Ecclestone on Mining M&A – the Mid-Tier as Predators

Mark Twain said: “History does not repeat itself but it rhymes”. It seems particularly apt when commenting on how the mining M&A scene will look on the “next go around”, if this is indeed the next go around that we are currently in. We have sustained that those who hope they can “party like its 1999” or at least like 2008 will be sorely disappointed.

There will be differences from the good old days and its useful to highlight here what they might be… and what the pressures will be in the M&A market over the coming year for those predators prowling around, the potential prey and how investors should position themselves.

The main feature of what we feel might happen is that the first wave of transactions will be driven by mid- and bottom-tier companies. Such is the trauma the big companies have faced with digestion of bad deals (not to mention image erosion) from the last M&A splurge that they are going to be treading very carefully. It was at the start of September that Barrick Gold announced it was disbanding its corporate development team, a sure sign of the times.

The rationale for big players being sidelined is that the biggest bargains are at the very bottom of the market (in terms of market cap) and you just never see the likes of Goldcorp or Newmont buying a $10mn market cap stock, no matter how great its attractions. Therefore mid-tiers will do the buying. Usually they will be companies with a mine or two functioning already and then they will augment this with a stalled junior’s project thus fleshing out a pipeline which can then be funded into production via cashflow and using the existing management skillset.

In turn the mid-tiers will then merge with each other, bulking up and, in the process, making themselves potential fodder for the majors to buy or to merge with. The best example of how this can play out is New Gold (NGD.to) which started out as a merger of three smaller miners and has gradually bulked up doing progressively bigger add-ons.

The Denuded Mid-Tier

The early part of the mining boom in the last decade saw a drastic thinning of the mid-tier, in Canada in particular. Newly empowered majors swallowed them up, with the natural order of the acquisitions food-chain being disturbed. Majors would only buy juniors when they had gotten big enough to no longer be juniors. The most perverse example of the this was the now infamous Underworld Resources purchase by Kinross where a stock that should have been much lower valued (for where it was on the exploration continuum) was snapped up for a price that suggested that there was much more to it than met the eye. There wasn't!

It was only juniors who scrambled up the greasy pole of development (usually to the construction phase or at least having a BFS in their back pocket) and briefly entered the mid-tier that were picked off. Juniors that did not much more than perpetual drilling or acquisition (and dropping) of moose pasture were ignored and still will be..

Thin Pickings

More recently the long lean years of feeble financing have thinned down the field of potential targets. While it seemed like 2010 and 2011 were somewhat like the period pre-2008 and gold was exceptionally healthy price-wise it was really just a case that stories that had been stopped in their tracks with the 2008 Crash were only able to restock their treasuries during a rather tight window of opportunity before the shutters came down again and financing was choked off. This meant that the projects and mines we see now available for acquisition are not projects from 2010/11 but ones from 2008 and before. The brief recovery in markets then did not provide much in the way of fresh meat.

Spooking around in the background also is the new predatory vehicle of Mick Davis (late of Xstrata) which is all cashed up and on the prowl for properties to rebuild his empire. The recent decision of BHP Billiton to spin out its “less desirable” projects as a separate listed entity, probably signals that the fire sale of second tier projects by majors like BHP and RTZ is now at its end. This implies Davis will have to hunt amongst base metal juniors to get what he wants. It would take a very large spending spree to build a diversified mining group out of the odds and sods lying around unloved in the TSX and ASX. The interesting thing is whether this vehicle will pursue whole companies or just try and acquire projects.

Vacuuming up some of the bigger base metals projects that have been sitting around awaiting financing will also enhance the pipeline of buildable projects.

More Elbowing?

We have debated with ourselves whether Agnico Eagle (TSX:AEM)(NYSE:AEM) counts as a major or just a big second-tier company. Either way its bid for Cayden Resources (which we would classify as large third tier) provides further proof that advanced projects are very much vulnerable to interlopers. We might remind investors that companies like Agnico are desperately seeking deals to fill up their pipelines (and maybe escape predators themselves). In mid-April, Agnico Eagle and Yamana Gold (TSX:YRI)(NYSE:AUY) teamed up for the CAD$3.9 billion acquisition of Osisko Mining to get their hands on its flagship Canadian Malartic mine in Quebec. This was a tussle which Goldcorp lost as it could not be seen (as we mentioned earlier) to be paying too much.

In its latest deal Agnico has agreed to purchase Cayden Resources for CAD$205 million, or CAD$3.79 per share. The deal brings into Agnico's orbit Cayden's wholly-owned El Barqueno property in Jalisco state, Mexico as well as Cayden's Morelos Sur property, which includes three properties – La Magnetita, Tenantla and Las Calles. However, as Cayden's property cramps Goldcorp's potential of its own neighbouring pit, speculation has already surfaced of a Goldcorp counter bid.

A Key Difference

The thing one needs to keep in mind with this current trend is that majors can offer cash, while generally mid-tier acquirers or third-tier "merger of equals" deals offer, at bes,t a modicum of cash but in most cases all stock, and sometimes with not much of premium. This means that if a major does wander into a battle for control it almost instantly has an advantage in being able to offer almost the same price in cash as an all-stock offeror and walk off with the prize because cash is still best in vending shareholders' eyes.

The biggest attraction for the general marketplace of offers from majors is that it spills cash from their coffers back into the hands of investors who (hopefully) will then go into the market to reinvest their takeover gains in another name. This does not happen with all-stock offers.

Conclusion

The stop-start nature of the mining finance market has not been conducive to creating fresh meat for the carnivores of the gold mining space (and even less so in the base metals and specialty mining areas). Bidding wars will become more common… mergers of equals will be the response to provide some sort of defensive posture.

Even for those investors not positioned in the "victim" stocks the trickledown effect of higher valuations, reratings of juniors, and investors from stories that are taken out redeploying funds will give a fillip to the whole universe of listed miners.