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## **Funding Brazilian Mining Projects:**

*A New Design in Foreign Investor's Perspective*

**By Eduardo Vale**

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# Funding Brazilian Mining Projects:

## *A New Design in Foreign Investor's Perspective*

By Eduardo Vale \*

### 1. ABSTRACT

After the South American gold rush had conspicuously crossed the Brazilian borders, the prominent presence of the junior mining companies brought about a crescent interest about the role fulfilled by the Canadian stock exchanges in funding prospects and projects. Instigated by few positive initiative taken before, some national mining companies have been seriously considering this alternative financial route within their funding strategies.

In this paper, however, we analyze a recent governmental decision taken by *Comissão de Valores Mobiliários - CVM* (Brazilian Security Exchange Commission), addressing the capital market, but focusing fundamentally its potential significance under the point of view of the foreign companies financial engineering. Additionally, we make some comments concerning the expected spill over effects to the Brazilian mining sector flow of funds deriving from the capital market.

### 2. INTRODUCTION

Traditionally, one of most critical constraints to the developing countries' process of economic growth has been the lack of capital committed with the long range. Not only in volume as well in terms of schedule of payments and cost conditions. Brazil is not an exception to this dogmatic remark. To the economic policy of the government, foreign capital, specially risk investments, has been considered for a long time to be a critical vector in granting a good profile to foreign trade accounts, in building up the level of international reserves and to complement the internal saving rate in order to support an aggregated gross rate of fixed investment in accordance with the achievement of a minimum established growth rate pattern<sup>1</sup>.

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Our financial market is considered modern and on a general sense keep up with the rules, services and products prevailing on prominent international centers, although presenting some singular aspects. Nonetheless, the effective role of the risk capital market has been constricted as a funding source not only in terms of aggregated investments needs as well as in its condition to effectively attracted an expressive amount of the private saving. In this respect, the omnipresence of monetary corrected investments alternatives, available until recently, have obstructed a faster path of development of this market.

In the last years, the Brazilian's capital market has been submitted to a continuous revision and upgrade in order to accompany to the global financial integration process. These modernization efforts are linked fundamentally to the influence emanated from aspects as such:

- the international pattern of an increasing importance attributable to the institutional investors as source of risk capital. This trend is already manifested domestically<sup>2</sup> and is going to grow up in importance. By 2000 the total assets in hands of the Brazilian pension funds is expected to amount to US\$ 350 billions in order of magnitude;
- the advanced privatization program, that brought about an appreciable dynamic to the market characterized by listing important ex state companies now operating under private rules and philosophy;
- the ever increasing importance of the international capital markets on funding Brazilian companies. This route initially available to larger companies only, have began to be explored by medium sized ones; and
- the continuous integration of the Brazilian's stocks exchanges with the international risk capital markets in general. On this respect we should mention the initiative that is been conducted under the Mercosur.

Restricting our comments to the capital markets, specially the stocks exchange segment, despite the unexplored potential and the high concentration on some few stocks<sup>3</sup> the *general rules and legal frame*<sup>4</sup> of the Brazilian market are quite in harmony with the prevailing regiments on most developed centers. On the other hand, on the context of nations inserted into the group of emergent

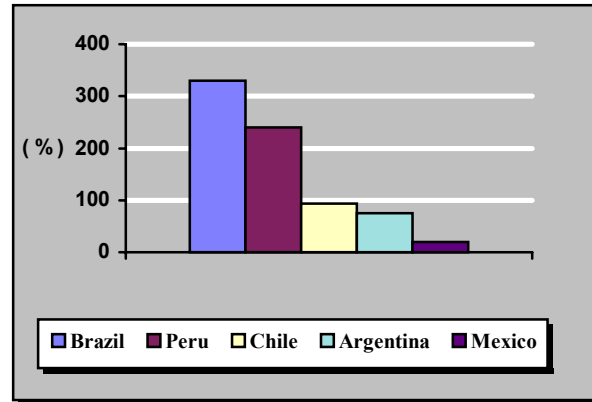
countries its capital market offers some of the most promising returns envisaged on a global scale.

In **Figure I** can be visualized the relative behavior of some Latin American stocks exchanges, during the period 1996/92.

**Figure I**  
Average Capitalization: 1996 / 92

## 2. MINING SECTOR

To the mining sector, however, suffering from a lack of attractiveness and tradition when focused by local investors as an alternative of investment, excepting some few and large companies, the path has been more difficult and the Brazilian experience in capitalize mining companies is elementary when compared with the Canadian one, for example.



On 3<sup>rd</sup> of July, 1991, the *CVM* launched what had been supposed to be a promising instrument to capitalize mining companies (*Instrução n° 149<sup>5</sup>*), but it had not succeed . Although not exclusively directed to mining companies, at that time some segments of the mining community were expecting a good impact on the mineral sector. In reality, beyond the above mentioned problems its development was obstructed by unfavorable macroeconomic and sectoral environment.

After 1994, with the crescent confidence emanated from the macroeconomics policy, and supported by a stabilized economy in process of consolidation, by the extinction of the monetary correction, by the expectancies to resume the historical growth rate by the end of the century, and ultimately, by the real perspective of reelection of the actual president the macroeconomics constraints were quite removed<sup>6</sup> . In parallel, on mining sector level, after the constitutional prohibitions to foreign capital have been eliminated, taking into account the already noticeable increase in exploration investments, and considering the expressive need of capital for funding exploration and exploitation projects in order to satisfy the derived demand of the economy all

these forces forge themselves to figure out *now* a new climate of investments in Brazilian *minebusiness*.

Its with this referential in mind that we should analyze a recent decision taken by *CVM* in direction of world integration.

### **3. INSTRUCTION N° 255**

The announcement of the *Instruction n° 255*, regulates the permission to issue and negotiate **Brazilian Depository Receipts - BDR** which are similar to the ADR - American Depository Receipts.

We have three alternatives to conduct a program of emission of BDRs.

On ***BDR class I***, the negotiation process is restricted to the electronic market and the information to be declared are the same requested by the security exchange commission in the country of origin. There is not a need to register the company in *CVM*.

On ***BDR class II***, we have the same conditions of BDR I, but its permitted to negotiate in stocks exchanges.

On ***BDR class III***, is permitted go public, but the company must be registered in *CVM*.

**On summary, this new mechanism offers to national investors the possibility to acquire - internally - and include in their portfolios the stocks of foreign companies. From a foreign investors perspective they have the option to funding their Brazilian operations, for example, taking into account the design of structured emissions on our stocks exchanges.**

#### 4. CONCLUSIONS AND REMARKS

❖ From the point of view of the foreign mining companies coming to and/or operating in Brazil, they have an another alternative to funding their projects, beyond the emissions on VSE or TSE, for example. Taking into account the *differing aspects and conveniences concerning* the relationship between the listed *holding* company, from one side, *and* the capitalization of his *affiliate* operating in Brazil, from the other, this mechanism *will probably offer an another insight of strategic resolution*.

❖ Although the BDRs were launched having the development of the national capital market as the target, **our expectance is that this new instrument have the condition to provide a strong economic and financial leverage to the Brazilian mineral sector. On the medium to long term, if the adequate specific oriented sector rules and the self regulation conditions were enforced, unquestionably, the interface of the mining sector with the capital market will take off to levels comparable to North American and Australasia stocks exchanges, preserved the right proportion.**

We are sure that, in behalf of the interests' array of the Brazilian mineral sector, this instrument can set forth the conditions to launch the Brazilian mining industry to its proper dimension.

On this scenario, we can infer that a selected matrix of gold projects are probably going to start up and conduct the process, fulfilling a leadership stand and helping to consolidate the legal sector frame. Seasoned and capitalized international gold producers with a remarkable expansion path of growth and a outstanding record of indicators, certainly will not have difficulty to attract the needed capital to compose his financial engineering package committed with the exploration and/or development of good properties in Brazil.

Finally, we can envisage that this demonstration effect will induce a cultural impact leveraging all the mineral economics system and contributing to gradually structure and consolidate an expressive segment of specialized institutions and professionals. In these terms, been aware of the relative magnitude of the Brazilian stocks exchange movement when compared with similar Latin American entities it is ease to infer what the future is reserving to.

## NOTES

1. For 1996, the available estimates to this rate point to about 17% of the PIB. To resume the historical growth pattern of the PIB, around 7% per year, the gross rate of fixed investments should be at least 25%.
2. Fundamentally during the privatization process and in the acquisition of some large companies as Parapanema Group.
3. In its majority issued from state companies.
4. Not in terms of the mining sector.
5. This disposition had created a sectorial fund of investments on stocks.
6. The recent disfunction in foreign trade accounts and the polemic that stabilizes thereafter are not going to be evaluated. In fact, as a comment, considering the measures already taken by the government to incentive the exports sector, the other instruments that can be mobilized and the expected rate of growth on international trade we are quite optimistic. Only by incompetence or omission Brazil is going to face a crisis on external front.