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## Commodity Price Downturn and the Impact on O&G and Mining Industries

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# Introduction

- Commodity price downturn has adversely affected oil and gas (O&G) and mining industries
- Prices in the mining and metal sector are now far below their 2011 peak, especially for coal, copper and iron
- Gold companies however have experienced stronger performance relative to other commodities
- Lithium has experienced an unprecedented demand due to its widespread application in batteries

# Introduction (Cont.)

- Oil prices have dropped to below $40 per barrel at the end of 2015, down more than 60% from their high in mid-2014
- Falling stock market valuations and reduced earnings have forced O&G and mining companies to cut CapEx and extend liquidity runways to survive until prices recover
- Unfortunately, "V-shaped recovery" of prices has not yet materialized

# Mining Industries – Recent Trends

- Estimated that $156 billion has been wiped off the market value of the top 40 global mining companies due to prolonged commodity price deterioration, while mining stocks have been slashed by around 43% since 2010 (PwC)
- Top 40 mining companies had impairments of $53 billion in 2015 and have written-off the equivalent of 32% of CapEx since 2010
- Leverage is at an all-time high of 46% and cash used to repay debt is broadly equal to cash from borrowings

# Mining Industries – Recent Trends (Cont.)

- Moody's placed 55 mining companies on review for downgrade in January 2016
- Many mining companies are struggling with financing covenant compliance

# O&G – Recent Trends

- O&G has undergone a significant structural shift – moving away from an era when capital investment decisions were driven by perceptions of "resource scarcity" to an era of "abundance"
- In the Q3 of 2014 (when oil prices were still above $100 pb), O&G producers posted aggregate net income of $22.9 billion. In Q3 2015, upstream profits have been wiped out (Bloomberg)
- Capital structures became unsustainable in a lower-price environment

# O&G – Recent Trends (Cont.)

- CapEx spending has been cut approx. 30% in 2016, and according to recent estimates, nearly $200 billion worth of projects have been cancelled or postponed
- Moody's also placed 120 O&G companies on review for downgrade in January, 2016, exacerbating the problems facing O&G companies
- Excellence in operational and project execution has now become essential not only to success but to survival

# Response to the Current Challenges

They include (non-exhaustive list):

- Downsizing / Derisking:
  - Monetisation of both core and non-core assets - Disposal programs have been accelerated
  - Massive cost-cutting and lay-offs: more than 200,00 employees have been or will be let go in the O&G industry alone, according to recent company announcements

# Response to the Current Challenges (Cont.)

- Relentless focus on capital discipline:
  - Reworking large-scale development projects so that only those with sustainable returns and able to attract large capital investment survive
  - farm-outs to those with stronger balance sheets
  - Formal restructuring solutions

# Response to the Current Challenges (Cont.)

- Complex transaction structures:
  - Joint ventures, swaps and strategic alliances
- Increased negotiation between borrowers and lenders:
  - Lenders may be willing to offer covenant relief or amendments for increased collateral, restrictions on future draws and additional protection for lenders

# Response to the Current Challenges (Cont.)

- Adopting new fundraising techniques, which may include:
  - Alternative financing
  - Acquisition financings
  - Private capital (e.g., Magris Resources, Waterton, Greenstone Resources)

# Obtaining Financing in the Current Climate

- Traditional Sources:
  - Available capital – debt and equity – remains constrained
  - Public market trends – may not be available to issuers
  - International commercial bank activity – not as focused on these sectors
  - Where not constrained, competition for funds is fierce

# Obtaining Financing in the Current Climate (Cont.)

- Alternative Sources/Structures
  - Sourcing funds from non-traditional debt and private equity providers often required/can be advantageous
  - Alternative Sources include:
    Streaming/Royalty Companies
    High Yield Bond Purchasers
    Private Equity/Hedge Funds
    Commodity Trading Companies
    Strategic/Industry Investors
    Construction Contractors

# Alternative Sources/Structures

- Similarities to traditional sources:
  - Advantages and disadvantages
  - Question of "fit" for a project/company
- Differences from traditional sources:
  - Developed within last 8-10 years
  - Limited experience through life cycle of projects and commodity cycles
  - Structures and terms still evolving in material ways, which may work in favor of O&G and mining companies navigating through the downturn

# Alternative Sources/Structures (Cont.)

GOAL =
Match particular company/project's objectives/characteristics with capabilities/requirements of traditional and alternative sources/structures for optimal financing plan

THE CHALLENGE =
Consider the consequences

LEARN FROM THE PIONEERS

# Lessons Learned So Far

- Streaming/Royalty Finance – most prevalent alternative finance for mining companies
- Confusion regarding nature: debt versus equity: a positive and a negative
- Effect on ratings and ratios = effect on borrowing capacity
- Circumstances which affect risk of unintended value transfer and assessment of pricing
- Intercreditor arrangements
- Specifics determine the consequences

# Lessons Learned So Far (Cont.)

- High Yield Bonds
  - Market differentiation – effect on execution risk and process
  - Aversion to construction risk
  - “Comps” – really?
  - Challenge for multi-phase projects
  - Waivers/Amendments – not likely/EXPENSIVE!

# Lessons Learned So Far (Cont.)

- Private Equity/Hedge Funds
  - How much money is really there?
  - Know your investor
  - What are their objectives?
  - Who makes the decisions?
  - Sector experience

# Lessons Learned So Far (Cont.)

- Commodity Traders
  - Core objectives = match to customer needs
    - Stable access to commodity is a must
  - Depth of knowledge of commodities, jurisdictions and players
  - Analyze all in cost – debt + offtake

# Lessons Learned So Far (Cont.)

- Strategic/Industry Investors
  - SWFs/SOEs/Corporates/Asian trading companies
  - Importance of diligence on investor
  - Political considerations
  - Maximize benefits – mobilize other funding sources
  - Importance of coordinating negotiations

# Lessons Learned So Far (Cont.)

- Construction Contractors
  - Regardless of financing plan specifics – need to address overrun issue
  - Current market dynamics

# Lessons Learned So Far (Cont.)

- Trend towards EPC from EPCM?
- Contractor as lender
  - Deferred, subordinated final payment
  - Overrun facilities
  - Mezzanine/equity investments
- Timing/coordination of negotiations
- Intercreditor issues

# Conclusion

“Just as, during the super cycle, people imagined prices would go up forever, people now imagine the market will never recover. Neither extreme represents the truth. What is true, however, is that our cycle times are lengthening. That means it could take years to adjust to current market forces – but it’s still a cycle.”

***Tracking the trends 2016 - Deloitte***

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