RAYFIELD ASSOCIATES

MINING IN NIGERIA: FINANCING ALTERNATIVES

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SECTION I: INTRODUCTION

Mining in Nigeria: An Overview

Nigeria is blessed with a vast amount of mineral resources, which is predominantly present in all the states of the federation. As a result, mining is done in all the states of the federation. The vast amount of mineral resources existing in Nigeria largely contributes to her recognition in the international community as the giant of Africa. Whilst this reputation is mostly attributable to the size or her ever increasing population, (reported to be over 180 million as of Year 2015, and a projected population of over 440 million by the Year 2050)[1] it can safely be stated that a reference to her prowess in Africa is not only as regards a population boom, but also the many natural resources embedded within her territory.

Asides the more popular natural resource of oil and gas, Nigeria is also famous for her over 34 different categories of solid mineral deposits with gold, bitumen, coal, tantalite, zinc, lead, and iron ore deposits being some of them.

Economically, these natural deposits have not only sustained and developed the nation considerably but have also contributed largely to attracting the much desired foreign direct investments.

Whilst the Federal Government has a first-hand control and ownership of these solid minerals as promulgated under the Nigerian Minerals and Mining Act LFN 2004[2], it gives a free hand to eligible individuals, co-operatives or corporations to engage directly in the unearthing of these solid minerals[3]. As such, Individuals, Corporations, and Small-and-Medium-sized Enterprises (SMEs) all play a significant role in the solid mineral industry, not only as key generators of employment and income, but also as drivers of innovation and economic growth; and contributors to the nation's gross domestic product (GDP).

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[1]United Nations Population Fund, World Population Prospects: the 2012 Revision

2The dominant mining legislation in Nigeria is the Nigerian Minerals and Mining Act 2007. The Act vests all ownership and control of mineral resources in the State. Persons permitted to practice within the industry include qualified individuals, a body corporate; or a mining co-operative.

3 As mining titles under Section 46

At present, the key players in the solid mineral industry in Nigeria include small scale miners comprising Artisanal and Small Scale Miners ("ASMs") and Junior Mining Companies ("JMCs").

The ASMs represents individual, group, family or cooperative miners with minimal or no mechanization for the activity they carry out. Nigerian mining law recognises these artisanal miners and makes provisions for them to: possess a mining title; comply with environmental legislation in carrying out their mining activities; pay taxes and royalties; and legally export products. In addition, ASMs have been encouraged to operate as registered entities by registering its presence with the mining authority or other fiscal authorities.

JMCs, on the other hand, are as aforementioned, small and medium scale enterprises involved in mining activities in Nigeria.

The ASMs and JMCs form the universe of small scale miners currently subsisting within the exploratory mining stage in Nigeria at present. It is fitting to note that there are no large mining companies save for the large scale operators in the cement manufacturers and construction companies, whose primary activity is not mining, but to operate in the industry mainly for the purpose of extracting raw materials required for their businesses.

SECTION 2: FINANCING THE NIGERIAN MINING SECTOR

The Challenges and Potential Solutions

As with most sectors in Nigeria, small-scale miners are fraught with a number of challenges, the greatest arguably being financing. In particular, financing is a challenge peculiar to the mining industry as a result of the nature of their operations. The industry is characterised by: the long time frame necessary for developing mineral resources; the difficulty of evaluating reserves available for development; the lack of accounting principles for valuing those reserves once estimated; the lack of free transferability of mining properties and the inability of most miners to provide sufficient collateral. These factors put the small-scale miners in a precarious position, as most commercial banks find them too risky to fund.

In addition, development process of a small-scale mining venture takes longer than most bankers would like to wait for the repayment of their loans. Coupled with the banks inability to put a value on their security for a loan, to have it periodically audited, or to sell it if the loan goes into default are some of the reasons why banks and other lenders are reluctant to finance mining operations.

The difficulty in obtaining finance is further compounded by the fact that most Nigerian miners lack proper corporate structures, particularly in the case of ASMs, and where corporate structures exist, they suffer from poor internal operations management, which creates lack of trust in the credibility of the management of the corporate structure and the ability of the miners to repay funds borrowed.

Corporate Structure

The prime position for a mining venture to be, when seeking for proper financing, is within an adequate corporate structure, registered and validly existing as a going concern in its place of operations. As simple as it sounds, the first thing an investor or financer will look for in an application for a loan or some type of funding is permanence and nothing represents permanence greater than a registered limited liability company.

In Nigeria today under the Companies and Allied Matters Act[4] ("CAMA"), ASMs may be incorporated as limited liability companies which could either be private or public[5].

It is without a doubt that the adoption of a sound corporate structure by Nigerian mining companies will inspire the confidence of local and international financiers thus making the mining sector an attractive investment opportunity.

Corporate Governance

The place of corporate governance as a tool for obtaining finance cannot be overemphasised. The Global Mining Finance Guide 2014 states that one of the biggest obstacles companies face in gaining the trust of institutional investors is the credibility of the management team[6]. Corporate Governance refers to the formally established guidelines that determine how a company manages its affairs or the manner in which the power of a company is exercised in the management of the company's asset and resources. Corporate Governance is the structure that defines the division of the powers within a company and establishes mechanism for achieving accountability among members of the board of directors and the management.

It is no longer sufficient for a company to merely be profitable; it also needs to demonstrate good corporate citizenship through environmental awareness, ethical behaviour and sound corporate governance practices. These practices will ensure the highest standards of transparency, accountability and good corporate governance, which will in turn enable such company maintain and increase its shareholders' value, attract investors and assure all stakeholders that their investments will be secured and efficiently managed.

Essentially, basic corporate governance practices include appointing independent directors to build a strong, qualified board of directors (Board); establishing clear lines of accountability among the Board, Chair, CEO, Executive Officers and management; ensuring that their directors not only declare conflicts of interest and refrain from voting on matters

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[4] Cap C 20 LFN 2004
[5] Section 21 CAMA
[6] Global Mining Finance Guide 2014 p. 29

in which they have an interest, but also develop a general culture of integrity in business dealing and of respect and compliance with laws and policies.

In Nigeria, there are certain rules binding on companies registered in Nigeria, which are directed at establishing the general notion of accountability by a corporation. Examples of such rules include the mandatory requirement of all companies registered in Nigeria to file audited financial statement and annual returns once every year,[7] and the adoption of corporate governance codes such as the Code of Corporate Governance for Public Companies 2013 issued by the Securities and Exchange Commission, and the Code of Corporate Governance for Banks and Discount Houses in Nigeria 2014 issued by the Central Bank of Nigeria, and the Operational Guidelines (Insurers and Reinsurers) issued by the National Insurance Commission. Other than these codes, Nigerian companies have also borrowed from corporate governance codes operative in other countries such as the United Kingdom Combined Code ("the UK combined Code"), the King Reports of South Africa, the US Sarbanes-Oxley Act 2002 etc. to augment their corporate governance practices.

Companies in the mining sector, like all other companies, must have in place proper corporate governance structures. Clearly the corporate governance requirements of the mining sector are not, on the face of it, different from other industries. As such Nigerian mining companies will do well to adopt any or a combination of the corporate governance codes highlighted in the preceding paragraphs.

As a final point, and to achieving direct positioning for financing, small scale miners should ensure that:

- their operations are carried out legally in harmony with the national mining sector development policies and existing legal framework; i.e. no illegal mining;
- their operations should comply with international social standards, such as social security, occupational health and safety, labour regulations etc.;
- operations should also be environmentally sound;
- there should be no conflict between small scale miners and local communities and no degradation of traditional values;

[7] Section 376 of the Companies and Allied Matter Act, Cap 20 LFN

- exploitation should concentrate on products with high recovery values and systematically develop these deposits;
- there should be continuous operations over a long period of time; and
- there should be harmony between small scale miners and large mining operations.

SECTION 3: FINANCING SOLUTIONS/MODELS

Having been clothed with the veil of incorporation and imbued with international best practices and corporate governance, the next step for small-scale mining companies is to pursue attainable financing[8].

To overcome financing challenges, miners in key mining states of world have adopted certain financing techniques tailored to provide financing solutions to small-scale miners. Some of these techniques include the following, each of which will be discussed in greater detail below:

- Using miners' own capital resources;
- Joint ventures;
- Equipment Financing
- Royalty Financing;
- Streaming Financing;
- Earn-In Agreements;
- Equity Capital
- Co-operative Financing

Using Own Capital Resources

Once the decision has been made to start a business, the logical next step is to raise capital for that business. As a serious business start-up, raising self-capital should be the first step i.e. first you should start to raise capital on your own.

Most entrepreneurs and small business owners these days have come to the realization that they will have to self-fund (also known as "boot-strapping") their projects for a significant amount of time until more formal funding opportunities become realistic. There are many ways to accomplish this, from savings accounts and zero interest credit cards to leveraging other personal assets. It is also possible to sell owned assets to raise capital, particularly those that can be done without. Self-funding, one of the benefits being that it encourages

[8] As discussed earlier, not all financing will be suitable to small mining companies

potential investors and make them more comfortable knowing the owners of the business have skin in the game.

Once own funds have been put in, next step will be to raise own capital through other means. This may be done by borrowing money from family and friends. It is easier to borrow money from family as most time family members will be interested in your project.

Joint Venture

Loosely defined, a joint venture is a combination of entities to achieve a common purpose. It is a flexible form of business enterprise that allows member companies to carry out an undertaking together for a particular commercial purpose. It involves two or more parties undertaking an economic activity, which is subject to joint control[9]. ASM's usually benefit from partnering with other corporate entities in a joint venture capacity in order to engage in a single undertaking for joint profit by combining their respective resources. This mode of financing is particularly useful where there is a single project that both entities are interested in. There must be a community of interests in the performance of a common purpose, a proprietary interest in the subject matter, a right to direct and govern policy in connection therewith, and a duty, which may be altered by agreement, to share in profit and losses[10].

Usually, where a small mining company has identified a mining project but has neither the financial or management capability to participate in the project alone, it can approach other mining companies (usually significantly larger than it) in order to combine their different components (financing being a major part of) to implement the project and make a profit.

Joint Ventures can take the form of either incorporated joint ventures or unincorporated joint ventures. Incorporated joint ventures, on one hand, typically involve the incorporation of a company under the relevant companies legislation wherein the parties are the shareholders. This creates a separate legal entity from the parties. Unincorporated joint ventures, on the other hand are, relatively speaking; the easiest to set up as they do not

[9] Joint control being the contractually agreed sharing of control over an economic activity
[10] Carrol v Caldwell 147 N.E.2d 69, 74

require the incorporation of a company, rather, the rights of the parties are wholly housed within the joint venture agreement as opposed to an incorporated company.

From a small mining company's perspective, the crux of a joint venture with an LMC may be to have access to funds that would otherwise be difficult to obtain[11]. Notwithstanding the prevalent structures, joint venture arrangements can also be birthed between ASMs and JMCs to develop the Nigerian Mining Sector.

It is fit to note that once a joint venture is formed and the alliance proves strong, this may attract the commercial lenders to extend finance towards the project and the newly formed joint venture.

Equipment Financing

It is a fact that small mining companies do not always have the adequate mechanisation/tools required for mining. This is usually because these tools cost a lot and as aforesaid, obtaining financing in the mining industry is an arduous task. However, a financial solution highly recommended for small mining companies is the use of equipment financing. Basically, the purpose of equipment financing is to make possible the acquisition by a business enterprise of requisite production equipment. Under this type of financing arrangement, the financing agent (could be a commercial bank, or manufacturer, or an equipment leasing company) retains title to, or holds lien on the equipment acquired and the small mining company agrees to pay on an instalment basis.

There are different forms of equipment finance, which shall be discussed below. They include title retention, finance leasing, hire purchase, and sale and lease back.

Title Retention

This involves the sale of an asset whereby the buyer of the asset does not acquire title to the asset until he has fully paid for the asset. In the event the buyer becomes insolvent without having paid for the asset the seller can retake possession of the asset. This form of title

[11] Especially in cases where the SMALL MINING COMPANY posses the skills and technical capacity and the LMC has the funds but no technical capacity

finance gives the seller security for the unpaid purchase price, thereby protecting the seller form the insolvency of the buyer.

Finance Leasing

In a finance lease, the lessor may lease the equipment to the lessee on the condition that the title to the equipment remains with the lessor while buyer acquires possession of the equipment and the right to use the equipment. The lessee pays an amount which would usually include the capital cost and finance charge on instalment basis. On the other hand, the lessor could sell the equipment to a finance house and the finance house would then lease it to the buyer. The buyer also pays on instalment basis an amount which would usually cover the capital cost and an interest during the useful life of the equipment and thereafter the buyer may pay a nominal rent. It is important to note that, in the event the buyer defaults in making his instalment payment, the seller is permitted to sell the equipment and account to the buyer for an excess of the sale proceeds in order to liquidate the rental payment due to the seller. The buyer is required to insure the equipment against the risk of loss or damage to the equipment.

Hire Purchase

A lease of equipment may give the lessee the option of purchasing the equipment at the end of the lease period and upon the payment of an agreed sum usually calculated with the unpaid instalments. The difference between hire purchase and the other forms of equipment financing is that the lessee has the option of purchasing the equipment at end of the lease period.

Sale and Leaseback

In a sale and leaseback, a party sells equipment to a finance house, the finance house then leases back the equipment to the party (lessee) for a period which would cover the useful life of the equipment. The lessee pays an amount equal to the principal sum and interest on instalment basis. In the event the lease becomes insolvent, the lessor retakes possession of the equipment, sells the equipment and accounts to the lessee for an excess of the sale proceeds in order to liquidate the rental payment due to the lessor.

Royalty Financing

This mode of financing takes the form of upfront financing in return for future payment based on either a percentage of the value of the products produced or the profit or revenues generated from the mine. This mode of financing is categorised into two namely, Net Smelter Returns Royalty and Royalty on Net Profits.

Net smelter returns royalty is essentially calculated as a percentage on the amount (minus the costs of transportation, insurance or security, penalties, sampling and assaying, refining and smelting, and marketing) received by the mining company from the sale of the mineral product to the treatment plant that converts the output of the small mining company to marketable product. Royalty on Net Profits, on the other hand, is calculated as a percentage of the gross cash income from a mine-mill complex less all expenses incurred to produce the income.

As a transaction, royalty financing involves a finance institution providing the mining company/ borrower with capital in exchange for a share in the project's future revenue. Typically there is no obligation to repay the capital and the capital does not bear interest[12]. The investor achieves returns through fixed royalty payments – these are fixed costs which must be met regardless of actual profitability of the borrower or the management's view as to whether such distributions would be appropriate given the performance of the company and its capital needs.

Royalty financing will therefore reduce the liquidity of the company which could be used to pay dividends or invested in the business. However the advantage of this over bank loans include: generally no penalties for construction delays; fewer financial, legal and information covenants and undertakings, and fewer events of defaults. In May 2013, Midas Gold Corp received a US$15 million payment from Franco-Nevada in return for a 1.7% NSR royalty on any future gold production from Golden Meadows, Midas' PFA-stage project located in Idaho. Midas planned to use the proceeds for resource evaluation, metallurgical studies, engineering and other work related to its ongoing pre-feasibility study.

[12] Unlike a corporate loan

Streaming Financing

A streaming transaction is an agreement whereby a financing party agrees to make an upfront capital payment (or a series of payments) to the mining company in exchange for the contract to purchase from the mining company an amount of metal calculated based on future production from the mine. The transaction is essentially a long-term commodity purchase contract at pre-agreed prices with the delivery obligations contingent on future production over a specified period or for the life of the mine. Streaming finance is raised by selling a right to a commodity in exchange for an up-front payment.

Streaming transactions are used by mining companies to finance resource development and the acquisition of a new resource asset and to monetize a portion of the value of existing assets. Streaming financing has been filling the gap created by the challenges of raising sufficient traditional equity, debt and project financing.

Typically, streaming transaction is based on precious metals that are (or will be) produced as a by-product of the mine, and payment by the investor for each delivery of metal is at a significant discount to market price.

Certain key issues always arise in the structuring and implementing of Streaming financing, which most times relates to the manner, time and conditions for the payment of the deposit. The deposit may be paid in a single lump sum or by way of instalments based on the satisfaction of certain conditions. In most cases, the financing party seeks to ensure that its contribution is “last dollar” i.e., once the deposit is advanced, the project will have sufficient financing to reasonably assure completion. In essence, Streaming Financing is often used once a mine is in production as a means of raising further capital in order to secure its completion.

Streaming financing is distinct from royalty financing as it creates a right for the financing party to purchase all or a portion of one or more metals produced from a mine rather than, in the case of royalty financing, creating a right to a percentage of revenue from the sale of production.

Under the Streaming agreement the financing party normally takes security over the project assets and related subsidiary companies to secure the performance of the obligations under the streaming agreement. In the North America, streaming financing is a popular means of investing in mining companies. Major streaming transactions in recent years have included Inmets Mining's US$1billion precious metals streaming agreement with Franco-Nevada for the development of its Cobre Panama mine; and Vale's US$ 1.9 billion precious metals streaming agreement with Silver Wheaton in connection with its Salobo, Brazil and Sudbury, Canada mines. Streaming transactions have also been completed for smaller transactions.

Earn-In Agreement

This is a type of financing whereby the financer commits to incur a minimum cost on certain mining activities (usually the exploration or the development stage) of a small mining company over an agreed time period, often with the right to spend further at its own election or the obligation to incur further outlay if certain targets are achieved, in order to earn a pre-determined share of ownership in the mining company. This method of financing allows the mining company to outsource early-stage exploration activities to another party that not only holds prospective ground, but may also have the requisite local expertise to advance the project more effectively thereby extending its exploration reach.

These structures allow small companies to gain funding, which they could not otherwise access, and can reduce the potential ownership dilution if the earn-in price of further commitments is adjusted at each stage

Earn-in agreements are mostly concluded between small mining companies and major mining companies. For example, in 2012, Kibo Mining Plc formed an exploration joint venture with the mining division of Brazilian industrial conglomerate Votorantim Group at Kibo'sHaneti properties in Tanzania. Under the agreement, Votorantim agreed to provide a maximum of £2.7 million that would be used to fund a three-year work programme. Upon completion, Votorantim will earn a 50% interest in Haneti.

Equity Capital

Whilst debt capital has historically been the major source of funds for oil and gas projects, mining companies have tended to use various forms of equity capital. These include different structures, ranging from issuance of corporate stock, the use of general or limited partnership, or joint ventures (as discussed above). The reasons for the use of equity capital as hereinbefore stated include the long time frame necessary to develop mineral resources, the difficulty in evaluating reserves available for development, the lack of accounting principles for valuing those reserves once estimated, and the lack of free transferability of mining properties. All these make equity capital an attractive source of finance as equity financers will be more patient to wait for a return on investment much more than the debt financers

Cooperative Financing

Another non-traditional financing solution targeted at ASMs will be the establishment of a cooperative of ASM whereby they all pool resources together under one umbrella. Cooperatives provide a method for miners to join together in an 'association', through which a group of miners can acquire a better outcome, typically financial, than by going alone. This approach is aligned to the concept of economies of scale and can also be related as a form of economic synergy, where two or more agents working together to produce a result not obtainable by any of the agents independently. These cooperatives are useful in solving the financing challenges miners face with commercial banks in particular, as miners can, as a credit union, group together funds that can be loaned out to members. Alternatively, this 'cooperative credit union' can raise loans at better rates from commercial banks due to the cooperative having a larger associative size than individual miners. Often members of a credit union will provide mutual or peer-pressure guarantees for repayment of loans.

This solution is common within the agriculture sector and used by local indigenous farmers. It can however be adopted and adapted for ASMs.

SECTION 4: THE ROLE OF THE GOVERNMENT

The Nigerian Government has identified the solid mineral sector as one of the key drivers of economic growth and diversification. The reason is not far-fetched. The solid mineral resource sector holds potentials to create value for investors and help boost fortunes of the Nigerian economy. We are aware that many policies and provisions aimed at improving the solid mineral sector is contained within the Nigerian Minerals and Mining Act[13] ("the Act").

A few of these policies include:

- Intervention funds and packages such as the solid mineral fund established under section 37 of the Act;
- Geo-science development under section;
- Infrastructure Development;
- Mining and Power Development;
- The development of mineral buying centres and Lapidaries.

However, we also note that not all policies set out under the Act have been implemented or are successfully being carried out. The Nigerian Government is thus encouraged to make a more long-term commitment to exploration and development in the solid mineral sector by abiding by the provisions of the Act and fostering a stable regulatory, economic and political environment.

[13] Cap N162 LFN 2004

CONCLUSION

In conclusion, as enunciated above, small scale miners have a range of financing techniques to pick from in financing their projects. In addition to the government's effort in reviving the moribund sector, the small mining company can ensure that they are listed on the Nigerian Commodities Exchange and on any international Commodities Exchange, in order to boost the bankability and viability of the sector and also to create viable market for their products.

CONTACTS AND LINKS

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This document was concluded on 10 January 2017. Subsequent developments have not been included.

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