Deloitte.

Asia's expanding influence on the global mining industry

Why, and where does the world fit in?

Contents

The lay of the land:
Asian investment activity means opportunity

From homes and cars to Blackberries and iPads, Asian domestic demand is taxing suppliers around the world. Nowhere is this more true than in the mining industry where the global supply chain begins. To meet this demand, Asian companies have accelerated global investment activity, making them major players on the international stage. So far, however, western companies are taking a haphazard approach to partnership building, despite the growing willingness of countries like China to choose strategic alliance over outright acquisition. For mining executives in non-Asian nations, this seismic shift presents both pitfalls for the unwary and opportunities for the prepared. To be sure you're in the latter group, it's essential to understand the trends currently in play.

To meet this demand, Asian companies have accelerated global investment activity, making them major players on the international stage. To seize the opportunity, western companies must enhance their focus on partnership building, especially as countries like China demonstrate more willingness to choose strategic alliance over outright acquisition.

Digging in:
a deeper look at the issues

The recovery of many emerging Asian economies - including those of China, India and Korea - were aided by a rapidly growing middle-class and accompanying increases in both purchasing power and demand for goods.

Asian demand looks to western supply

Despite the global scope of the recent economic crisis, the recovery of many emerging Asian economies - including those of China, India and Korea - were aided by a rapidly growing middle-class and accompanying increases in both purchasing power and demand for goods. Meeting that demand requires large infusions of commodities, not only to fuel production across a range of industries, but to build and maintain the infrastructure that rapidly-industrializing nations need.

As a result, China continues to dominate global consumption of metals of all kinds, including traditional metals like copper, aluminum and iron ore, as well as metals with growing markets and developing industrial applications, like cobalt and lithium. It has also surpassed the U.S. as the number one importer of Saudi oil. [1] Yet current supply of many commodities simply cannot keep up with this supercharged demand. Although exchange rate and currency controls, domestic inflation and commodity price escalation stand as potential barriers to growth, the Chinese economy is widely predicted to remain strong. Demand should continue to grow and supply will need to be secured. To address this challenge, Asian governments and companies are engaging in foreign mergers and acquisitions at an unprecedented pace. Some Asian commodities exports are also being curtailed.

Foreign investment and M&A activity covers the compass

From percentage investments to mergers to full acquisitions, China will continue to seek out significant outbound investment in metals supply. In a recent Deloitte/ Mergermarket survey of 26 mainland China-based mining corporations, 69% expected this sector to see the highest levels of M&A activity. [2] China continues to invest steadily and heavily across a broad swath of commodities and is being more flexible about the types of investments it is willing to undertake. Until recently, the typical Chinese M&A approach was more all or nothing, but now - with the sheer number of deals taking place - majority and even minority deals are not uncommon. The case is clear. China and its neighbours are investing in just about all mining commodities in practically every corner of the globe, including Australia, North America, South America and increasingly Africa. The investment is on a scope and scale previously unseen, creating a slate of potential investors and financing opportunities mining companies cannot ignore.

Government intervention creates complex scenarios - for both east and west

Global mining companies doing business in Asia need to think carefully about how and when government intervention comes into play, not only from Asian governments but from their own.

In China, it can be hard to distinguish the notion of government intervention from business as usual. For state-owned enterprises (SOEs), "government intervention" is a relatively meaningless term - whatever moves they make are, in a sense, already approved, and this gives them the advantage of acting quickly to do deals or take advantage of trends. Government intervention has more meaning for private Chinese companies, but government approval is still

1 Energy Daily, February 24, 2010. "China passes US as top Saudi oil importer: energy secretary," by staff writers. Accessed at http://www.energy-daily.com/reports/China_passes_US_as_top_Saudi_oil_importer_energy_secretary_999.htm. on December 6, 2010.

2 Deloitte Touche Tohmatsu CPA Ltd, Mining for Growth: A review of outbound Mining M&A activity from China, http://www.mergermarket.com/PDF/Deloitte_MINING_English.pdf, p. 4 (accessed December 6, 2010).

required for all initiatives and approval can be slow - as it can be for foreign operators - and permits for building and expansion can be difficult to obtain. This is simply the way things are done, and companies that want to do business in China must learn to operate in this milieu.

Notably, however, government intervention is not confined to Asian soil. In recent years, various jurisdictions have responded to foreign investment in the mining sector by raising taxes and sometimes taking more immediate steps to limit competition and protect national assets. The collapse of the Unocal deal in 2005 is a clear example, when "the threat of selling a U.S. concern to one 70%-owned by the Chinese government ignited a firestorm of controversy." [3] Ironically, it may also have been a watershed moment in the development of China's current modulated approach to foreign investment and partnership. The realization that different tactics are more effective in countries where government, regulators, corporations, interest groups and the citizenry often have unique and sometimes clashing agendas changed the game.

A cooperative investment model is gaining strength

Though Canada, similarly perceiving a threat to resource autonomy, stopped the bid by Australia's BHP Billiton for PotashCorp, China has not stepped in to bid, despite obvious interest - perhaps wary of igniting another Unocal. This seems a likely indicator that its former approach to M&A has been replaced by a more cooperative model, and it may ultimately prove the most significant take-away from the failed Unocal bid. While commodity supplies may be short in Asia, the supply of investment goodwill and capital is definitely healthy in the form of massive cash reserves. While this is good news for mining companies around the world, equally encouraging is China's growing understanding that western companies want to explore partnership arrangements, and that such arrangements may be the most effective way to get things done.

Western companies, however, despite desire and intention, continue to engage with Chinese investors in disorganized and unproductive ways. To be sure, the actions mining companies choose to take depend on what the type of mining they are involved in. Gold producers, for whom commodity value is not based on industrial applications, are minimally affected. Base metal companies in current production have much more of a vested interest in maintaining good relationships with Chinese customers.

Western companies, however, despite desire and intention, continue to engage with Chinese investors in disorganized and unproductive ways. To be sure, the actions mining companies choose to take depend on what the type of mining they are involved in.

3 Business Week, August 4, 2005. Why China's Unocal bid ran out of gas, by staff writers. Accessed at http://www.businessweek.com/bwdaily/dnflash/aug2005/nf2005084_5032_db016.ht. on December 6, 2010.

But if you're a company with property to develop and need capital that the banks are not ready to provide, you are - or should be - very interested. China's state-owned banks are prepared to finance development projects where Western banks won't, and a Chinese partner must be involved to open the channels to this scarce capital. China's growing willingness to engage in a variety of partner models is at an all-time high, and now is the time to explore strategies to capitalize on its substantial means and goodwill to help develop, finance and even build your project.

"China possesses some comparative advantages in infrastructure construction, such as ports, railways, highways and telecom, and is willing to get more involved in Canada's implementation of the Asia-Pacific Gateway and Corridor initiative."

China's transport minister

If they come, they will build it

The need to secure adequate transportation, water and energy puts infrastructure needs at the forefront of any mining discussion. Those same infrastructure requirements, however - roads, bridges, sewage, public transit - are the necessary underpinnings of any industrialized society, and many countries, including both emerging and established economies, are lacking in infrastructure critical to further development. As a result, some Chinese mining companies are taking on the task of constructing the infrastructure necessary to make project operations viable in other countries - infrastructure which can also become a vital part of those countries' national systems and supports.

In Canada, for example, British Columbia is looking to leverage Chinese investment to forward its Asia-Pacific corridor program. "China possesses some comparative advantages in infrastructure construction, such as ports, railways, highways and telecom, and is willing to get more involved in Canada's implementation of the Asia-Pacific Gateway and Corridor initiative," said China's transport minister recently, adding that his country looks forward to "the opportunity to participate in Canadian infrastructure projects."[4]

As an extension of China's current model for mining expansion, the willingness to support infrastructure building has obvious advantages on both sides. This has been particularly prevalent in Africa where the need is substantial. These types of infrastructure partnerships show the cooperative model effectively at work, getting projects done and breaking down one of the key barriers to mining expansion.

Resource monopoly? - a storm in a teacup

As the hue and cry around Unocal and BHP-PotashCorp has demonstrated, there is still some trepidation about Chinese control of global commodities. One Australian journalist writes, "We are especially vulnerable because of the likely scale and duration of the Chinese threat." [5] Those who view Chinese M&A activity as an outright "threat" are at the extreme end of the spectrum, but they do exist, as do those who are simply unnerved without looking hard at the facts.

4 The Vancouver Sun, November 20, 2010. BC can benefit from China's expertise: Chinese minister, by James Kwantes. Accessed at http://www.vancouversun.com/business/benefit+from+China+expertise+Chinese+minister/3858920/story.html#ixzz17LPGx2mL on December 6, 2010.

5 The Sydney Morning Herald, December 3, 2010. Plenty of reasons to be concerned about China, by Barry Ferguson. Accessed at http://www.smh.com.au/business/plenty-of-reasons-to-be-concerned-about-china-20101202-18i5j.html on December 6, 2010.

The rare earth issue has proven a thorny example as China moves to preserve its supply. One Chinese representative notes, "China accounts for only 36 percent of rare earth deposits, however we contribute more than 90 percent of the world exports. Many countries also have abundant resources of rare earths but they don't explore them or export them and rely on imports. Can this be sustained? The answer is no." [6] In fact, panic over Chinese 'hoarding' is largely misplaced, especially given the fact that Molycorp is planning to re-start its California production facility - possibly with investment from Japan, the country most hurt most by China's rare earths export cutbacks [7] - while Australia's Lynas Corporation is planning to exploit its large Malaysian deposits. [8] Regardless of Chinese export quotas, a worldwide shortage is unlikely to continue beyond 2012. One expert contends that, having had a functional U.S. industry as recently as 2002 and with significant rare earth deposits in Canada, "North America could be completely independent of China - and could, in fact, be a supplier to China - if just a few of North America's deposits were developed."[9]

China is faced with a supply and demand conundrum. It must continue to dominate metal consumption because the numbers say it needs to. It must satisfy domestic demand first, build its industrial infrastructure and provide its vast population with access to the goods they want and need. By taking action to ensure supply, it is doing what most countries do, but - for obvious reasons - on a more epic scale. And the world is clearly prepared to respond strategically when shortages arise. So while the press may look for something sinister in Chinese mining expansion and resource preservation, it may instead be seen as the natural result of a burgeoning middle class and massive urbanization.

China is faced with a supply and demand conundrum. It must continue to dominate metal consumption because the numbers say it needs to. It must satisfy domestic demand first, build its industrial infrastructure and provide its vast population with access to the goods they want and need. By taking action to ensure supply, it is doing what most countries do, but - for obvious reasons - on a more epic scale.

6 Chinamining.org, November 29, 2010. China Won't Stop Exports of Rare Earth Products, Ma Kai Says. Accessed at http://www.chinamining.org/News/2010-11-29/1290994233d41113.html on December 6, 2010.

7 Bloomberg, December 6, 2010. Molycorp Rises on Report Sumitomo Corp. May Invest in Rare-Earth Miner, by Jack Kaskey. Accessed at http://www.bloomberg.com/news/2010-12-06/molycorp-climbs-on-report-sumitomo-may-buy-stake-in-u-s-rare-earth-miner.html on December 7, 2010.

8 Lynascorp.com. Accessed at http://www.lynascorp.com/page.asp?category_id=2&page_id=41 on December 7, 2010.

9 International Business Times, June 21, 2010. Jack Lifton: North America Doesn't Need China's Rare Earths, by The Gold Report. Accessed at http://www.ibtimes.com/articles/29794/20100621/rare-earths-silver-copper-uranium-iron-aluminum-zinc-lead.htm on December 6, 2010.

Mining the silver lining:
use your resources to move your resources

The mining investment void left by hesitant banks, still smarting from the global economic meltdown, is being filled by Asian investment. Since Asian banks are far more likely to finance deals and projects if an Asian partner is involved, western companies are finding ways to court and close deals with China and its resource-hungry neighbours. China, for example, poured a record $9.2 billion US into 33 foreign mining deals in 2009. [10] In Canada, Cameco seized on China's expanding nuclear reactor program, signing a deal with China Guandong Nuclear Power Group (CGNCP), to supply uranium through 2025.[11]

Since Asian banks are far more likely to finance deals and projects if an Asian partner is involved, western companies are finding ways to court and close deals with China and its resource-hungry neighbours.

With this unprecedented backdrop, it's time to take stock of your company, assess value and plan strategies that will invite investment and deter unwanted acquisition. Or if you're ready for a merger or sale, start looking to the vital Asian market to find out what will make your company most appealing to Asian investors. Asia is open for business, and establishing connections is the place to start. Go east - literally. Connect with Asian mining companies and the broader investment community. Use any local knowledge and resources you may have, and when those resources run dry, consult advisors who specialize in your industry and have resources in place - in China and throughout Asia. They can help you strategize carefully, taking cultural differences into account when dealing with the nuts and bolts of communications and deal-making.

Political fears of a Chinese resource monopoly do, indeed, amount to a "storm in a teacup." Companies should think instead about how to leverage the abundance of new opportunities created throughout Asia by the current convergence of Asian commodity demand and western supply, and the willingness of Asian investors to form equitable partnerships that include crucial infrastructure financing. Slower companies - companies that don't begin strategizing around Asian economic growth - may be left behind or eaten up.

1. Deloitte Touche Tohmatsu CPA Ltd, Mining for Growth: A review of outbound Mining M&A activity from China, http://www.mergermarket.com/PDF/Deloitte_MINING_English.pdf, p. 4 (accessed December 6, 2010).

11 Neimagazine.com, November 25, 2010. Cameco to supply uranium to China Guandong Nuclear Power. Accessed at http://www.neimagazine.com/story.asp?sc=2058260 on December 6, 2010.

At Deloitte, we back up analysis with action.
We believe firmly in the future of the Asian mining industry and have recently relocated our global corporate finance mining and oil & gas leader to China.

For more information, please contact a Deloitte mining professional:

Jeremy South
Partner
Corporate Finance Advisory
Global Mining Leader, Financial Advisory
Beijing, China
Direct: +86 10 8512 5686
Mobile: +86 1521 046 7097
jesouth@deloitte.com.cn

Glenn A. Ives
Chair of the Board
Deloitte & Touche LLP
Toronto, Canada
Direct: +1 416 874 3506
Mobile: +1 604 220 1459
gives@deloitte.ca

Phil Hopwood
Partner
Global Mining Leader
Melbourne, Australia
Direct: +61 3 9671 6461
Mobile: +61 414 9100 70
phopwood@delotte.com.au

Jeremy is Deloitte's Global M&A and Mining Leader for Deloitte China. Based in Beijing, he specializes in the delivery of lead advisory services, focusing on public company M&A and project finance.

His clients include Asian trading houses on outbound investments as well as both mid-market and large cap miners on M&A and strategic investor negotiations. Jeremy also has extensive expertise in transaction execution as well as valuation and due diligence engagements.

His 25 years of capital markets experience includes senior investment banking positions at Deutsche Bank (London), Alex Brown and Nat West Markets. Jeremy's expertise also comes from having been seconded to the London Stock Exchange where he helped shape listing policy, including the establishment of the AIM market. He was also the joint Managing Partner of a leading Canadian private equity fund.

Glenn is Deloitte's North American Mining Leader and Chair of the Board. Based in Toronto, he started his prestigious career with Clarke, Henning & Co. and then moved to Coopers & Lybrand in 1985 where he spent a year in Toronto and two in the UK. Glenn returned to Canada in 1987 and joined TVX Gold Inc. the following year. In 1993, he became Director and Chief Financial Officer of Vancouver-based Vengold Inc., whose operations took him to Latin America, Papua New Guinea and Indonesia. In 1999, Glenn joined Deloitte as a partner and audit specialist and transformed the firm's mining practice into one of Canada's largest professional services groups dedicated to this sector.

In 2008, Glenn was elected to the Deloitte Board of Directors and was appointed Vice Chair of the firm in 2009. He was elected by the partnership as Chair of Deloitte in June 2010. In addition to his Canadian responsibilities, Glenn is a member of the firm's global board as well as its nominating and risk committees.

Phil Hopwood is Deloitte's Global Mining Leader. A consulting partner with more than 20 years of experience, his practice focuses on performance improvement, operating model development and value extraction from business transformation initiatives.

As Global Mining Leader, Phil's goal is to continue to build our global mining team commitment to focusing on client business needs to ensure they reach their business objectives, therby providing them with an "As One" Deloitte experience.

In his role Phil also serves on the executive of Deloitte's global Energy & Resources Industry team working with clients around the world.

www.deloitte.com/mining