Enabling the environment for Juniors

(Johannesburg 21 May 2015) Attracting international investor interest, or indeed any investor interest, is one of the key questions delegates will be seeking answers to at the 2015 Junior Indaba taking place from 3-4 June in Johannesburg.

The junior mining sector is plagued by insurmountable challenges. Exploration is notoriously risky, yet it is the first vital step to realising any mining rights.

Ensuring the project is good enough to build a sustainable relationship between the investor and the investee company, the owner of the rights, is essential.

"Risk sharing is key and fundamental for maintaining such a relationship. Owners must contribute in sweat equity and a percentage of license ownership, if they are cash strapped to ensure commitment", states Alugumi Dzebu, Senior Investment Manager, Partnership Funds, at Anglo American.

Early stage exploration is risky and requires a patient investor, one of the reasons why owners need to be involved in the day-to-day management of the business, on a permanent basis, as the owner invariably is handing over his company to the investor as a reward for investment.

"To achieve a real return on investment, a value adding investor establishes a longer, lasting relationship with the investee company, and will ensure that the company succeeds in achieving its goals, concludes Dzebu.

Deals are often structured such that the owner's equity is transferred in tranches to the junior mining company, as cash or equity is invested by means of exploration work or study completed by the investor, commonly known as an 'earn-in'.

Equity markets for junior explorers continue to be tight, primarily driven by investor uncertainty regarding short and medium term minerals demand given the slow-down on the demand side.

"Reduced exploration activity will inevitably exacerbate a future supply crunch, with key metals, such as aluminum, zinc, lead, copper and nickel, expected to go into deficit already in the coming few year" says Sacha Backes Senior Investment Officer, Mining Investment Division – Africa International Finance Corporation, “continued efforts to discover and progress new projects are thus important and junior companies have in the past and will continue to play a critical role in this”.

Despite equity being scarce, it does continue to be available for projects with demonstrated technical merit, and companies with strong technical and management teams. “Management teams need to weigh the benefits of raising equity at current low prices, ideally from existing shareholders, and adding value to projects, versus doing nothing or leveraging projects prematurely at high risk and potentially to the detriment of shareholders” concludes Backes.

Investors need to understand that exploration takes a long arduous path, on average 10 years, and funding is paramount in all phases during this time.

Where would mining be without junior minors and exploration? *Australia Mining* covered a great news story recently on an Australian based nickel and copper miner Sirius Resources who were down to their last drilling exercises funding would allow, when they managed to hit a large nickel seam. Subsequently their shares rose 4500 per cent in two months from .6 cents in July to peak at $3 a share, valuing the company at more than $600 million. This is what the game of exploration is all about, the risk and the reward. Both investors and junior minors are hungry to discover more investment opportunities, new funding strategies, and to jointly find solutions to the challenges in this risk and reward game of exploration. The Junior Indaba has heeded this call bringing together funders and junior mining projects in Johannesburg at the beginning of June.

Whilst seeking finance may be a challenge, the junior sector also faces a rather challenging outlook in terms of the current tax legislation.

The bottom line is that there is no clear distinction between junior mining, exploration, prospecting and mining proper when it comes to South Africa’s tax legislation.

“Where a pure prospector has no “mining income” as it is still in a prospecting phase, but it has incurred prospecting expenditure, tax deductions for the prospecting costs may be may be lost even though the prospector may have other non-mining income on which it may end up paying tax. This anomaly seldom arises in major miners since inevitably they will have some form of “mining income” to offset the prospecting expenditure. This treatment actually weighs against the junior miner and junior prospector,” mentions Muhammad Saloojee, Director and Head of Corporate Tax at KPMG.

There is a glimmer of relief to help juniors in the form of venture capital incentives, but to qualify the expenditure threshold currently sits at R50 million.

To tax or not to tax, this is the question.

To gain tax incentives, how would legislation define a mining company that wishes to explore a brown field site, a site next to its current operations, or a green field, new, site?

If an exploration company applies for an exploration license which includes “bulk sampling”, which often occurs in coal mining, then is the exploration company not crossing the line to be a mining company? Current legislation applies no clear distinction.

“We have an enabling environment for juniors and prospecting, and there are some learning curves out there already in Australia and Canada, states Saloojee, “but we have seen no real major benefit so far to stimulate this sector”.

Saloojee and others will be unpacking the good learning curves, exploring solutions to the current fiscal and tax regimes, to cutting the red tape existing in the current form of the MRPDA at the 2015 Junior Indaba 3-4 June in Johannesburg.