Crowe Horwath

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Welcome to the April issue of The Global Corporate Advisor.

After witnessing another difficult year in 2014, with the value of completed global deals in the mining sector hitting a 10-year low, the industry is pinning its hopes on a turnaround in 2015. From our Perth office, our colleague says that while few would be so bold as to predict a rapid rebound in M&A deal activity, we can at least expect to see some turning of the tides.

In Kuwait, direct investment is expected to pick-up following the introduction of the Direct Investment Law. The new law appears to have addressed the flaws inherent in the repealed FDI Law of 2001 and makes it much easier for investors to obtain a license.

From London, we have a viewpoint on raising funds on the city's capital markets for natural resources companies. In recent times this has been extremely difficult, bordering on the impossible. The article discusses two types of tax incentivised schemes, which are now available to both UK and international operating companies.

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The GCA team is here to respond to your needs relating to M&A transaction support, valuations and advisory services. If there is a topic you would like us to cover in future issues of the GCA newsletter, don't hesitate to contact Peter Varley, Chairman of GCA, at *peter.varley@crowecw.co.uk.* Alternatively, please contact your local GCA team member to discuss your ideas.

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Mining Sector M&A – Will the Tide Turn in 2015?

by Justin Audcent, Perth

Despite initial optimism within the industry, 2014 turned out to be another difficult year for the mining sector, with continued global economic uncertainty and depressed prices for most commodities providing a very challenging environment for making long-term investment decisions – whether for major project development or to take advantage of M&A opportunities. In fact, the total value of completed global deals in the sector continued to decline for the fourth consecutive year to just US$45bn – the lowest level in 10 years.

With strategic buyers in the market, new sources of private capital available, valuations at a historic low, and several major mining companies seeking to divest non-core assets and businesses, many are now asking just when the tide will turn. What are the key barriers to getting deals done, and what is the outlook for 2015 and beyond?

Closing the valuation gap

Whilst asset values across the sector have fallen, a valuation gap still frequently exists between buyer and seller expectations. Many buyers remain concerned that commodity prices may have further to fall, and are reluctant to commit to deal pricing without stronger evidence that they are close to bottoming out. Impairment write-downs across the industry have also undoubtedly dented confidence in the market, perhaps unfairly so, given the cyclical nature of the sector. Major investment decisions are therefore being scrutinized particularly closely by boards, institutional investors and analysts.

At the same time, while many majors are pursuing portfolio rationalization strategies and seeking to divest non-core assets, boards are reluctant to do so at a perceived low valuation, which may be viewed as giving a free kick to the purchaser, once a rebalancing of supply and demand drives market recovery. Several, including BHP Billiton's Nickel West and Rio Tinto's Pacific Aluminium business, have tested the market and withdrawn assets for sale, while many high cost North American coal assets on the market have gained little or no buyer interest. Spinouts, such as BHP Billiton's demerger of South32, expected to be effective in May 2015, provide an alternative route to creating value, effectively giving shareholders the option to hold or sell their interests in the market.

With buyers factoring in further downside risk and sellers reluctant to give away value for perceived upside, closing the gap requires either a highly strategic acquisition and/or considerable commercial, operational or structural synergies to be achievable by the purchaser. Examples include a vertically integrated trading house acquiring physical production for its global marketing operations, such as the $1bn acquisition by Swiss-based Glencore and Japan-headquartered Sumitomo Corporation of a 50.1% stake in the Clermont coal mine in Australia (from Rio Tinto), completed in June 2014. In addition, rapidly industrializing countries continue to seek security of supply of strategic commodities through acquisitions, such as Chinese company MMG's $7bn acquisition of the Las Bambas copper project in Peru, completed in July 2014.

Unless the purchaser is able to extract greater value from an asset than the vendor, valuation gaps are likely to persist, and bolt-on acquisitions are unlikely to reach agreed upon terms, other than when dealing with a distressed seller in a weak negotiating position.

Other deals have been driven by forced asset sales – either for regulatory reasons, such as Glencore's sale of the Las Bambas copper mine to MMG (a condition of its merger with the Anglo-Swiss Xstrata) or where the company or asset is distressed. With the current price of certain commodities being below production cost for some companies, it is surely only a matter of time before we see some mid-tier players at risk of breaching banking covenants and forced into distressed asset sales, particularly those without the benefit of a diversified asset portfolio.

This environment, with limited buy-side competition to drive up valuations, also favors consolidation of similar operations, particularly among mid-tier and smaller players, who are able to extract significant capital, operating and commercial advantage from combining their businesses, leading to shared or reduced risk, increased optionality and longevity, along with improved access to funding. Strategic partnerships or joint ventures may be an alternative, although the challenge may be to find opportunities, which deliver equal benefits to both parties.

Access to capital

Access to debt and equity capital for M&A remains challenging. Only top tier mining companies are genuinely able to access the debt markets – in most cases this has been for refinancing, rather than new investment. As recently as this March, with iron ore prices below $60/metric tons, Fortescue Metals Group, the third largest iron ore producer in Australia (after Rio Tinto and BHP), was forced to abandon a proposed $2.5bn refinancing, due to lack of support from the debt markets.

At the same time, equity markets have seen investment flow away from mining into more defensive sectors, with investors largely seeking dividend yield and returns of capital from mining companies, rather than reinvestment of cash flows into major project development and M&A. Companies have also been reluctant to increase debt levels to fund M&A, given the uncertain outlook around economic conditions and commodity prices. At the junior end, equity markets remain all but closed, and, for

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many, survival is the name of the game. These continuing market conditions have, however, given rise to new sources of funding. Private sources of capital – including private equity, hedge funds, government/sovereign wealth funds, pension funds and high net worth investors – are increasingly seeing long-term value growth opportunities in the sector, buying in at the low point in the cycle. Specialist funds across the world are currently estimated to hold at least $8bn in funds earmarked for investment into the mining sector, with key players including Apollo Global Management, Brookfield Capital Partners, Resource Capital Funds and Warburg Pincus.

Traditionally, private capital has not been a major source of funding for the mining industry. However, in the current environment, public equity markets have become increasingly focused on cash flow, return on capital and other short-term performance metrics, and it is the private sources of capital, which seem to be taking a longer term view.

A number of private sources of capital have formed funds or investment consortia, combining access to substantial capital with experienced executives who have a proven track record in the industry. One of the most prominent new entrants, X2 Resources, led by the former Xstrata management team, announced in March 2015 that it had secured funding commitments of $5.6bn from cornerstone investors including Noble Group and TPG Capital, as well as sovereign wealth and pension funds. With the aim of building a new mid-tier diversified mining and metals group, X2 seems poised to be a major player in M&A in 2015, with the capacity to complete $1bn+ deals and its targets likely to include assets earmarked for divestment by the majors.

Another such entrant to the market is Magris Resources, established by Aaron Regent, the former CEO of Barrick Gold, which announced the acquisition IAMGold's Niobec niobium mine in Canada for $530m in October 2014, through a consortium, which included Temasek, the Singapore government-owned investment company, and Hong Kong-based investment company, CEF Holdings Ltd.

Outlook

With all indications that global economic growth will continue to be slow and uncertain over the short to medium-term – meaning that there will be no panacea through a rapid recovery of commodity prices – significant transformational M&A activity seems likely (and necessary) over the next few years. This will be mostly driven by asset sales as all market participants seek to realign their businesses to this market environment. The challenge is to maintain a portfolio of assets, which delivers long-term sustainable growth, while being resilient to economic cycles and commodity price volatility. Ultimately, this redistribution of assets may well lead to stronger, more resilient business models, where assets are held by companies with the greatest competitive advantage, and who are best able to optimize returns and manage risks associated with their asset portfolio.

For the large global mining companies, the ongoing focus on capital allocation and portfolio rationalization will continue to see assets earmarked for sale or spinout, with most pursuing a strategy of focusing on fewer core commodities and/or geographic operations. Inevitably, private capital will play a greater and welcome role, while major trading houses are also well-funded and likely to pursue strategically aligned acquisitions. It remains to be seen whether the majors continue with their divestments when commodity prices begin to recover – in which case the young pretenders may risk missing the boat. Consolidation through M&A is likely and necessary for many mid-tier players and – for many at the junior end of the market – may be their only chance of survival.

Notwithstanding access to funding, completing non-distressed deals will remain challenging in the context of continuing economic uncertainty and commodity price volatility, with bidder and vendor price expectations likely to be met only where the value is supported by genuine value-add opportunities and compelling strategic drivers for the purchaser. But the right deals should get done.

While few would be so bold as to predict a rapid rebound in M&A deal activity, barring any major shocks to confidence, we can at least expect to see some turning of the tides in 2015.

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The New Direct Investment Law in Kuwait

By Mohamed Raoof, Kuwait

The Foreign Direct Investment (FDI) environment in Kuwait has changed significantly with the introduction of the new Direct Investment Law, which was issued in June 2013 and came into force six months later in December 2013. This is a part of the Kuwait Development Plan (KDP), the government's long-term economic vision for the country, which aims to reduce oil dependency by transforming the state into a diversified commercial and financial hub. It sets the scene to boost FDI inflows into Kuwait against the background of a national drive to bring the private sector on board for several billion dollar infrastructure projects to be undertaken over the next five years. The new five year development plan (2015-2020), which was approved by the National Assembly in February 2015, envisages spending KD34 billion on development projects over the plan period.

Projects stipulated by the plan include construction of 45,000 housing units, a metro system, a railway network and a large number of mega oil projects. In the annual plan for fiscal year 2015-16, several projects of strategic importance have been earmarked for investment spending of KD6.6 billion.

A new independent public authority, the Kuwait Direct Investment Promotion Authority (KDIPA) has been established to oversee all matters relating to both domestic and foreign investment in Kuwait, in accordance with Law No. 116 of 2013 regarding Promotion of Direct Investment in the State of Kuwait (the Direct Investment Law), which repealed its predecessor Law No. 8 of 2001. On December 14, 2014, KDIPA issued Executive Regulations (ER) to the law through Ministerial Decision No. 502 of 2014. The ER provide guidelines to simplify the process of obtaining a license for FDI and certain benefits as set out in the law.

The objectives of KDIPA as laid down in the Direct Investment Law are:

- Developing and improving the investment environment, facilitating of procedures and removal of hurdles encountered by investors, as well as the provision of various means of assistance and support to encourage direct investment in the country.
- Raising awareness on the importance of direct investment, especially foreign investment, and the promotion of the Kuwaiti investment environment and available direct investment opportunities by all means of marketing, orientation and promotion.
- Encouraging investors to transfer, settle and use modern and sophisticated technologies, means of production and operations, management methods, technical and marketing expertise, and to encourage partnerships between Kuwaiti and foreign investors that foster the objectives of development.

As the KDIPA Director General Sheikh Dr. Meshaal Jaber Al Ahmad Al Sabah explains: "Kuwait is not seeking FDI for the sake of capital per se, as Kuwait belongs to the group of countries with a high per capita income, but rather to maximize the objectives of the transfer and the settlement of modern technology, know-how, as well as the adoption of advanced administrative and marketing schemes."

In March this year, the KDIPA Director General underlined Kuwait's huge potential to Japanese investors and provided an overview on KDIPA's services to support them at a business seminar in Japan which was attended by Japanese trading and engineering firms, banks, and government officials. The seminar focused on the improvement in Kuwait's business environment and investment opportunities under the nation's ambitious national development plan for 2015-2020.

Three routes have been specified under the Direct Investment Law and the related ER for obtaining a license to invest in Kuwait:

- Formation of a Kuwaiti company, incorporated for the purpose of direct investment pursuant to the provisions of the Companies Law No. 25 of 2012. While the general rule requires companies to have 51% Kuwaiti ownership, the law provides an exception to the rule and permits foreign investors to obtain 100% share of the capital of a shareholding company, or a limited liability company, or a single-person company.
- Establishment of a branch of a foreign company licensed to operate in the State of Kuwait for the purposes of direct investment.
- Establishment of a representative office with the sole purpose of preparing market studies and production possibilities, without engaging in a commercial activity or activity of commercial agents.

Burdensome bureaucracy and lack of clarity have been frequently cited as disincentives for investment in Kuwait by foreign entities. For example, in the World Bank's Doing Business Report 2015, Kuwait was ranked at 150 among 188 countries in the study that measures the number of procedures, time and cost for a small and medium-size limited liability company to start up and formally operate.

These are likely to be overcome by a new administrative unit within KDIPA that will act as a one-stop shop to facilitate and expedite the entire investment process. The one-stop shop is required for bringing out guidelines advising potential investors on issuing and renewing approvals, permits and licenses, and also for responding to their queries. To further ensure that the licensing process does not get caught up in bureaucratic delays, KDIPA is required under

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the law to decide on the merits of the license application within 30 days, once all conditions have been fulfilled and data, papers and documents required by KDIPA and the competent authorities have been submitted.

Incentives and exemptions have been provided under the law. These include a tax holiday for 10 years and exemption from customs duty for five years.

Investment opportunities are available in diverse sectors of the economy that do not fall under a negative list of activities that are excluded from the scope of the Direct Investment Law through a resolution of the Council of Ministers. A decision was issued by the council on 26 January 2015 excluding 10 activities from the scope of the FDI Law. These include extraction and manufacture in the field of oil and gas, security and defense, real estate, and hiring of labor.

Kuwait had introduced its original FDI Law in 2001. However, to date, the old FDI Law has arguably not had the desired impact that was envisaged at the outset. Greenfield investments monitor fDi Markets shows that a total of 147 FDI projects were recorded in Kuwait between January 2003 and December 2014. These projects represent a total capital investment of $1.97 billion. Inward foreign investment levels in Kuwait have consistently decreased over the past four years, with capital investment levels falling by as much as 60% in 2009, according to fDi Markets data. The new law appears to have addressed the flaws inherent in the repealed FDI Law and is expected to encourage more direct investment in Kuwait and make it much easier for investors to obtain a license.

A significant improvement appears to be the provision of a one-stop shop, by which a KDIPA license application is considered by a specialized unit comprising of all relevant officials from the various relevant government departments. This unit will hopefully deal with the issuance of commercial, employment and all other licenses required for operations and avoid or reduce bureaucratic delays.

Additionally, this specialized unit is expected to deal with the grant of land required for many projects, a role typically held by the Public Authority for Industry. The timeline of 30 days to issue a license, once adhered to, will enable foreign investors to plan and execute their investments within time expectations of global businesses.

A further improvement is the introduction of the negative list concept, which expands the available sectors, unlike the earlier law that permitted investments only in certain identified sectors.

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Raising Funds when Capital Markets are Closed – A View from London

By Paul Blythe, London

Raising funds on London's capital markets for natural resources companies in recent times has been extremely difficult, bordering on the impossible.

With the current oil price where it is and with the vast majority of mining companies focusing on production efficiencies rather than expansion, the present funding malaise evident in global stock markets looks set to continue for the near future.

At the time of writing, no natural resources company has raised equity on either London's primary market, the London Stock Exchange (LSE), or its growth market, AIM, this year.

Indeed, during 2014, Gulf Marine Services PLC was the only natural resources company admitted to the LSE, raising £166m in March on a valuation of £537m.

The story is only slightly more encouraging on AIM, with a total of seven companies being admitted to trading during 2014, raising £54m of new equity in aggregate. However, of the seven admissions, only four raised new equity.

Savannah Petroleum PLC raised £29.3m on a valuation of £77m in August 2014, Hurricane Energy PLC £18.0m on a valuation of £235m in February 2014, Bacanora Minerals Limited £4.75m on a valuation of £67m in July 2014 and Mosman Oil & Gas Ltd £1.5m on a valuation of £5m in March 2014. The other three companies, Leyshon Energy Ltd, Tengri Resources Limited and Dalradian Resources Inc. all came to AIM last year by way of introduction, with no new equity being raised.

So, where do natural resources companies seeking funding go?

Mainstream institutions aside, alternative sources of new equity funding rest with private individuals and a few equity funds. Following changes in government rules in the UK in 2013, two types

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of tax incentivised schemes are now available to both UK and international operating companies. These are the Enterprise Investment Scheme (EIS) and the Venture Capital Trust (VCT).

In broad terms, the EIS and VCTs provide private individual UK tax-paying investors with an attractive method of investing in small to medium-sized unquoted trading companies, which would otherwise be difficult to invest in directly. For the individual investor, income tax relief at 30% on the funds invested is available, capital gains tax can be deferred, capital gains arising on the sale of investments are free from capital gains tax and investments are free from inheritance tax. In short, the EIS and VCTs are the government's way of stimulating investment into growing, entrepreneurial businesses.

But can non-UK natural resources companies access the EIS and VCT investors in the UK?

The answer to this question is normally yes, but it depends on the following conditions.

- There is no requirement that the company is resident in the UK, but a non-UK company must have a "permanent establishment" in the UK. A permanent establishment can take the form of a branch of the company.
- The company is not allowed to raise more than £5 million in total in any 12-month period. That said, a £5 million fundraise from the EIS and VCT investors can be used as the cornerstone to a larger fundraise.
- The company, or the group, must be undertaking, or be preparing to undertake, a qualifying trade. For natural resources companies, only coal production is prohibited.
- Furthermore, the qualifying trade must be conducted on a commercial basis with a view to realisation of profits. This may cause pure exploration companies issues with qualifying.
- The company must be unquoted at the time the new shares are issued. In London, AIM is deemed unquoted.
- The company or group cannot have gross assets exceeding £15 million immediately before any new share issue and £16 million immediately after that issue.
- The company or group must have fewer than 250 full-time employees (or their equivalents) at the time the new shares are issued.

In summary, if you are trading, or looking to trade, with a view to profit and seeking new equity capital of up to £5 million or more, either privately or in conjunction with an AIM admission, an assessment as to whether your company qualifies for EIS and VCT investment is advisable, as EIS and VCTs are specifically designed to help smaller, higher-risk trading companies to raise finance by offering a range of tax reliefs to investors who purchase new shares in those companies.

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