

# BRAZIL mineral

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MINING IN BRAZIL

Moving UP





## Mining takes the Bovespa road to growth

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In recent years the global economic scene raised further challenges to the funding equation of mining companies, especially junior companies' exploration investments. Up till 2008, the flow of funds was robust, reflecting favorable expectations about Asian demand and future price trends for minerals. It was a time of super-cycle economic moods. According to the international consulting company Metals Economic Group, from a record amount of US\$ 13 billion in 2008, global exploration investment had fallen to US\$ 7 billion in 2009. It was the sharpest decline in twenty years.

Well before the international crisis, several companies were already listed on more than one stock exchange. These companies were in search of additional funds by means of double or even triple stock exchange listings. Examples can be found combining, for example, listings on the:

Stock Exchange and the Alternative Investment Market (AIM); the Johannesburg Stock Exchange (JSE); the Toronto Stock Exchange (TSX) and the Australian Securities Exchange (ASX); AIM plus JSE plus ASX; JSE plus ASX; and the Lima Stock Exchange (BVL). With global shrinkage in the willingness to invest in exploration projects, this strategy was reinforced by several companies.

Leaving aside international centers of reference for funding junior companies such as and AIM, the strategic purpose is to raise additional risk venture capital, available mainly at regional stock exchanges: ASX, JSE, Bovespa, BVL, Hong Kong, etc. Now that the emerging economies are becoming global players, these exchanges are magnets for risk capital generated by regional growth. Currently, they are located on the frontier of expansion of the

global economy and in their area of influence there is an ever increasing stock of risk capital. Part of this capital is locked and blocked within national boundaries under different constraints: regulatory, transaction costs, available technology, etc. Several changes are being observed at the moment:

- the removal of constraints and barriers for the flow of funds;
- integration and consolidation between stock exchanges; and
- adoption of common international standards and procedures.

A specific company will seek to select stock markets that address specific issues. Leaving aside concerns about cost and level of disclosure, most of the time the issues are related to the exchange's place of origin, the affluence and dynamics of its growth path, as well as the re-



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gions where properties and investors are located. Companies with portfolios in eastern Europe usually focus on niches of potential risk venture capital investors located in that region. The same can be said when they are going to invest under an international jurisdiction such as the United Kingdom (the London Stock Exchange and the AIM). For example, the AIM is known for attracting companies with exploration prospects in Africa. On the other hand, the JSE has been trying to attract Australian and Canadian companies with properties in Africa for listing on the JSE, on the strength of its role as a liquidity enhancer. About 65 companies are now dual-listed on the JSE.

Although the controversy over the relative power of emerging economies to decouple or not has now been dropped from the agenda, unquestionably these economies succeed in supporting a limited but decisive decoupling from the industrialized economies that has partially compensated for the global economic decline arising from the economic setbacks of the United States, Europe and Japan. Although the return of part of this capital — whether speculative or risk-averse — in an economic recovery scenario seems inevitable, it will be very limited in the mid-term (three to five years) when considering the current climate of investment in developed countries. At the same time, the flow of funds from abroad towards the regional exchanges located in emerging countries is being observed. This reflects the movement of large amounts of capital from developed to emerging countries. For 2010, the stock markets in the main emerging countries are expected to offer higher returns than those in industrialized markets. Although operating at different levels of risk perception, Hong Kong (Hang Seng index), South Korea (Kospi index), Russia (RTS index), and India (BSE Sensex), as well as Bovespa, Lima (BVL) and Santiago (BCS) in Latin America, are all expected to deliver very high returns.

In the case of mining companies in particular, two further points should be taken into consideration:

- the increasing importance of Hong Kong as a center for attracting risk capital. This role has been perceived not only by Asian mining companies, such as those in China and Mon-

golia, but also by Vale with its recent decision to opt for a secondary listing of its common shares and Class A preferred shares in the form of Hong Kong depositary receipts (HDRs) on The Stock Exchange of Hong Kong Limited (HKEx) by way of introduction, without any fund raising; and

- the manifest interest of the ASX and the Singapore stock exchange to merge. By the end of October, the market capitalization of this new entity was more than US\$ 12 billion. The deal will create the world's fifth-largest listed exchange group with over 2,700 listed companies from over 20 countries.



## Latin American spin-off effects

Despite the acute contraction in global exploration, Latin American investments fell less steeply. By the end of 2009, Latin America had increased its share to above 26 per cent of global investments (MEG), the highest level since 2001. In recent years the region has become the most popular exploration destination. Since 1994, it has received around one-quarter of accumulated global exploration investments. In 2009, five countries concentrated 82 per cent of the investments in the region: Peru, Chile, Mexico, Brazil and Argentina. Looking at the medium term, the emergence of Colombia as an important regional destination is remarkable. In terms of flow of funds, the region has much to offer in real primary assets: new and highly favorable exploration sites and prospects.

At the capital markets level, the integration of the stock exchanges of Lima (BVL), Colombia (BVC) and Santiago (BCS) will create the largest

regional market in terms of listed companies (560) and the second largest (behind Bovespa) in market capitalization. The exchanges will maintain their operational and legal independence. At the end of September, this "new" market had a capitalization of around US\$ 600 billion, compared with Bovespa's US\$ 1.4 trillion and Mexico's US\$ 440 billion.

From the point of view of mining companies, the most advanced of the three exchanges is the BVL. No surprise there. This leadership reflects the importance of mining in the Peruvian economy—public opinion recognizes the standing of "Peru Minero". Peru was successful in implementing a legal framework embracing a partnership between the BVL, the government and the private sector. The mining industry accounts for about 55 per cent of the BVL's market capitalization. Along with dozens of Peruvian mining companies, there are a number of Canadian juniors listed on the BVL, such as Alturas Minerals, Andean American Mining, Bear Creek, Fortuna Silver, Inca Pacific, Panoro, Plexmar Resources, Vena Resources, Candente Resources, Norsemont Mining, Apoquindo Minerals, Rio Alto Mining, and Zincore Metals.

This move toward dual listing will probably increase and gain momentum with the consolidation of the integration between the BVL, the BVC and the BCS. This new operating mechanism will generate trans-border benefits for all the players. Chile and Colombia can use the Peruvian experience as a model. It is remarkable that in relation to issues such as resources and reserves classification, compliance with international standards, implications for capital market transactions and reciprocity of professional practice, Peru and Chile are very well positioned when compared with Argentina and Brazil, among other jurisdictions.

In Chile, the government is discussing a legal framework to grant incentives and set regulations for trading in mining stocks. Currently, only three mining companies are listed on the BCS. In any case, an important constraint (opportunity cost) to Santiago arises from the long-term funding for the expansion of Codelco in connection with a stock exchange flotation.

## The Bovespa road to growth

Following the merger of Bovespa with the São Paulo Commodities and Futures Exchange



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(BM&F), Bovespa itself has been the subject of an ongoing review and upgrade of its processes, systems and hardware, in order to keep up with the global financial integration. At government level, the Comissão de Valores Mobiliários (CVM), the national securities commission, is reinforcing the legal framework and the exercise of its regulatory powers by tackling issues of concern such as insider dealing, hostile takeover bids, minority rights, disclosure and poison pills. Several of these specific aspects are now at the public hearing stage, with due attention being paid to the importance of the following factors:

- the presence of two major global companies listed on Bovespa: Petrobras and Vale;
- Brazil's investment grade status;
- the increasing importance of international capital markets for funding Brazilian companies;
- the importance of FDI flow for the Brazilian economy, especially institutional investors as a source of risk capital. Sovereign Wealth Funds, in particular, offer prospects for substantial growth. For many of these players, the Asians in particular, Brazil is one of the top priorities; and
- an increasing flow of investments abroad as the result of the international expansion strategy followed by an ever-growing number of Brazilian companies.

Currently, important mining companies are listed on Bovespa, such as, for example, Ferbasa, Vale, Magnesita, Paranapanema, MMX, CSN and Usiminas. Two of the most significant strategic movements expected to occur in the short to medium term are:

- IPO of Vale Fertilizantes in the first half of 2011. The company will consolidate the fertilizer-related assets of Vale in Brazil and abroad. The IPO is associated with an investment program estimated at US\$ 12 billion by 2014; and

- CSN's strategic plan to spin off its mining assets (the Casa de Pedra mine among others) in the form of a specifically mining company, which is to go public and be listed as a consolidated mining company under its control. In the 2008-2009 period, the initiative was postponed in view of the international crisis. Given the current circumstances of the iron ore market, it may now go ahead before the end of 2011. The transaction is expected to exceed US\$ 20 billion, depending on the financial design of the deal.

For transactions of this magnitude, Bovespa has demonstrated its capacity to fulfill the expectation of major players. Traditionally, when seeking to raise capital through Bovespa, these companies have conducted operations at

higher levels of aggregation. In this situation, the communication interface with the investor is somewhat diffuse, since the operation is associated with the portfolio of projects and investment program of the company as a whole, rather than with a specific project. It is typical of an emerging market that has not yet gained exposure to operations addressing project and company (non-operational) concepts. In Brazil, this situation is relatively new, but it is evolving and attracting market attention. A good example of this is the road to growth as well as the dynamics of transactions of companies such as MMX, LLX and OGX. Thus Bovespa has succeeded in mobilizing the funds needed to meet the market demand for risk venture capital in this area of the market.

Finally, in terms of the market conditions needed to promote the allocation of risk venture capital to a mineral exploration company, there is a long way still to go. In the mining sector, as usual, the process has been carried out by oil exploration companies. The continuous solution of the valuation equation of companies such as OGX and HRT has been of great value to the market in terms of consolidating concepts and procedures. Even the controversial megacapitalization of Petrobras has left an important legacy, raising an open discussion of questions associated with the adoption of best practices, international standards, certifications and classifications, risks, and so on. Unquestionably, the trajectory of oil exploration companies listed on Bovespa will become a benchmark for mineral exploration companies. The increase in the number of oil companies seeking a stock exchange listing reflects the huge amount of investments projected for the years to come, especially with the incorporation of pre-salt exploration oil fields.

Taking into account the size and diversity of market capitalization, flow of funds, partnerships in place or forthcoming, and the interfaces with the rest of the world, for some mining companies Bovespa may already represent an alternative for a dual listing. It should be noted that among emerging countries Bovespa offers some of the most expressive returns expected on a global scale (83 per cent in 2009). Bovespa's trading volume now amounts to about 82 per cent of the whole of Latin America.

Looking beyond the partnerships now being developed with NASDAQ, OMX and the Chicago Mercantile Exchange (CME), Bovespa is seeking to enhance integration with other exchanges. In South America, it is in negotiation with Santiago

(the BCS) and has made contact with the BVL and with Colombia for the same purpose. Common to all such agreements is the integration of platforms. In the long run, it aims at enabling trading in all stocks of all the companies listed on both exchanges.

Lastly, it is important to note the beginning of trading in BDRs — Brazilian Depositary Receipts Level I (not sponsored) deserves to be registered. Like ADRs, these are receipts for stocks of selected companies. The first group of companies includes Apple Inc., Arcelor Mittal, Avon Products, Bank of America, Exxon Mobil, Goldman Sachs, Google Inc., McDonald's, Pfizer Inc. and WalMart Inc. The operation was conducted by Deutsche Bank. Under the leadership of Citibank, the approval of another group of companies is in the pipeline: Cisco, Alcoa, Citigroup, Wells Fargo, Freeport-McMoran Copper & Gold, Intel, Microsoft, Merck and Procter & Gamble. These BDRs represent another important option for investors interested in accessing international companies, while benefiting from local transaction costs and conveniences.

Bovespa is well positioned to offer a significant contribution as a channel for risk venture capital into the mining industry — exploration, mining and transformation — especially in South America. In this sense, the integration with the exchanges of Chile, Peru and Colombia is of the greatest interest. The real challenge to Bovespa will be to navigate in the Brazilian mining sector without proper institutional and legal guidance: resources and reserves classification, professional certifications, etc. In this area, Brazil is lagging behind Peru and Chile. This institutional issue is pushing Bovespa to achieve its full potential. The solution will depend on public and private Brazilian mining institutions coming together to do their homework. In the long run, the bridge to Africa will probably be leveraged by synergies still to be explored with the JSE and by the array of investment opportunities in countries such as Angola, Mozambique and Namibia. □

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