Precious metals | 0.5 | 0.9 | 2.4 | **1.6** | **9%** |
| Other | 0.8 | 2.0 | 5.0 | **8.1** | **47%** |
| **Total** | **US$11.1bn** | **US$7.3bn** | **US$19.2bn** | **US$17.1bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

# 16 Deal places: Russian Federation and Commonwealth of Independent States

The total value of deals involving assets or companies primarily located in the region rose 21%, from US$20.9bn in 2007 to US$25.2bn in 2008 (see Figure 11). However, the step change in international expansion that had characterised activity by Russian companies in 2007 did not follow through as strongly in 2008. Mining acquisitions by Russian companies dropped back to US$20bn in 2008 from US$26bn the previous year. Much of the total was domestic activity with no foreign acquisitions to rival the 2007 US$5.4bn purchase of Canada's LionOre by Norilsk Nickel.

The largest foreign purchase was the US$1.5bn purchase of UK-based nickel and gold producer Oriel Resources by Russian miner and steel maker, Mechel OAO, followed by SeverStal's US$875 million deal for Canada's PBS Coals (see North America section on page 12). In Russia, a privatisation of the Verkhnekamskoye potassium-magnesium salts deposit in the Ural region raised US$2.3bn in a sale to four Russian fertiliser manufacturing and mining companies. US$10bn of the US$20bn Russian deal total stemmed from the move to purchase a 16.66% stake in Norilsk Nickel by Interros Holding, owned by Vladimir Potanin, already a major shareholder in Norilsk Nickel. The deal, which remains pending, is the latest stakebuilding move in the company which has also seen acquisitions by Oleg Deripaska whose Basic Element company controls aluminium producer Rusal. However, speculation about a merger between Norilsk Nickel and Rusal has not, thus far, been borne out.

Figure 11: **Russian Federation and CIS mining deals by sector – 2005-2008**

| | 2005 By value (US$bn) | 2006 By value (US$bn) | 2007 By value (US$bn) | **2008** By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 0.17 | 7.07 | 0.0 | **13.1** | **52%** |
| Diversified | 0.85 | 2.98 | 15.8 | **4.4** | **18%** |
| Ferrous | 2.30 | 1.25 | 0.0 | **0.2** | **1%** |
| Precious metals | 1.43 | 3.79 | 1.0 | **4.0** | **16%** |
| Other | 0.88 | 1.55 | 4.0 | **3.5** | **14%** |
| **Total** | **US$5.63bn** | **US$16.64bn** | **US$20.9bn** | **US$25.2bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

The major regional activity outside Russia was in Kazakhstan where target mining values totalled US$3.8bn in 2008, up from US$1.4bn in 2007. A major focus in that country is the government's ambition to develop a national champion mining company that can develop worldwide scale. A holding company has been created to facilitate this process although it remains unclear whether this will be a vehicle for an attempt to combine the two largest players – London-listed Kazakhmys and Eurasian Natural Resources Corporation (ENRC) – or whether the holding company will seek to integrate deposits and smaller companies that are not owned by the two main players.

Deals for Kazakh companies and assets leapt from US$1.4bn in 2007 to US$3.8bn in 2008, largely due to the acquisition of a US$2.3bn 7.66% stake in ENRC by Kazakhmys in return for the Kazakh government building a 15% minority share in Kazakhmys. In a separate deal, Kazakhmys made a US$784 million open market purchase of a 2.66% stake in ENRC with the aim of gaining sufficient minority control to prevent any acquisition by its rival.

## Mining deal dialogue:

**Targets are cheap now – why bother with due diligence?**

The slump in the global economy and the major financing issues facing many mining companies are leading to cheaper valuations and more special situations. In turn, this is spurring deal activity. With increased deal activity, shortened deal timetables as target company's bleed cash, and the rapid emergence of major players in key developing economies with less history in the international mining M&A arena, effective and efficient due diligence will become even more critical for achieving strategic goals and executing successful deals.

Due diligence can often identify earnings or asset quality weaknesses of the target. This could include declining production efficiency, cost increases, labour pool redundancies, capitalised assets with no future economic value, and significant off-balance sheet liabilities such as third party claims, employee pension obligations, asset retirement obligations, or environment-related exposures. In turn, these could indicate that the target's financial position is not as strong as originally presented or that the target's historical performance may not be sustainable.

It is also common to identify significant regulatory and taxation-related deal risks, such as pre-emptive rights triggered by a change of control, failure to secure all necessary approvals for exploration/production, aggressive tax planning structures in the target's organisation, ambiguity regarding the target's satisfaction of all criteria necessary to enjoy local tax incentives, failure of the target to make all appropriate filings in each tax jurisdiction, or the potential loss of significant future tax deduction assets as a result of proceeding with the contemplated transaction.

Each target has its own unique challenges and issues. Some will have only just emerged while many others might still be lying hidden beneath the surface. In this context, it is very important to work with experienced advisors with the ability to organise your diligence process and work with your deal team in a cross-functional manner to manage all key deal risks, from the initial assessment phase through to assisting you with gaining leverage during negotiations.

PricewaterhouseCoopers' unmatched network of transactions specialists is best placed to assist the world's mining companies with all their important deals. Our mining industry-focused deal experts use their extensive experience with domestic and cross-border mining deals to conduct the most effective due diligence as rapidly as possible while working closely with the client deal team and other deal advisors.

# 18 Deal places: Africa and South America

In the rest of the world, the biggest number of deals and total deal value continued to come in South America and Africa. There were year-on-year increases in deal numbers for assets in both continents – up by 39% from 94 to 131 in Africa and 3% from 174 to 180 in South America. But while African deal value reduced from US$13.5bn in 2007 to US$9.6bn in 2008, South American total deal value rose dramatically from US$8.7bn to US$22.8bn.

US$17.7bn of South American deal value centred on Brazil, headed by Anglo American's US$4.7bn purchase of iron ore projects from Mineracao e Metalicos (MMX). It gained a 100% interest in the Minas-Rio iron ore project and a 70% interest in the Amapa project. In a complex deal structure, the controlling shareholders of MMX and Anglo American signed a share purchase and sale agreement by which Anglo American acquired a 63.47% stake of IronX Mineracao SA, a newly formed company owning 51% of the share capital of MMX-Rio Mineracao and 70% of MMX Amapa Mineracao.

South American deal value was further boosted by two other US$1bn plus deals in 2008. In a US$1.9bn deal, Brazilian steel producer USIMINAS bought Brazilian iron ore mining company Mineracao J Mendes. Finally, Canadian-based mining gold company Kinross purchased Toronto-listed Aurelian Resources in a friendly US$1bn deal that adds Aurelian's Fruta del Norte gold discovery in Ecuador to Kinross' mining interests in the United States, Brazil, Russia and Chile.

Figure 12: **South America mining deals by sector – 2005-2008**

| | 2005 By value (US$bn) | 2006 By value (US$bn) | 2007 By value (US$bn) | **2008** By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 0.3 | 1.0 | 2.1 | **0.9** | **4%** |
| Diversified | 0.2 | 0.5 | 1.4 | **2.4** | **11%** |
| Ferrous | 0.2 | 2.6 | 2.1 | **16.9** | **74%** |
| Precious metals | 0.6 | 2.3 | 1.6 | **2.0** | **9%** |
| Other | 0.0 | 2.2 | 1.4 | **0.6** | **3%** |
| **Total** | **US$1.4bn** | **US$8.6bn** | **US$8.7bn** | **US$22.8bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

The African deal-making spotlight in 2008 was centred on attempts to combine Impala Platinum and Northam Platinum in a US$2.6bn deal that would have created a world champion in the sector. Negotiations continued through much of 2008 only to finally flounder in January 2009 due to the global economic climate and continuing volatility in commodity and equity prices. It is included in our totals because it remained 'pending' at the end of 2008. It's failure to complete, however, reduces the headline deal value for Africa still further.

A big African deal that did take place was UK-owned Central African Mining & Exploration Company's (CAMEC) purchase of the remaining 50% stake in Democratic Republic of Congo-based cobalt and copper mining holding company DRC Resources Holdings from Israeli holding company Prairie International Ltd. The acquisition was one of a handful of deals for assets in the DPR in an African deal list dominated by South African targets. Six of the top ten but only 29 of the total 131 African deals involved bidders from within Africa itself – the remainder comprising predominantly Australian, American, European and Asian buyers.

Figure 13: **Africa mining deals by sector – 2005-2008**

| | 2005<br>By value (US$bn) | 2006<br>By value (US$bn) | 2007<br>By value (US$bn) | **2008**<br>By value (US$bn) | % share |
|---|---|---|---|---|---|
| Base metals | 0.1 | 0.3 | 2.1 | **1.0** | **11%** |
| Diversified | 0.3 | 0.3 | 0.5 | **0.3** | **3%** |
| Ferrous | 0.0 | 0.0 | 0.4 | **0.4** | **5%** |
| Precious metals | 1.0 | 8.6 | 6.7 | **5.1** | **53%** |
| Other | 8.2 | 0.5 | 3.7 | **2.7** | **28%** |
| **Total** | **US$9.5bn** | **US$9.8bn** | **US$13.5bn** | **US$9.6bn** | **100%** |

**Source:** PricewaterhouseCoopers, *Mining Deals 2008 Annual Review*

# 20 Looking ahead

Continuing financial market uncertainty, economic slowdown and actual recession in many countries look set to provide the background to mining deal-making for the immediate future at least. In the foreground, depressed and, in some cases, collapsed share prices and an inability to access debt markets are causing immense distress for some mining companies. In contrast, others have relatively healthy balance sheets.

Such a climate suggests a subdued short-term deal outlook compared to recent years although the constraints and contrasts in the market will create their own impetus for deal momentum. Entities with balance sheet strength will regard the current environment as a buying opportunity although many may be content to bide their time for the right conditions to emerge. On the financial front, Asian banks are not as constrained as their western counterparts and are still willing to lend.

The current environment presents a unique investment opportunity for acquirers from China to get in ahead of competitors and gain access to targets which might be denied to them in more normal circumstances. Chinalco's stakebuilding in Rio Tinto is the most high profile example and all eyes will be on shareholder reaction and, in particular, the Australian government's regulatory response to Rio Tinto's strategy.

Activity by private equity players, who traditionally have been relatively absent from the sector, may increase. Such players, as well as sovereign wealth and other investment vehicles, will be looking for opportunities to buy in at the bottom of the cycle. As with any deal-making in heavily cyclical sectors, timing is everything and, just as mining companies have discovered who have bought close to the top of the market, much will hinge on the financing and economic background.

Access to equity and debt has dried up for many small-to mid-cap mining companies. Those with portfolios that are at the development stage or that are not sufficiently revenue generating will have to sell assets to survive. The spate of impairment announcements and write-downs will intensify and, across all tiers of the industry, we are likely to see considerable sector reshaping as stronger companies seize opportunities to acquire assets at low prices.

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