SE Exclusive

HD **China pays premium for top-quality mining assets**

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China's interest in high-quality overseas mining assets is certainly not diminishing, according to industry commentators, but the number of deals being done is a lot lower than in other countries due to the high premium the nation is paying for these assets.

China completed just seven deals in the second half of 2013, according to data compiled by SNL Metals & Mining; a far cry from the 81 deals done by Canada and the 52 done by Australia, but the total value of the collective acquisitions was US$1.78 billion, compared to US$1.50 billion for Canada and US$361 million for Australia.

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The largest deal in the second half of the year was China Molybdenum Co. Ltd.'s US$820 million acquisition of Rio Tinto's 80% stake in the Northparkes copper-gold mine in New South Wales, Australia. The transaction was China Molybdenum's first and largest acquisition outside of China.

Su Aik Lim, Fitch Ratings director of metals and mining north Asia, told SNL that Chinese interest in overseas assets is continuing. "I would say all Chinese companies are interested in buying overseas resources and I wouldn't say it has increased or decreased, I would say there's always an ongoing interest there," he said.

Ernst & Young Asia-Pacific IPO leader Ringo Choi told SNL that it is not just state-owned companies that are showing interest.

Choi said that with China being the largest manufacturing base in the world, the nation needs a lot of resources, and state-owned enterprises, as well as listed and private companies, are seeking high-quality assets. "I think every choice that is economically sound Chinese investors will be interested in," he said.

But sellers around the world appear to have formed the opinion that Chinese investors have deeper pockets than most, and are more willing to pay a higher price than other buyers.

"[They think] that Chinese companies are cash-rich and also have high rates of resources, so naturally they will ask for a higher price," Choi said.

"If they hear about some company from China that is interested in their asset, then naturally they will think that they have bigger pockets, and so that's why the price may be higher."

Another reason China may be paying more for M&A could be that companies, particularly state-owned enterprises, have greater access to financing than miners in other countries.

"What we understand is that Chinese companies, not only the state-owned enterprises but in general Chinese companies, when they have the opportunity to make overseas acquisitions in natural resources, the Chinese government does have a policy in place in terms of providing help to the companies," Lim said.

Ernst & Young's Choi said the central government provides funding to Chinese companies to promote investment in resources to maintain a constant supply of raw material.

He added that Chinese firms also do not have difficulty in sourcing debt funding from domestic or overseas banks as they are viewed as "cash-rich" and China seen as a growing economy.

Need for greater iron ore investment

According to Fitch Ratings' Lim, China is typically short of copper and iron ore. The country's National Development and Reform Commission is calling on Chinese firms to raise investment in the overseas iron ore sector to improve the balance between iron ore and steel prices, The Sydney Morning Herald reported Jan. 27.

China, which imported 819 million tonnes of iron ore in 2013 — 10.2% more than it imported in 2012 — believes that large foreign miners such as Rio Tinto, BHP Billiton and Vale SA are using their position to drive up prices and reduce steel sector margins, the report said.

The NDRC wants an investment fund established to support local companies in the development of overseas mining projects and in building steel mills and other heavy industrial projects abroad to reduce domestic iron ore use, the Herald reported.

China has been working to diversify its supply sources, particularly since 2009, when it became aware of Indonesia's plan to introduce a mineral export ban, which finally came into effect Jan. 12.

Industry watchers expect the ban to have a limited impact on China in the short term because the nation has accumulated between eight and 12 months' worth of stocks in nickel ores and bauxite.

In terms of alternative sources, it is expected that China will increase its imports from the Philippines as well as other Pacific Rim nations, to reduce the anticipated gap in its nickel supplies, and it will engage with countries such as Brazil, Papua New Guinea and Australia to help boost its bauxite supplies.

Lim said the countries that are likely to be the recipients of the Chinese buying interest will largely depend on the availability of assets. "I wouldn't say there would be any preference," he said.

"Anywhere — be it Canada, Australia, the African continent or the South American continent — there are still resources I would say they will still be sought after by Chinese companies, of course at a reasonable price."

Meanwhile, Ernst & Young's Choi said Australia, South America and Africa are all "hot" places for potential Chinese investment. "They mostly approach a country that has more resources and is suitable to meet the needs of China, and then they will put effort to promote interest in that area for investment," he said.

Partnerships another option for China

Chinese firms will not just consider the standard merger or acquisition to lay their hands on much-needed resources, but will also look for potential joint venture partnerships and off-take deals.

"I think in all natural resources investments the Chinese are open to exploring, be it a joint venture with an off-take arrangement or being the lead in managing those projects, either way I think Chinese parties are interested," Lim said. "Essentially it's still gaining direct access to resources."

Choi said that when Chinese firms head overseas, they often secure joint venture arrangements to manage their investment, but the question is how much of an investment they can make in that particular partnership due to government restrictions. "Sometimes they may face obstacles from the government worrying about the Chinese investors buying too many assets," he said.

China Moly reiterates interest in global assets

When SNL Financial spoke with China Molybdenum overseas CEO Kalidas Madhavpeddi in December 2013, he said the company is always looking for good assets around the world. "Given that we have a presence, with a very good operation and great workforce here, we obviously would look at Australia, but we also look around the world for good assets that we can buy," he said.

While China Molybdenum produces mainly molybdenum and tungsten, as well as some gold, the company is targeting an expansion in base metals, specialty metals and precious metals, with a particular interest in copper due to the favorable outlook for long-term supply and demand.

Fierce competition for the Northparkes mine did not deter China Molybdenum, which has a large amount of cash and very little debt. The company beat possibly between three and five other bidders for the asset.

CO chmoly : China Molybdenum Co Ltd

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