Ways To Play A Financing Drought For Resource Companies

Description

These are not the best of times for resource companies in Canada, or around the world. Flat commodity prices, inflated operating costs and perhaps worst of all, the river of life for some, new money, has slowed to a trickle.

This doesn't mean all resource oriented companies are struggling. In fact, it is just this type of environment in which some industry participants thrive. The following are two types of participants that stand to benefit over the long-term from the current environment.

1. Mid Tier Producers With Strong Balance Sheets

This is a time for mid-tier miners with strong balance sheets to make their mark and set their company up for long-term growth by acquiring assets on the cheap. **HudBay Minerals (TSX:HBM)** is one company that is ready to pounce as the CEO was recently quoted as saying that "it's a buyer market for mining projects". Smaller companies are struggling to raise funds to build out their project pipeline and larger companies can't afford the mines they have and are considering sales. HudBay would be willing to make an acquisition(s) that amounted to 20% of its $1.97 billion market cap to help bolster its portfolio.

Another Canadian player with its ear planted firmly to the ground for deals is **Lundin Mining (TSX:LUN)**. Lundin has its eyes on Eastern Europe for copper acquisitions and could afford a deal in the $700 million range.

If the Inmet/First Quantum deal goes through, just two independent mid-tier copper miners will be left in Canada, HudBay and Lundin. Both sound ready to make their mark in the current environment.

2. Royalty Companies

When banks won't lend and the equity market says "no thanks", for those companies who don't want to sell out, there is always the royalty angle. The royalty model is beautifully simple. In exchange for a percentage of ongoing revenues, royalty companies will give an upfront cash infusion. Because they are skimming from the top, royalty co's are not exposed to the inflated operating costs that have so plagued the mining industry.

Two of the best known royalty companies in the mining space are **Franco-Nevada (TSX:FNV)** and **Royal Gold (NASDAQ:RGLD)**.

Another company that is equally well-known but operates under a slightly different model is **Silver Wheaton (TSX:SLW)**. SLW is a “streaming” company that focuses on silver (go figure) and to a lesser extent, gold. In exchange for an upfront payment, Silver Wheaton gains the right to buy all, or a part, of a specific mine’s silver and/or gold production at a low, pre-determined, fixed cost. Their target is mining companies who treat silver and gold as by-products of their primary mining operations.

Silver Wheaton was in the news on Wednesday as it has acquired a gold stream from mining giant **Vale SA (NYSE:VALE)**. In exchange for $1.9 billion and 10 million 10 year warrants, SLW has acquired the rights to buy 25% of the gold produced at a Brazilian mine that Vale owns and 75% of the gold from a Vale mine in Sudbury. Silver Wheaton will buy the gold from these mines at a price no higher than $400/oz. If the price of gold increases, this deal will work out very nicely for Silver Wheaton. Vale needed cash – Silver Wheaton was there to help.

Bonus

An honourable inclusion to this list is a company by the name of **Sprott Resource Lending Corp. (TSX:SIL)**. Like the royalty co’s and SLW, Sprott will be there with open arms if the more traditional debt/equity financing routes are not.

Unlike the royalty co’s, SIL is a more traditional lender. Rather than taking some percentage of production, they structure their deals as a senior/secured debt issue and give themselves upside participation by taking on shares, warrants, or commodity exposure. The duration of the loans averages 18-20 months and a cash yield of 9-13% plus annualized bonus of 5-8% is targeted.

The company focuses on the junior end of the spectrum, is 39% owned by insiders, pays a yield of 4.1% and at a share price of $1.48, trades below its most recently reported (Sept. 30, 2012) book value of $1.60.

The Foolish Bottom Line

Even though the producers and prospective producers of materials are having a tough time of it, it doesn’t mean there aren’t other ways to play in the resource space. Though valuations are wide ranging across the group, the companies mentioned are well positioned with the most important resource of them all, access to cash.

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Fool contributor Iain Butler does not own shares in any of the companies mentioned in this report at this time. The Motley Fool has no positions in the stocks mentioned above.

CATEGORY

1. Investing

TICKERS GLOBAL

1. TSX:HBM (Hudbay Minerals Inc.)
2. TSX:SIL (SilverCrest Metals)
3. TSX:WPM (Wheaton Precious Metals Corp.)

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Date
2025/07/01
Date Created
2013/02/07
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