

Due Diligence Reviews: Assessing Effective Acquisitions

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The current lack of easily available credit combined with the corresponding drop in stock prices has left several mining projects and companies scrambling to stay afloat. This situation has also generated opportunities for those companies with positive cash balances available to acquire new assets.

One of the key requirements in evaluating possible acquisitions is a strong due diligence team capable of carrying out a quick and effective review of the assets after the confidentiality agreement has been attained. The composition of an effective due diligence team will vary greatly depending on the asset to be reviewed.

This article addresses three of the more common situations where a due diligence team may be required to properly assess an acquisition.

Acquisition of Exploration Project or Joint Venture Partnership

The review of a single or multiple exploration project or the acquisition of a joint venture interest where the partner is no longer capable of meeting its joint venture requirements is usually considered a single discipline review involving only a geological team. The key aspect of focus in this situation is the identification of exploration potential or “blue sky” of the property or properties being acquired. The review may or may not involve a site visit by the due diligence team. A site visit is recommended if the acquisition is by a public company and will be deemed material by the regulators. It is important that the team selected for the evaluation has significant expertise and exploration experience in the type of deposits being acquired. The team must be capable of quickly identifying both the positive and negative aspects of the property to be acquired.

Prior to engaging a due diligence team, a company should have its legal council review any joint-venture agreements to ensure that the property can be acquired and that the acquisition will not trigger any back-ins of the first right of refusal clause. Public companies are also reminded that any acquisitions that may be deemed material by the stock exchange will require the filing of a National Instrument (NI) 43-101 compliant report which will add to the cost of the due diligence review.

Acquisition of Producing Properties

The review of a producing mine involves a large and multi-disciplinary team. The composition of this technical team will include professionals from geological, mining, metallurgical and environmental disciplines. It will require significant input from the company’s legal team to review contracts for all aspects of the mine operation including but not limited to permits, sales or hedging contracts and union and employee contracts. While the technical team need not be sourced from one consulting company, our experience has demonstrated that a due diligence team built from one consulting group is usually more efficient and quicker at delivering results.

The due diligence team must carry out a site visit to evaluate the current condition of the assets to be acquired; both the physical assets as well as the personnel involved in operating the property. The principal aspects of focus for the due diligence team are the existing reserves within the mine, any modifications that can be implemented immediately to reduce costs or improve recoveries and a review of the possibility of expanding the reserves picture with near-mine exploration. The mine infrastructure and equipment must be evaluated and valued as part of the due diligence process.

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Any public company acquiring a producing asset is reminded that while immediate cash flow from production may be realized, the reserves can not be added to its current balance sheet until it has filed a NI43-101 report with a securities commission. Legal counsel should be sought prior to making public disclosure of newly acquired assets that include mineral resources or mineral reserves.

Acquisition of a Public Company

An alternative to acquiring a property from a mining company that is no longer capable of funding its assets is to indirectly acquire the company. Several opportunities exist today where public companies are trading below their cash value. For example, the value of all issued and outstanding shares is less than the total value of the cash that the company holds. The acquisition of such a cash-positive company by a company that is in a temporary cash deficit could benefit both parties and the takeover need not be hostile.

The due diligence team involved in such an acquisition will include several legal and accounting professionals. As well, it should be noted that the regulatory filing requirements are beyond the scope of this article. The acquisition should be reviewed by a technical due diligence team comprised of geologists, mining engineers and metallurgical and environmental engineers. It is important in the case of a merger that the teams of professionals of each company examine the material assets of both companies. The due diligence review process will sometimes be carried out in two steps, a primary preliminary analysis to confirm the information that is available in the public domain followed by a more detailed and extensive review of all assets being acquired.

The negative aspects of company acquisitions are that the costs associated with the mergers and acquisitions are often orders of magnitude larger than a simple asset acquisition, and the time to consummate the transaction is usually several months, which may be too long for a cash-strapped company. Additional forms of funding such as bridge financing may be required to assure that the companies can survive long enough to complete the deal.

Wardrop's success includes assisting the global junior mining industry in due diligence reviews and helping to move development projects forward from grassroots exploration to prefeasibility, feasibility, detailed engineering, procurement and construction management. With offices located in North America, Africa, China, India and the United Kingdom, Wardrop is a "one-stop shop" with rapid-response due diligence teams capable of evaluating any of your mining acquisitions.