KPMG

cutting through complexity

KPMG GLOBAL MINING INSTITUTE

Growth in a time of scarcity

Managing transactions in the mining sector

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KPMG INTERNATIONAL

Growth Series

Contents

Introduction

A combination of demand from the East, dwindling mineral resources and rising costs is reshaping the mining sector. As mining companies attempt to manage their asset life cycle in this new landscape, their three main strategic priorities are growth, performance and compliance.

Whether organically or (increasingly) through mergers and acquisitions, growth is a perennial objective in an industry where assets continually erode. To cope with the rising costs of power, labor and materials, businesses are seeking to improve performance through operational efficiency, intelligent supply chain management and technological innovation. And with regulations getting tougher, mining companies must preserve their reputation by remaining compliant and embracing a sustainable philosophy.

The rapid urbanization of China and India is driving up demand, inflating the price of commodities. Although this makes mining more attractive to investors, the lower yield of many existing mature mines means that businesses must now venture into new, unfamiliar regions with relatively undeveloped infrastructure and less predictable political systems. Projects are no longer restricted to the mine itself and may encompass railways, roads and port developments, often across different countries.

Aware of their strong negotiating position, governments of mineral-rich countries are practicing 'resource nationalism' through tougher legislation and tax reforms in order to claim a larger slice of the revenue from resources mined in their country. They are also protecting their own future needs by limiting the export of raw materials such as thermal coal and rare earth minerals.

Communities are also having a greater say in decisions over new mining developments, and failure to consult with local representatives can put projects at risk of being delayed or even terminated.

The scale of new mining and associated infrastructure developments calls for a huge investment, with joint ventures and public-private partnerships (PPPs) are becoming more common. Much of the capital to fund such initiatives comes from the East, shifting the balance of power further towards Asian investors.

Security of supply has become a major concern for many Asian countries, and the Chinese steel and mining industry in particular is expected to consolidate and integrate vertically. China also controls the bulk of the planet's rare earth metals and significant reductions in its export quota have led to a rush for such materials.

As resources get scarcer and more expensive, society needs to recycle effectively, and companies should play their part by looking for alternative technologies and working with the end consumer to try to reduce energy and raw material consumption.

All these changes create greater complexity and call for an integrated approach to managing the asset life cycle, bringing together a host of disciplines to ensure that mining companies continue to grow, become more efficient and meet the highest standards of transparency and governance.

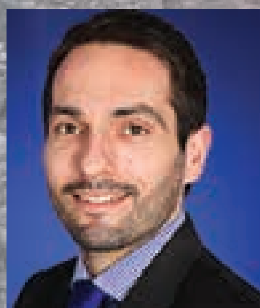
This guide is the first in a series that discuss how mining companies can best navigate the asset life cycle, and covers the five key elements of the transaction phase: geographic expansion, financing and mergers and acquisitions, tax structuring, due diligence and integration.

We believe that these publications will make a valuable contribution to the quest to optimize growth, performance and compliance in the industry. We are committed to being your long-term partner.

Wayne Jansen
Global Head of Mining

Geographic expansion: testing the water

Local knowledge and contacts are essential for assessing the social, political, economic and commercial risks associated with mining in any given target country. Crucial to the success of such a geographic expansion strategy is the organizational response to these obstacles; what resources are deployed and how.



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As commercially exploitable reserves become depleted in existing markets, mining companies are increasingly looking further afield to secure new resources. In doing so, they will need to build up as clear a picture as possible of the external – social, political, economic and commercial – environment before committing to invest. They will also need to be aware of their own internal competencies to ensure that appropriate resources are deployed to respond to the risks and opportunities presented by the external environment.

After the quality of the resource, the availability of skilled labor to construct and operate the mine, and quality and depth of infrastructure to transport the ore to market, will be major considerations for any mining company when assessing the attractions of a given country.

Government policy towards mining – which can often vary between the national and local level – is another critical factor. State approval will count for little if regional politicians are opposed to your plans and fail to provide appropriate licenses and permits. Even apparently stable countries with a dominant ruling party can have significant political risk, notably in the form of 'resource nationalism' where governments may apply onerous tax regimes for the extractive industries or even expropriate assets.

It is not just governmental authorities that must be consulted; communities are having a growing influence and often have the power to restrict or even stop developments. Before granting a 'social license to operate,' community groups may demand contributions in the form of investment in schools, hospitals and infrastructure, guaranteed employment for local people in the mine, locally sourced inputs, and a commitment to preserving the environment.

> "It's not just governmental authorities that must be consulted; communities are having a growing influence and often have the power to restrict or even stop developments."

Boots on the ground

The initial profiling of geographic expansion opportunities will be largely desktop-based as companies identify commodities of strategic interest, consider the risk reward profile they are willing to accept and determine which countries they are willing to do business in. From this point on, local contacts and knowledge become crucial in order to establish and nurture relationships with key stakeholders within government and the local communities, as well as setting up representative offices to establish a presence.

Importantly, it is how an organization responds to the external environment that will create value. Mining companies must carry out a thorough assessment of their internal competencies across all functional areas (e.g. Finance, HR, Legal, Tax IT, Health and Safety and Geology etc.) in order to determine the unique combination of resources (both internal and external) that will be required to create sustainable value through geographic expansion.

In some regions, the only effective way of managing the inherent risks is to find an appropriate local partner. In such a scenario, it is imperative that a well-defined joint venture or partnering strategy is established to ensure an appropriate structure that drives value.

A clear governance structure is required to implement the expansion strategy and ensure ethical compliance. Investors will not only require adherence with local legislation but also international legislation such as the US Foreign Corrupt Practices Act (FCPA) and the UK Bribery Act.

An independent, knowledgeable presence

Through its global network, KPMG member firms have highly experienced mining professionals working in virtually every major territory. KPMG member firms have advised numerous companies with their geographic expansion strategies, whether it be establishing a rep office, creating a joint venture or acquisition. We can help clients assess country risks, evaluate internal competencies, benchmark competitors and introduce them to the right contacts in industry, government and the wider community to help create sustainable value.

Case study

Background

A global mining company had identified Mozambique as a potential geography for expansion. Understanding and evaluating the specific country risks, opportunities, geology and state of development prior to making any investment decision was a pre-requisite for the client.

Key activities

A KPMG firm assisted the client to quickly understand the environment for doing business in Mozambique by:

- Leveraging our extensive in-country knowledge and corporate intelligence services to provide a comprehensive country briefing;
- Producing a detailed country risk analysis tailored specifically to the client's chosen investment strategy;
- Introducing key stakeholders and government officials; and
- Assisting with rep office set up and provision of back office support (accounting, payroll, tax compliance).

Result

We were able to help the client quickly establish a presence in Mozambique through:

- Our local knowledge – the previous Mozambique managing partner (now in South Africa) has a very good understanding of the coal mining sector in Mozambique and the associated issues;
- Our network of contacts – the current managing partner in Maputo has held several ministerial positions in Frelimo governments, providing him with a deep understanding of government thinking and an extensive network of government contacts including at ministerial level; and
- Corporate intelligence – KPMG's corporate intelligence team has extensive experience of sensitive pre-investment due diligence across sub-Saharan Africa, including 'on the ground' experience in Mozambique, South Africa, Cote d'Ivoire and DRC amongst others.

Case study

Background

A Russian natural resources company was due to commence the construction of a new downstream production facility through a JV, at an estimated investment cost of USD2 billion over a 5 year construction schedule, followed by a 20 year production agreement.

The JV facility would consume a large proportion of existing upstream production under a mandatory supply agreement.

This expansion formed part of the company's growth strategy which had been communicated to their major shareholders. In addition a signing ceremony was planned between the Russian Premier and his counterpart in the country of investment, leading to significant political and internal pressure for a deal to take place.

Key activities

A KPMG firm was approached to advise on:

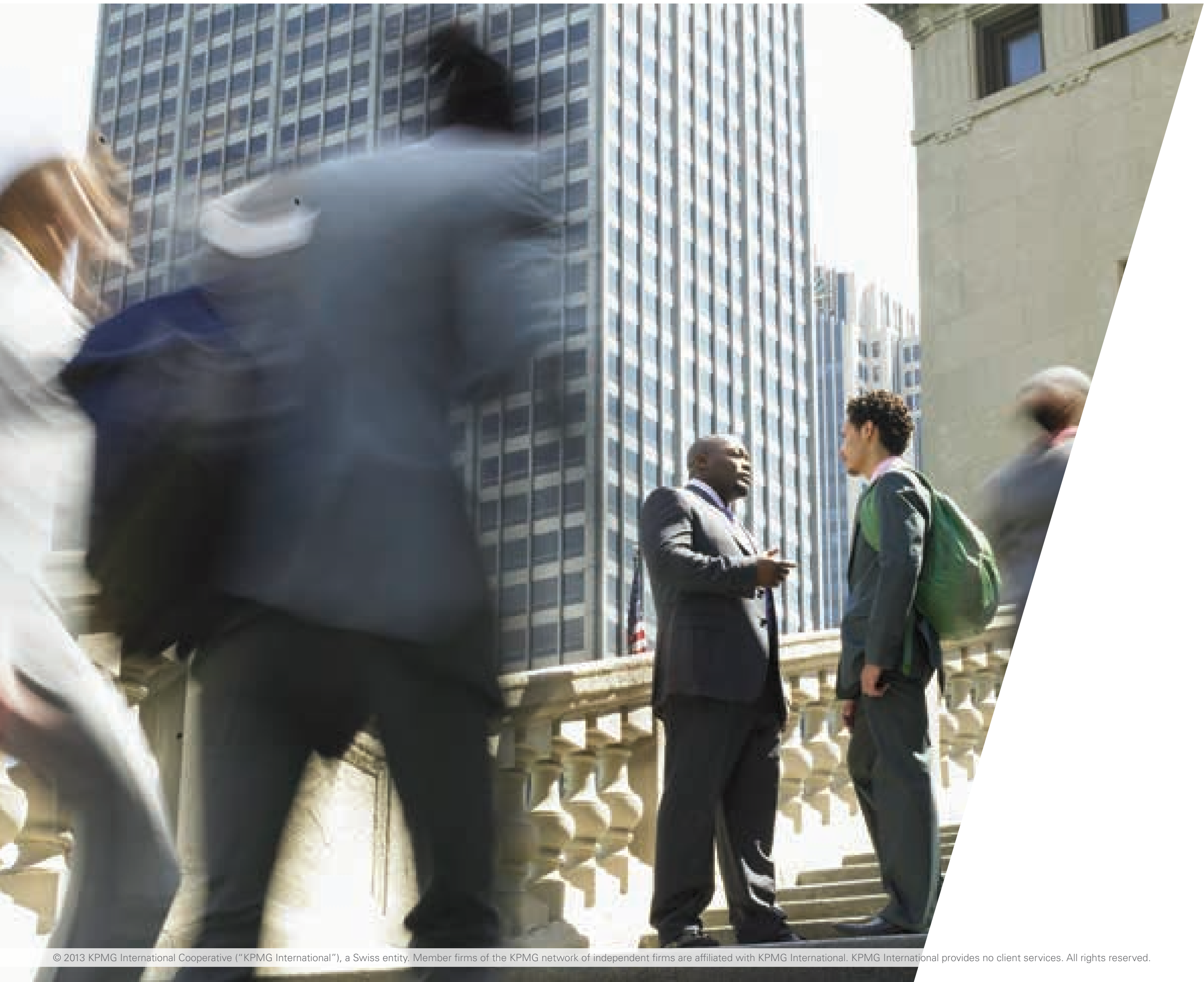
- Whether the draft JV Agreement and the existing signed MoU provided an appropriate framework for resolving issues likely to arise during the life of the JV as well as a suitable governance structure;
- Potential weak points in the JV business model; and
- Potential weak points in the clients corporate capability to undertake JVs.

KPMG's work involved bringing together value driven analytics, an 'external investor approach' and a depth of operational experience and delivery capability to identify risks and upside opportunities.

Result

The KPMG firm identified a significant number of issues which had not been addressed properly in the JV agreement; these included legal, tax financing, supply chain, governance and regulatory approval. The magnitude of the issues identified required significant renegotiation of the terms of the JV, and subsequently the JV Agreement was not signed despite the pressure on management from multiple stakeholders.

M&A and financing: **replenishing a diminishing asset base**



As mining companies seek targets in unfamiliar parts of the world, they will need strong local knowledge to form relationships and cope with foreign regulations and cultures. A flexible financing package can help hedge against a volatile commodities market to achieve positive margins and improve shareholder value.

Shareholders are increasingly asking mining companies to pursue a disciplined portfolio approach in line with their core competencies whether in exploration, mine development, or managing mature cash flow generating assets to enhance value for investors. KPMG member firms often act as a long term partner of mining companies in optimizing their acquisition and divestiture programs in order to best leverage the client's core competencies.

The nature of mining means that assets are being depleted every day that they are in production, and with limited organic growth opportunities, mergers and acquisitions (M&A) form an integral part of corporate strategy.

But it is getting harder to find suitable targets. Most quality deposits in established areas have been partly or fully exploited, and as a result many potential purchases lie in the world's less developed regions. Buyers unfamiliar with these territories may struggle to find appropriate contacts or understand the local regulations and business culture. KPMG member firms bring a unique mix of in-country knowledge and M&A expertise in the metals and mining sector, which is indispensible when buying an undeveloped site or negotiating a shareholding in a mining project, due to the manifold risks involved in both transaction structuring as well as obtaining planning permission and managing construction.

'Resource nationalism' is a particular concern, as governments may choose to revise their taxation and/or royalty regimes or even worse, unilaterally expropriate part or all of a property on behalf of themselves or local investors. Although it is not possible to predict precisely if and when such actions might take place, a good understanding of the country's political, regulatory and tax environment can certainly help when assessing the risks.

Another trend in resource nationalism which is becoming more apparent is the consequence of an increasing awareness of governments in resource rich countries to retain more of the margins downstream in the host country by demanding further beneficiation of the raw materials produced from project owners. This trend will provide attractive opportunities in joint ventures between suppliers and immediate consumers of selected minerals.

Intense competition for acquisitions can push the purchase price up to a level where buyers overpay, which can in turn drive down the acquirer's share price. Consequently a number of mining companies are experiencing declining shareholder values, particularly for gold and base metals, in spite of rising commodity prices. These falling stock prices make it harder to raise finance to fund existing and future projects.

KPMG member firms bring a unique mix of in-country knowledge and M&A expertise in the metals and mining sector to their clients, seeking either acquisition of mining targets, strategic partners for joint ventures or investors and buyers for their asset divestitures, in almost any territory around the globe.

Funding growth

One of the most common ways to finance large mining projects is to offer a strategic partner a minority position – typically between 20–40 percent – for cash upfront to be used primarily for capital expenditure. This approach is looked on favorably by the financial markets as it reduces uncertainty over development financing and also potentially gives the buyer access to export credit support in the partner's country.

With many of the potential cash-rich investors based in the Asian markets of China, Japan, Korea and India, mining companies may again need help in seeking out partners, handling negotiations and putting together the right financing packages. An interesting deal structure that KPMG member firms have been developing with its clients in metals and mining is to introduce investors who could provide equity financing for project development as well as commit to long term Offtake arrangements, which in turn can greatly enhance project financing of the mine development. Project developers can also select from the full range of funding instruments, including traditional bank debt, corporate bonds, high yield credit and mezzanine financing, as well as project financing. Depending on specific clients and particular situations, a broad suite of alternative sources of finance may also be available, including export credit, fleet financing, royalties and commodity stream financing. When acquiring an asset, KPMG member firms can carry out an independent comprehensive financing review for its clients, as all the above options bring unique benefits and risks.

Help with navigating uncharted territory

KPMG firms have teams of specialists in every corner of the globe with longstanding local relationships, giving mining companies access to vital knowledge and contacts – even in the most remote regions. Through this reach we will help you navigate an uncertain environment and find the right partners. And with our extensive experience in M&A and project financing, our firms will help you put together a funding package that suits your risk profile and keeps shareholders happy.

Case study

Background

A global integrated business enterprise had identified a development stage PGM project in Canada in which the client was interested in acquiring a significant stake through a joint venture. The client needed an advisor that could assist in the valuation of the project, develop a negotiation strategy, as well as provide tax and financial due diligence.

Key activities

KPMG's Corporate Finance Practice ("KPMG CF") worked closely with the client, the client's mining consultants, and KPMG Tax to develop a fully integrated financial model for the project. The financial model incorporated all appropriate mining taxes and allowed our client to consider various mining scenarios to determine valuation of the project.

KPMG in Canada also provided the client with a tax and financial due diligence report which was used by the client in conjunction with the financial model to obtain internal approvals necessary to progress discussions with the target.

KPMG CF assisted the client with negotiation strategy and provided supporting analysis throughout a lengthy negotiation process. Working closely with the client's legal team, they assisted the client in reviewing joint venture agreements, providing recommendations from a business perspective. KPMG's Tax professionals assisted the client in determining optimal transaction structure (assets vs. shares) and joint venture structure (incorporated vs. unincorporated). Our tax team also helped the client in evaluating and selecting a country to establish a special purpose corporation.

KPMG CF advised the client through initial project finance considerations, and developed analysis to assist the client to assess the potential debt capacity of the project.

Result

KPMG in Canada helped the client structure, value, evaluate, and negotiate a successful acquisition of a 25 percent stake in the PGM project by way of an unincorporated joint venture for proceeds of USD95 million. The key success factor here was the availability and integration of KPMG's team of specialists with extensive experience in mining corporate finance, international tax, and accounting.

Case study

Background

An international mining company had identified an iron ore asset in Sweden and an iron ore, copper and gold mine in Finland which required funding to develop the project through to production. The client needed to assess all options for fund raising, including project finance, equity and other sources.

Key activities

A KPMG firm worked closely with the client to develop all of their PEA models to support the development of the mines in Sweden and in Finland. The firm also assisted the client consider options for an iron ore production plant and the logistics for the mines.

For the mining projects we developed the PEA model to support the BFS, ensuring that the needs of their client and the project finance banks were met – including presenting financials in a format which the banks could take to their credit committees.

The KPMG firm also developed a tool to enable management to collate project information to assess the impact of different capex and opex scenarios rapidly and incorporate this information into the BFS.

The BFS model gave the client the flexibility to evaluate different funding structures including bonds, debt funding, mezzanine finance, RCF, leases and equity, allowing management to assess quickly the best funding structure for its projects and perform high level and detailed sensitivity analysis on all aspects of the project.

The KPMG firm introduced the client to prospective lead banks and advised them through initial project finance discussions, and developed analysis to assist the client to assess options for a JV structure to finance and operate project logistics including port, rail and trucking.

Result

The KPMG firm helped the client to identify opportunities to utilize bond and equity finance to fund development of the project. As a result, the client successfully raised USD350 million of high-yield bond finance and USD325 million in new equity.

In addition, the client now has a common process and tools to use to evaluate projects giving the CEO and Board confidence and rapid decision making capability.

Case study

Background

In 2008, one of the largest Russian metals and mining companies acquired a 100 percent interest in three coal mining companies located in the USA. As a part of the compensation the Russian company granted the sellers an option to acquire its preferred shares planned for listing. At the same time the Russian company guaranteed the sellers that the preferred shares would be listed within a specified period of time, which would allow the sellers to realize the value of these shares. The company asked the KPMG firm to carry out an independent valuation of the shares so that a fair value could be established for them and that this value could be reflected in its consolidated U.S. GAAP financial statements.

Key activities

The KPMG firm faced the complex task of determining a fair value for the preferred shares at each reporting date up to when they were listed on the market. That value had to satisfy the strict requirements of U.S. GAAP and the expectations of the transaction's participants.

The choice of valuation method, even under U.S. GAAP, is always one of the most important stages of our work. In this case, the unique experience and knowledge of the KPMG team in carrying out valuations in accordance with U.S. GAAP standards and within the framework of transactions involving participants in the U.S. market proved invaluable.

The KPMG firm considered several valuation options, including the current cost method and the option price method. However, as the shares were shortly to be listed on the market it was concluded that the most suitable valuation would be the income method, weighted to take into account the probability of the income being received. Using this methodology, KPMG analyzed various return scenarios, and calculated the value of the shares taking into account the impact of factors such as the non-controlling interest and the lack of liquidity of the shares in the form of discounts to the value.

Result

The correctness and accuracy of the valuation of the preferred shares allowed a fair value for them to be reflected in the financial statements, as was confirmed by the company's auditors. The key success factors here were the availability of a team of experts with extensive experience in valuation in accordance with U.S. GAAP standards, and KPMG's individual approach to the specific features of the shares in question.

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Tax structuring: creating a tax-efficient future

When approaching a deal, mining companies should consider the tax implications of the initial transaction, the ongoing business and potential exit strategies. The location of the purchasing entity is critical in making the most of double tax treaties and hedging against expropriation of assets by local governments.

With much of the growth in the mining sector coming through mergers and acquisitions, the way in which a purchase is funded can have a big impact upon the amount of tax a company may have to pay.

A highly leveraged deal leaves the buyer with significant debt levels, enabling the interest to be potentially deducted against tax. To counter this practice, many countries have introduced 'thin capitalization' rules that limit the proportion of borrowing and insist on a minimum amount of capital. It is therefore vital to have a detailed knowledge of such local regulations when putting a funding package together.

Competition for scarce assets has pushed up the price of new mines and greenfield sites, with most purchasers likely to pay above the book value. This creates an opportunity to write off the resulting goodwill against tax in future years, and appropriate tax due diligence and effective tax planning can optimize these benefits in certain countries.

Having invested in a facility in a different country, the buyer and other investors will naturally want to ensure a return on their outlay, so must factor in the tax treatment on remittance of dividends, other repatriation alternatives, as well as the impact of withholding taxes (e.g. on interest, royalties or service fees).

Double tax treaties may allow tax paid in the country where the mine is located to be deducted against corporate income tax in the country receiving the payments, in the form of a credit. The existence of such a treaty can influence the location of the purchasing entity. If there is no treaty with the country where the buyer is headquartered, then it may be tax-efficient to carry out the deal from another nation where such an agreement is in place. This is especially relevant when there are opportunities to increase credits through tax sparing and matching credit clauses.

A lot of new mining opportunities arise in emerging markets where exchange controls can limit the repatriation of capital, so before leaping into a deal it is wise to receive some assurance that there will be no restrictions on how much money can be taken out. This will require an understanding of the target country's legislation as well as historical cases.

"'Resource nationalism' – where governments unilaterally expropriate mines – is a potential threat when investing in certain parts of the world."

Looking ahead

'Resource nationalism' – where governments unilaterally expropriate mines – is a potential threat when investing in certain parts of the world. Overseas assets are at their most vulnerable following a change of government or during a recession.

One way to hedge against such an event is through indemnification that guarantees compensation to the owner. Again, if the buyer's headquarters is in a country that has no indemnification arrangement or investment protection treaty with the nation where the mine is situated, then the sale could be conducted through another more favorable location.

Finally, a well-planned exit strategy can optimize the ultimate returns to the investors, some of whom may be private equity companies seeking to improve the value of the business and then sell within 4-6 years. An appropriate tax structure in the early stages can minimize the amount of capital gains tax paid on the eventual sale.

A big picture with small details

KPMG has a smoothly functioning worldwide network of tax specialists that combine detailed local technical knowledge with an understanding of the bigger international picture. Through this mindset, our tax structuring team can help you structure your investments to bring tax efficiencies at each stage, from the initial transaction and ongoing business, through to a successful exit strategy, keeping you informed of the implications of any updates in regulations.

Due diligence: sizing the prize

The value of a deal to the buyer and seller can be influenced hugely by the impact of unforeseen risks. Assessing an asset, as diverse as a mine, requires a broad range of technical, commercial, environmental and financial skills in addition to local knowledge and experience.

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The value of a mine is principally determined by what is still in the ground – the commercially exploitable reserves and resources. Beyond this, the principal considerations relate to whether or not an acquirer can operate the mine more efficiently than the existing owner and thereby generate a greater return, and whether brownfield or greenfield expansion cases are really feasible with sufficient demand for the incremental production.

The stage of the mine in the asset life cycle also has a significant bearing on the value given that the greatest period of appreciation is between discovery and development, as the degree of confidence in the commercial viability of the mine increases. Similarly the combination of skills required to due diligence a mine also changes over the life cycle – i.e. in the exploration to development stages a greater emphasis is placed on technical and legal, while operational and financial carry a heavier bias during the production stage.

Establishing whether the mine is technically feasible and ensuring that engineering has been costed in line with international standards and appropriately benchmarked is critical to the due diligence process, and requires technical consultants with experience of the ore type, and mining and processing methods in country.

Licensing and permitting issues need to be thoroughly assessed, particularly at the evaluation and development stages of the asset life cycle but which should not be overlooked when considering expansion cases. In some countries the legal and regulatory process for obtaining access to land, construction licenses and environmental permits can be particularly complex. It is essential to have people in country who understand the legal, environmental and sustainability issues to provide and assess the impact of risks to the schedule.

Financial performance should be scrutinized not only to get under the skin of the historical results and cash flow of operating mines. Understanding the evolution of cash costs and other drivers of financial performance are essential for assessing the linkage between actual and forecast results – but also to ensure that construction costs reconcile between the EPC records and the financial statements.

The operational efficiency of the target must also be carefully assessed to evaluate the validity of improvements baked-in to existing plans and opportunities to realize further 'upsides' whether through improved efficiencies, cost savings or rationalization of discretionary capex.

Taxation is a key area both in relation to unrecognized historical liabilities as well as the potential impact of changes to the group and/or operating structure, and implementation of new tax legislation post completion. Understanding taxation at the local operating and group level are essential to ensure an appropriate structure to realize value from the transaction.

Preparing for sale

Sellers have a limited window of opportunity to maximize value from disposals by identifying potential risks and mitigating their impact before marketing assets. Preparing assets by undertaking a pre-sale review of the business from a buyers perspective can be a cost effective way of preparing a business for sale, and can often result in latent value potential being identified, which can often be captured, rather than being left on the table.

A holistic mindset

Our approach to due diligence is based on providing an integrated team with the skills and experience required. KPMG firms have a unique combination of financial skills, in-depth mining knowledge and region-specific experience, and will partner with other leading consultants with complementary skills where appropriate. Our Transactions Advisory team has extensive experience of helping clients understand the multidisciplinary risks and opportunities associated with mining transactions, with a focus on maximizing value through the deal.

Case study

Background

The client, a global diversified mining company, was contemplating the potential disposal of two South American assets, as part of a strategic review. A KPMG firm was engaged by the corporate head office to assist in preparing the businesses for sale, identifying and assisting local management to unlock latent upside potential and maximize shareholder value.

Key activities

The KPMG firm undertook a detailed market, operational and financial due diligence review of the assets, looking at the business from a buyer's perspective.

The key focus of our work was to identify and implement value maximization strategies through early identification of:

- Opportunity upside;
- Potential risks and deal issues for mitigation;
- Separation issues; and
- To provide common understanding of the asset between local management, deal team and advisors.

KPMG's review identified:

- Cost saving opportunities equal to 16 percent of the operating cost base; and
- Significant pricing and other opportunities in the sales and marketing function.

Result

The performance improvement upsides identified by the KPMG firm were built in to a revised budget and business plan. These have since been achieved and the improvements in operating performance have been such that the client has now postponed (possibly indefinitely) the sale of these assets.

In addition, the client now has a much better understanding of the future potential of the asset, together with improved management information, effective monitoring and controls and a robust process for challenging financial performance.

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Integration and separation: a perfect marriage or a smooth parting of the ways?

Mining companies should devote dedicated resources early in the transaction process to address integration and separation issues quickly in order to realize the full value of their investment post completion.

Many companies fail to think about integration until late in the transaction process, when planning should really start well in advance of completion.

Synergy benefits, whether through increased revenues, reduced costs, operational efficiencies and economies of scale, are often key drivers of mergers and acquisitions. Potential synergies, such as back office integration, shared use of existing infrastructure, rationalization of mining plant and equipment, or renegotiation of contracts with rail operators to gain economies of scale, should be evaluated in parallel with the broader due diligence process and robust plans established for realizing them.

Integration may also present a number of technical and engineering challenges for mining companies where synergies are driven by operational efficiencies and economies of scale. These cases may require the capacity and design specification of an existing plant to be reworked in order to handle increased throughput of ore with potentially different grades and mineral characteristics or rationalization of existing and planned capital projects.

Shareholders and financial analysts will want to see genuine evidence that the new organization is delivering what was promised pre-completion. Implementing monitoring and benefits tracking tools help to keep control over the post-acquisition integration processes and provide a reliable way to quantify and measure the benefits over time, while minimizing business risks arising from a delayed completion of the integration activities.

A dedicated integration team should be assembled to prepare an integration blueprint for the new combined entity and identify quick wins while freeing up management to focus on the day-to-day business. The integration blueprint should be developed during the first 100 days post completion to ensure that the strategic priorities for and control of the new entity are quickly realized.

Buying a mining asset puts the acquirer very much in the spotlight, particularly when the mine is in the development stage of the asset life cycle. It is vital to consider early engagement with stakeholders as part of the integration blueprint in order to build a positive reputation with local communities who increasingly expect some form of contribution to schools, hospitals and other facilities, in return for their approval of the 'social license to operate'.

Beyond the financial, technical and social impact of integration, mining companies are also likely to be faced with the challenges of organizational change and cultural alignment, particularly when entering new geographies. The impact of change on people and cultural sensitivities should not be underestimated, especially where synergies are planned to be derived from right sizing the new organization post-acquisition.

"Buying a mining asset puts the acquirer very much in the spotlight, particularly when the mine is in the development stage of the asset life cycle."

A parting of ways

Separation is often viewed as simply the flip side of integration but the reality is often much more complex. Even in the simplest of corporate structures there are likely to be a number of key touch points between the target and retained operation which will need to be resolved prior to disposal of the entity. The challenge becomes even more difficult when the disposal involves a carve out from a complex and highly integrated global business.

Early planning to identify key touch points or 'separation hotspots' is critical for establishing a detailed separation blueprint. This provides bidders with a detailed understanding of how the entities will be physically separated. It may be that separation hotspots relate to shared services such as IT, treasury, HR and finance etc, provided by the seller group, where transitional arrangements can be put in place. In more complex situations, where the mine being disposed is in close proximity or adjacent to the operation(s) being retained and plant and/or facilities such as power supply, canteens and fire crews are shared. One solution may be to continue to provide such services on a third party basis.

Value is often created through separation by right sizing the business for sale prior to disposal and implementing robust transitional and long-term service arrangements to ensure the seamless transition of the business at close.

Staying in control

KPMG's integration and separation professionals provide support across all stages of the deal cycle, from synergy assessment and pre-planning in the pre-deal phase, through to integration or separation planning and assistance post-deal. We help our firms' clients stay in control by identifying any burning issues upfront, and establishing an appropriate operating structure for the new, integrated organization, including resource requirements and – in the case of a separation – transitional service agreements.

Case study

Background

In early 2011, one of the leading fertilizer producers in Russia merged with the country's leading potash producer to create the second largest potash producer in the world. Investors perceived the merger as compelling based on the strategic rationale alone, and similarities between the two companies.

Synergy benefits resulting from the merger were estimated at USD100 million per annum, through a combination of optimization of operational and transportation activities, reduction in administrative and commercial expenses and capacity expansion. Investors perceived this estimate as conservative and expected substantial gains from cost savings, scale and incremental capacity from expediting development of the combined operations.

The company was required to inform investors on the delivery of actual synergies in 2011 and identify additional opportunities in excess of the initially announced target.

Key activities

A KPMG firm assisted management of the combined entity with analysis of the announced synergy targets and progress in delivery of identified synergies, and included:

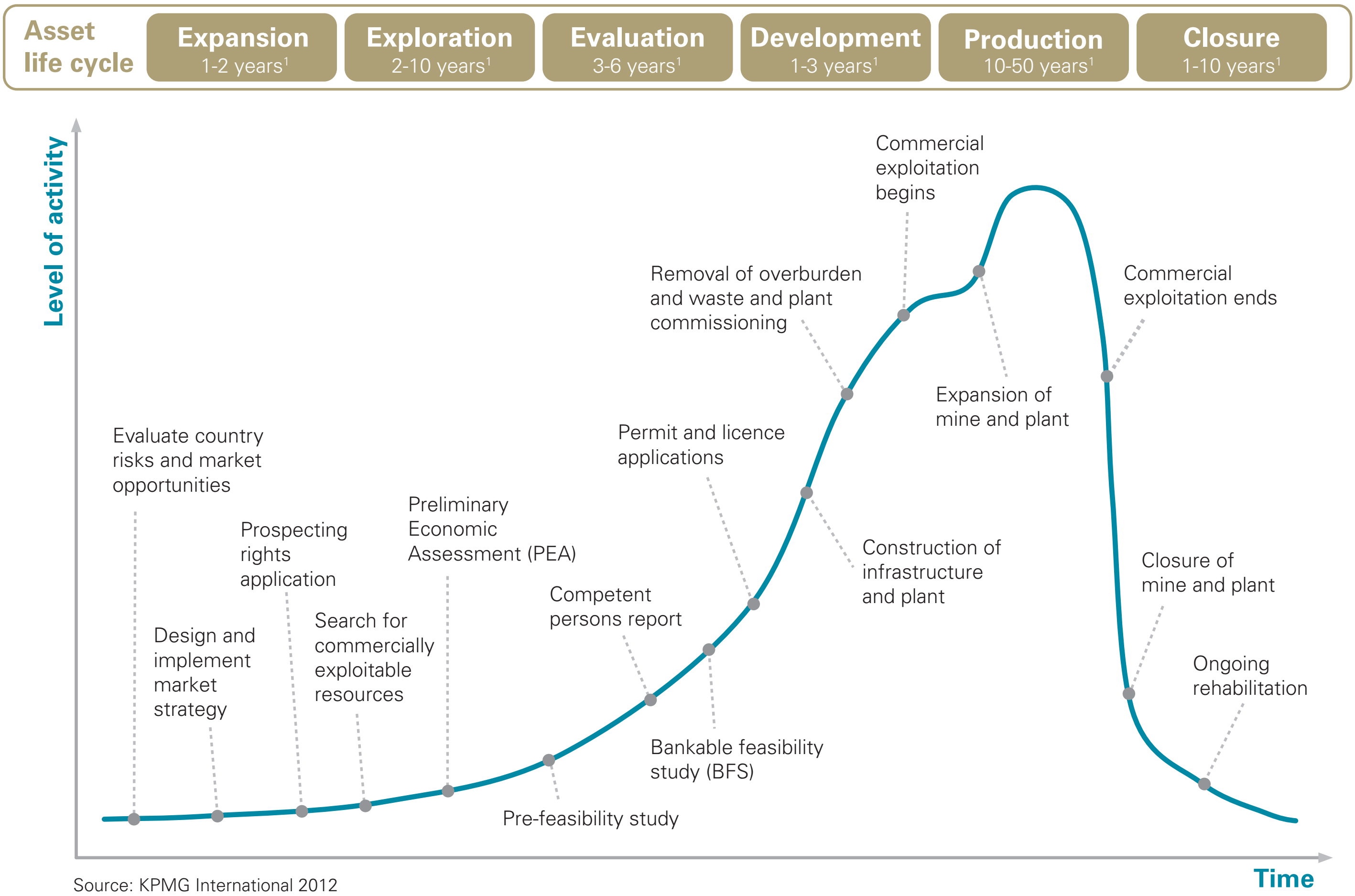
- Creating a framework for review of synergies delivered in 2011 and capturing new opportunities;
- Supporting management in documenting assumptions and underlying rationale, including identification of options for subsequent tracking of delivery;
- Facilitated engagement with the company's work stream leads and providing constructive challenge to the process; and
- Supporting functional work stream leads in articulating their assumptions and quantification of delivered synergies as well as future targets.

Result

The client has recently announced significantly improved synergy targets of USD300 million per annum, supported by robust assumptions and detailed action plans for delivery.

Knowledge and processes transferred from the KPMG firm to the clients central and functional teams during the engagement will enable ongoing identification and tracking of recurring synergies.

Mining asset life cycle



Source: KPMG International 2012

Note: 1. Estimated duration of stage in the mining asset life cycle

KPMG mining growth detailed solutions across the asset life cycle

Strategy | **Growth – Transactions** | Growth – Projects | Performance | Compliance | Sustainability

Transactions mining asset life cycle

	Expansion 1-2 years	Exploration 2-10 years	Evaluation 3-6 years	Development 1-3 years	Production 10-50 years	Closure 1-10 years
MARKET ENTRY	• Assessment of economic and political risk • Local knowledge and contacts – Executive ‘meet and greet’ service – Stakeholder network development	• Search for commercially exploitable resources • Preliminary Economic Assessment (PEA)	• Feasibility study • Availability of financing • Infrastructure requirements and evaluation	• Project execution, including Life of Mine plan • Project development and capital cost management	• Cost and margin optimization • Performance improvement review and management	• Decommissioning and rehabilitation • Sustainability review and evaluation of plans
FINANCING/M&A	• Buy side M&A lead advisory • Target/asset identification and evaluation • Asset valuation • Strategy and portfolio review	• Model build: – Cash flow forecasts – Project KPI’s – Scenario analysis • Asset valuation	• Equity and debt financing advice • Identify and negotiate with off-take/strategic partners • Operating and financial model build • Asset valuation	• Equity and debt financing advice • Identify and negotiate with off-take/strategic partners	• Buy/sell side M&A lead advisory • Strategy and portfolio review • Target/asset identification and evaluation • Divestment options and buyer identification	• Review of strategic options • Divestment and exit options
TAX	• Tax strategy, structuring and modeling	• Identify early tax issues	• Tax strategy, structuring and modeling, including M&A, due diligence	• Tax strategy, structuring and modeling	• Tax optimization	• Tax implications of asset closure/sale
DUE DILIGENCE	• Commercial due diligence and strategy review • Financial due diligence on target	• PEA model review • Commercial and financial due diligence on target	• Feasibility study model review	• Advice on establishment of project controls	• Vendor due diligence • Transaction advice (separation and integration) • Business reviews	• Due diligence of disposal/salvage values
INTEGRATION	• Community investment and social responsibility	• Strategic and operational fit	• Corporate integration strategy	• Sustainable development, including energy, water and carbon • Review of transition from development to operating	• Review of performance and monitoring plans: – Controls – Sustainability – Health and safety • People and change: – Shared services – Outsourcing – Change management	• Managing reputational risks • Compliance obligations

KPMG's Global Mining practice

KPMG Global Mining Centers

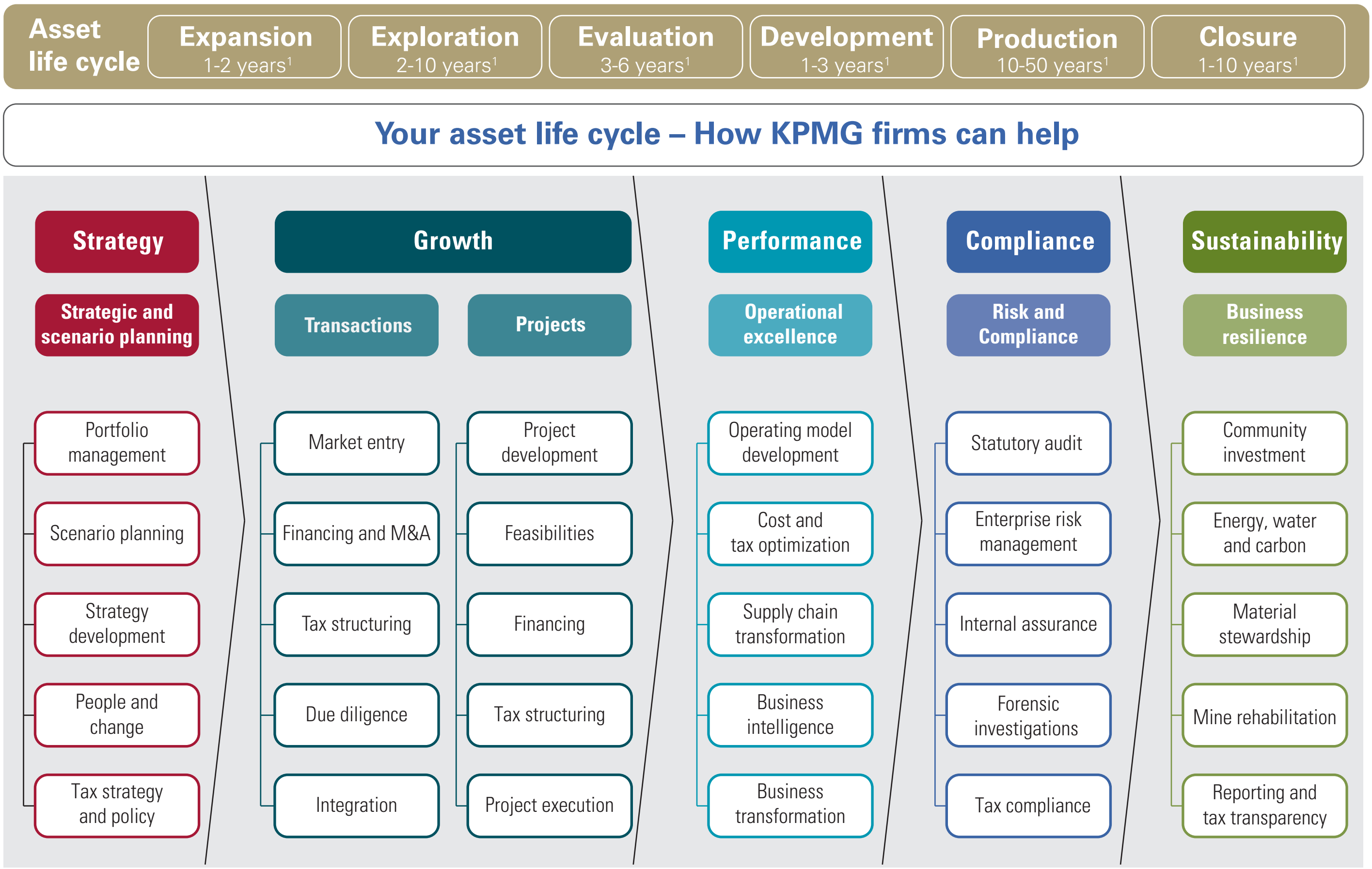
KPMG member firms offer global connectivity through our 14 dedicated Mining Centers in key locations around the world. By working together seamlessly, we help member firm clients adapt and respond to a rapidly-evolving mining environment.

Our centers are located in or near areas with high levels of mining activity: Beijing, Brisbane, Denver, Johannesburg, London, Melbourne, Moscow, Mumbai, Perth, Rio de Janeiro, Santiago, Singapore, Toronto, and Vancouver.

Each center is composed of professionals with extensive practical experience in the mining industry who work together to share information, thought leadership, training, and support. As a client, you will get access to the latest industry thinking, skills, resources, and technical development from a team that has local knowledge, backed up by in-depth global expertise. Our firms are continually building our understanding of global trends and developments by sharing observations and insights with you.

For more information, visit **kpmg.com/mining**

KPMG mining growth solutions



Source: KPMG International 2012
[1]Estimated duration of stage in the mining asset life cycle

Leading the field with **industry insight**

KPMG member firms offer a diverse range of audit, tax and advisory services to the world's leading mining companies; however, being the leader means more than just having a strong client base.

We invest in thought leadership and spearhead industry debates to help keep our clients at the forefront of progressive thinking. Our KPMG events and forums, as well as our support and participation in well regarded industry events, enables us to discuss industry issues with leading participants.

The KPMG Mining Institute features thought leadership and webcasts that provide insights into current issues and emerging trends.

Being at the forefront also allows us to give our people the skills and knowledge to provide the quality and customized services that our clients require.

For more industry insight, please visit our Global Mining Institute **kpmg.com/mining**

Strategy Series

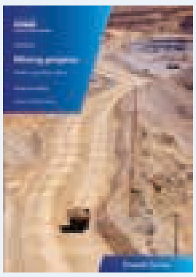
Country mining guides

This series of country guides provides an overview of the mining industry from a geographical, economic and legislative context. These country guides are invaluable for those already operating or considering an investment in a particular country.

Growth Series

Growth in a time of scarcity: Managing transactions in the mining sector

This guide is the first in a series that discusses how mining companies can best navigate the asset life cycle and covers the five key elements of the transaction phase: geographic expansion, financing and mergers and acquisitions, tax structuring, due diligence and integration.



Mining projects: Seeking greater value

Major projects are complex and time-consuming and success or failure is often determined by the degree to which they are aligned with company operations and strategy.

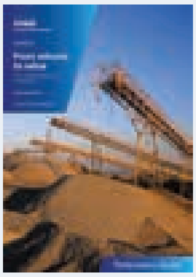
This publication considers the issues facing mining companies across the mining project life cycle, especially those who wish to develop new mines or expand existing ones.

Compliance Series

Mining risk and assurance: A survival strategy

Faced with falling commodity demand and prices and a continued escalation of input costs, mining companies are experiencing declining margins. A series of major project failures has also put risk management under the microscope.

Based on interviews with several partners from KPMG member firms, this paper identifies eight key drivers of value – from strategy to sustainability and reputation to taxation – and examines the risks inherent in each of these areas. In order to survive and prosper, organizations should adopt a holistic, integrated risk and assurance strategy that enables them to become masters of risk, rather than victims.



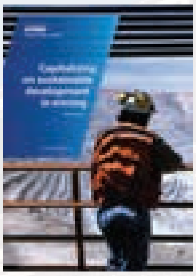
Performance Series

From volume to value: Cost optimization in the mining sector

This report looks at nine different levers that mining companies need to consider when implementing cost optimization programs to sustain profitability in today's more challenging economic environment.

KPMG's Mining Operational Excellence Framework

KPMG member firms have developed their own operational excellence framework following several years of association with leading mining companies. It starts off with an organization on a journey of efficiency and then, over time, embeds characteristics in its organization that makes the change sustainable over business cycles. This puts together all the capabilities necessary to assure the CEO of that 'operation' will be able to adapt to support their hunt for the next opportunity, whatever its nature.



Sustainability Series

Capitalizing on sustainability in mining

This publication examines how mining companies can leverage sustainable development to tackle resource constraints and sociopolitical challenges in remote areas in the world.

Commodity Insights Bulletins

A series of bulletins focusing on key mining commodities. Each bulletin is aimed to provide insight into trends and changes within commodity sectors. Our key mining commodities include: Gold, Copper, Diamond, Iron Ore, Metallurgical Coal, Nickel, Platinum, Thermal Coal, Uranium and Zinc.

INSIGHT: Population

This edition of Insight explores some of the biggest infrastructure challenges related to population growth. It also features a Special Report on Asia Pacific, a region at the center of the demographic shift now underway.

Infrastructure 100: World Cities Edition

Released at the World Cities Summit in Singapore, by KPMG's Global Infrastructure practice, the Infrastructure 100: World Cities Edition provides insight into the infrastructure projects that make great cities, with a particular focus on the innovations that make them 'Cities of the Future' – places where people want to live and do business.

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Designed by Evalueserve.

Publication name: Growth in a time of scarcity

Publication number: 120690

Publication date: May 2013