Stream financing: A primer

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Stream financing, also known as resource streaming or metal purchase agreements, is becoming increasingly popular in the resources sector. Stream financing can be used to help bring a development stage project into production or to expand existing production capacity of an operating mine. It provides an alternative way of raising capital for a project at a time when market conditions make equity financings very dilutive and debt financing difficult and expensive to obtain. Stream financing can be in respect of either primary or secondary products and can be used for either precious or base metals. In this post, we will provide an overview of how stream financing is used in the resource sector, as well as its benefits and a short case study of a recent streaming agreement.

What is Stream Financing?

In a typical metals stream financing, a streaming company makes an upfront payment to a resource company in return for the right to purchase a fixed percentage of future production of one or more metals produced by a project, and makes on-going payments for each unit of metal delivered under the streaming agreement. Streaming transactions are generally long term in nature and are often for the life-of-mine.

The upfront payment may be payable in one payment at closing but, for projects in the development stage, is often advanced in stages as the resource company reaches certain construction milestones. While some streaming arrangements require the upfront payment to be used for specific purposes, others permit the resource company to use the funds as it sees fit. Still others provide for payment on closing but require partial repayment if certain milestones are not met.

The upfront payment is typically now structured as a deposit which is reduced as metal is delivered and, if structured correctly, the deposit may be characterized as deferred revenue rather than debt for accounting purposes, which certain issuers may find favourable.

In addition to the upfront payment, the streaming company also makes an additional payment, on delivery, for each unit of metal purchased under a streaming agreement. These on-going payments to the resource company, together with the obligation to return any uncredited deposit at the end of the term, help align the interests of the streaming company and the resource company and can provide incentive for the resource company to continue producing even though it has disposed of an interest in the streamed metal.

In a standard streaming arrangement, the on-going payments are equal to the lesser of a fixed price and the prevailing market price at the time of delivery. The streaming company will pay up to the fixed price in cash and, if the market price is higher than the fixed price, the balance is credited against the deposit.

Thus, when the market price of the metal is higher than the fixed price, the upfront payment (or deposit) is amortized through the difference between the fixed price and the market price. When the market price for the metal is low, the upfront payment will be reduced more slowly and may never be reduced to nil. If the upfront payment has not been reduced to nil by the end of the term of the agreement, the resource company may be required to pay an amount equal to the remaining balance to the streaming company.

Streaming arrangements may provide for a buy-back option which provides the resource company with some protection in the event that there is a shortfall in production. A typical buy-back option would permit the resource company to buy-back a percentage of the production promised to the streaming company for a fixed price, usually in the form of a refund of a portion of the upfront payment, if the project does not achieve a target level of production. This option is usually only exercisable once and in very specific circumstances.

Some streaming arrangements also contemplate “top-up” deliveries in the event that anticipated future expansion is delayed. Where the resource company is required to deliver a fixed percentage of production to the streaming company, top-up deliveries are intended to compensate the streaming company in circumstances where expanded future production is promised but delayed. Top-up provisions provide for an adjustment mechanism to “top-up” or increase the amount of metals deliverable in the event that the resource company does not achieve a targeted level of production on or before a specified date.

The obligations of the resource company under a streaming agreement may be unsecured or secured, usually against the project assets or the securities of the project vehicle.

Benefits

Stream financing allows resource companies to capitalize on proven reserves before going into production, and to use those reserves to fund production or expansion. Streaming is typically done on a project by project basis and can allow the resource issuer to bring new projects into production more quickly than having to seek other sources of funding in difficult market conditions. It can be an attractive source of funding as it is non-dilutive to shareholders, allows the company to retain its borrowing capacity and the terms are typically less restrictive than debt financing.

A streaming transaction may also be seen by the market as an endorsement of the project’s potential by a third party finance provider, leading to increased investor confidence and higher share prices.

Where streaming arrangements involve a secondary products (or by-product) stream, that is, for the purchase of a precious metals stream from a base metals project, the stream can create shareholder value for the mining company as the net present value of its future precious metal production would typically be given a lower valuation by the market than if it had been produced by a precious metals company, resulting in a value arbitrage opportunity. That is, a streaming transaction allows a base metal company that trades at a lower net asset value (NAV) multiple to obtain the higher NAV multiple of a precious metals producer for the precious metals portion of its resource. Such secondary streaming arrangements can allow the mining company to maximize upfront proceeds while only impacting byproduct production.

Streaming arrangements allow the streaming company to benefit from exposure to resources without having to contribute to the operating or capital costs of the project after the initial payment is made and avoid many of the risk often faced by operators (for example, rising labour and fuel costs, environmental liabilities). Financing companies typically hold streams in respect of projects in production and development stages, in a variety of geographical locations and, often, in respect of multiple commodities, allowing them to diversify, so that the failure of one project may not have a significant impact on a streaming company’s overall portfolio.

The benefit of any additional resources beyond the proven reserves established by the feasibility study at the time the streaming transaction is entered into is shared by the resource company and the streaming company, as the resource company typically retains a portion of the streamed metal.

Streaming Companies

Although streaming transactions have recently been increasing in popularity, streaming has been an accepted form of financing for some years. As a result, there are a number of established stream financing companies including Franco-Nevada Corporation, Silver Wheaton Corp., Sandstorm Gold Ltd., and Royal Gold, Inc.

Case Study – Inmet/Franco-Nevada

In August 2012, Inmet Mining Corporation (Inmet) and Franco-Nevada Corporation (Franco-Nevada) announced what was then the largest streaming transaction to date, a $1 billion previous metals stream financing for the Cobre Panama copper project in Panama. The Cobre Panama project is owned by Minera Panama, S.A. (MPSA). Inmet owns 80% of MPSA, and the remaining 20% is owned by Korea Panama Mining Corporation (KPMC). KPMC is not participating in the stream.

Under the terms of the transaction, Franco-Nevada agreed to provide a $1 billion deposit to fund Inmet's share of the development costs of the project. In return, Franco-Nevada is entitled to receive 86% of the payable gold and silver attributable to Inmet's 80% interest in the project based on the project's 31 year mine plan.

Under the streaming agreement, until the deposit has been reduced to nil, Franco-Nevada will pay a price per ounce equal to the then prevailing market price. Of this, an amount equal to the fixed price is payable in cash and, if the then prevailing market price per ounce of gold or silver is greater than fixed price, an amount equal to the difference will be credited against the deposit. Once the deposit has been reduced to nil, Franco-Nevada will pay the lesser of the fixed price and the then prevailing market price. The fixed price is equal to $400 per ounce for gold and $6 per ounce for silver (subject to an annual adjustment for inflation) for the first 1,341,000 ounces of gold and 21,510,000 ounces of silver (approximately the first 20 years of expected deliveries) and thereafter the greater of $400 per ounce for gold and $6 per ounce for silver (subject to an adjustment for inflation) and one half of the then prevailing market price.

The Inmet/Franco-Nevada streaming agreement also provides for a buy-back option under which, if there is a shortfall in precious metals production, MPSA will have the option to reduce the stream by repaying up to 10% of the $1 billion deposit, net of the value of any metals delivered to Franco-Nevada under the streaming arrangements prior to the date of exercise of the option. This option is exercisable only once at either the 3rd or 5th anniversary of production commencing. There is also a top-up option in the event that a certain level of production is not achieved within the expected timeframe.

Conclusion

2012 featured a number of large streaming transactions, including Franco-Nevada's US$1 billion precious metals streaming arrangement on Inmet 's Cobre Panama copper project (discussed above) and Hudbay Mineral Inc.'s US$750 million precious metals stream transaction with Silver Wheaton in relation to Hudbay's 777 copper, zinc, gold and silver mine and Constancia copper project. We expect that demand for these non-traditional funding arrangements will continue in 2013.

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