

## Chapter 16

# UNDER THE ROCKS ARE THE WORDS: HOW A METAL PURCHASE AGREEMENT REVOLUTIONIZED ALTERNATIVE FINANCING AND LAUNCHED THE NEW MAJORS—A LOOK BACK AT THE FIRST DECADE OF METAL STREAMING TRANSACTIONS

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**§ 16.01 Introduction\* \*\***

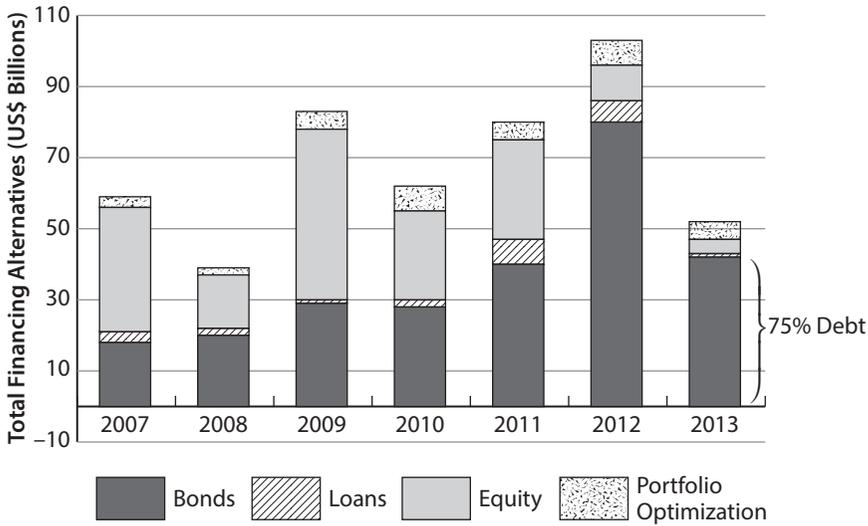
The capital-intensive mining (and resource extraction) industry has always focused on developing creative alternatives for project financing. Traditionally, debt and equity financings and alliances with alternative investors (including sovereign wealth funds) have been employed to finance mining projects. In the past decade, the increasing sophistication of portfolio optimization and alternative financing strategies and the market realities of volatile commodity prices, enhanced geopolitical risk, and contracting economies have led to the development of popular new forms of financing: metal streaming and royalty transactions.

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\*\*The authors’ firms, Goodmans LLP and Cassels Brock & Blackwell LLP, have represented certain of the companies referenced herein, including Franco-Nevada Corporation, HudBay Minerals Inc. and Newmont Mining Corporation, and Goldcorp Inc., Royal Gold, Inc., Sandstorm Gold Limited and Silver Wheaton Corp., respectively.

**Figure 1<sup>1</sup>**



What is a metal streaming transaction? In general terms, it is a purchase and sale transaction, whereby the streaming company purchases the metal to be produced from a mine, usually expressed as a percentage of the produced metal. A purchase price deposit is paid in advance (subject to the satisfaction of certain conditions), thereby providing necessary funding to the producer. Typically, the streaming company will also pay in cash an established fixed price for each ounce of metal delivered, with the difference between that price and the then current market price reducing the pre-paid deposit amount. Essentially, streaming transactions provide a producer the opportunity to leverage (by pre-selling) future production, providing necessary up-front funds without having to dilute existing shareholders in an equity raise or having to take on the additional covenants and risk associated with traditional debt financing. As discussed below, it is this purchase of future mine production that most clearly distinguishes streaming transactions from royalty transactions.

Since streaming transactions were introduced 10 years ago, the use of this model has increased immensely, bringing to the forefront complex issues related to tax efficiencies, the interplay of the rights of streaming companies and creditors, and mitigation of risks. In recent years, billion-dollar transactions have moved streaming transactions into the world of

<sup>1</sup>“The Future of Funding and M&A Activity in the Mining Sector: Taking a Novel Perspective” (2014) (Future of Funding) (on file with authors).

senior diversified producers and, in some instances, eclipsed traditional lending on projects. This chapter focuses primarily on metal streaming transactions, and examines the history of streaming transactions and their current structure in the mine financing market.

## § 16.02 Development of Alternative Financings

### [1] History of Royalty Transactions

Before 2004, two companies dominated the mining royalty space. A predecessor to the current Franco-Nevada Corporation operated in the gold royalty business between 1986 and 2002, until it was acquired by Newmont Mining Corporation. After being operated within Newmont as a royalty holding division for five years, Franco-Nevada was spun off in its current form in 2007 as a stand-alone public company. Franco-Nevada's focus on royalties began in 1986 with the purchase of a \$2 million gold royalty, and it was the first company to establish the ownership of gold royalties as a viable business model.<sup>2</sup> However, its business model at that time was primarily built on acquiring existing royalties rather than creating new royalties by providing financing to mining companies.

Royal Gold, Inc. began as an oil and gas exploration and production company (Royal Resources Corporation) in 1981. Similar to Franco-Nevada, Royal Gold transitioned into the gold mining business in the mid-1980s and began strategically acquiring existing mining royalties after the 1987 stock market crash.

As discussed in greater detail below, royalties (often considered the precursor to streaming transactions) are contracts under which the royalty company makes a one-time payment to purchase a percentage of the returns generated by a particular project. With royalties, it is truly the case that “under the rocks are the words,” as in Canada and the United States, it is typically intended that a royalty would create an interest in the land and remain with the land following the sale of a mine.

### [2] Evolution of Streaming Transactions

From the mid-1980s until 2004, the gold royalty business continued to grow. Then in 2004, the model evolved into metal streaming with the

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<sup>2</sup>By 2002, at the time of Franco-Nevada's combination with Newmont, the royalty it purchased in 1986 was generating \$30 million annually. More recently, in May 2013, Franco-Nevada paid \$15 million for a 1.7% net smelter return (NSR) royalty on any future gold production from Midas Gold Corp.'s Golden Meadows project. *See Franco-Nev., 2013 Annual Information Form 10* (Mar. 19, 2014). Midas indicated that it planned to use the proceeds for resource evaluation, metallurgical studies, engineering and other work related to its ongoing pre-feasibility study.

formation of Silver Wheaton Corp. Two elements of Silver Wheaton's strategy differentiated it from the traditional royalty companies. First, its initial commodity focus was singularly on silver, as silver companies were trading at higher price to net asset value (NAV) multiples than gold companies, which in turn traded at higher NAV multiples than base metal companies. Wheaton River Resources Ltd. (a predecessor to Goldcorp Inc.) had significant by-product silver production from its San Dimas mine in Mexico but did not receive the same value in the capital markets for its silver production as primary silver producers were receiving. By spinning off Silver Wheaton into a new public company with 100% of its revenue from silver, Silver Wheaton captured the arbitrage opportunity for the shareholders of both Wheaton River and Silver Wheaton. Second, and more importantly, Silver Wheaton structured its investments in a different manner than royalties, as is further described below.

Following 2004, the number of publicly traded royalty and streaming companies grew to over 15. Despite the proliferation of new entrants, Silver Wheaton, Franco-Nevada, and Royal Gold have dominated metal stream transaction activity and are the only companies to have undertaken individual transactions in excess of \$100 million.

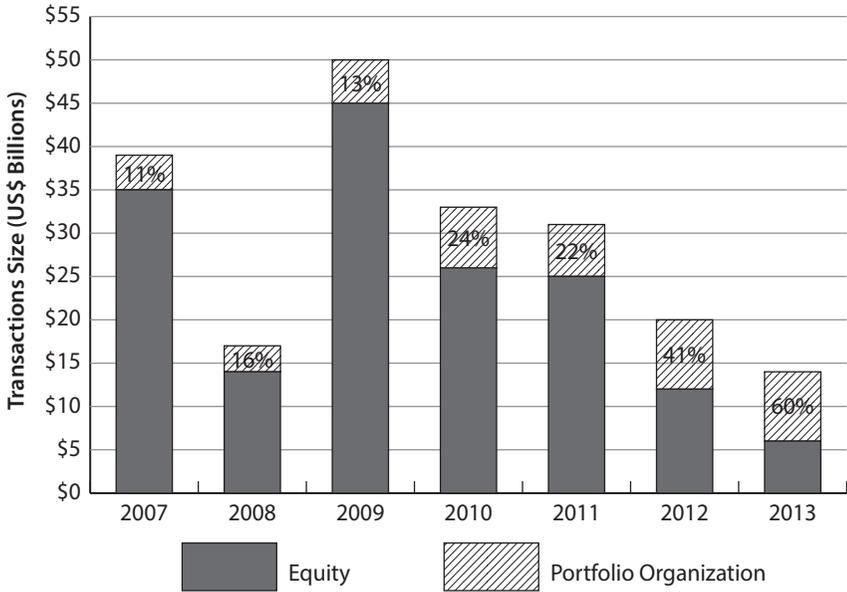
### **[3] Alternative Financings—Prevalence of Streaming Transactions**

Until 2012, the mining industry was highly attractive to capital market investors, generally thriving in the financial crisis of 2008–09. Then life changed for mining companies, no longer the darling of the capital markets. For the first time in a decade, there were no mining sector initial public offerings in the first quarter of 2013 on the Toronto Stock Exchange, the exchange representing the largest presence of mining companies in the world. Investor preferences had changed and although debt and equity continue to be a significant source of funding, the capital intensive mining industry has had to look to alternative sources of capital to make up the difference or, as recently demonstrated by senior producers like HudBay Minerals Inc. and Vale S.A., contribute to a diversified capital model.

In the third quarter of 2012, HudBay Minerals announced a \$750 million precious metal streaming transaction with Silver Wheaton, a \$500 million senior note offering, and the continuation of its \$300 million credit facility. This diversification of capital sources is becoming increasingly predominant as mining companies continue to optimize portfolios.

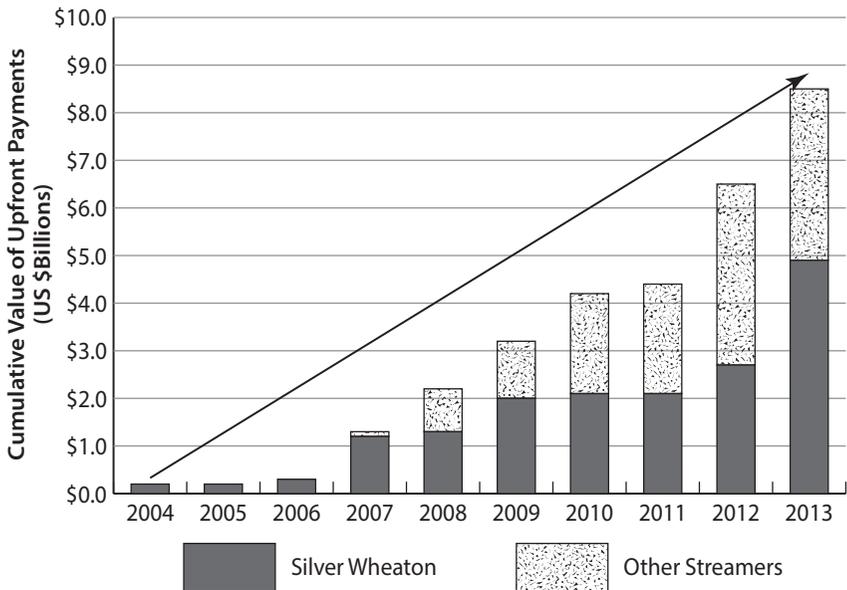
Portfolio optimization—the sale of assets, royalties, and streaming transactions—has played an increasing role in mine funding strategies in recent years, with streaming transactions representing an increasingly significant portion of the capital portfolio.

**Figure 2<sup>3</sup>**



**[4] Highlights of Recent Transactions**

**Figure 3<sup>4</sup>**



<sup>3</sup>Future of Funding, *supra* note 1.

<sup>4</sup>*Id.*

Recent examples of streaming transactions include Silver Wheaton's 10% gold stream acquired from Sandspring Resources Ltd. in respect of its Toroparu Mine in Guyana S.A. and Franco-Nevada's 6% gold stream purchased from Teranga Gold Corporation in respect of its Sabodala project in Senegal. Whereas Sandspring will use the initial deposit to be paid by Silver Wheaton (\$148.5 million) primarily for the advancement of the final feasibility documentation for the Toroparu project and to fund construction of the Toroparu Mine, Teranga used its deposit (\$135 million) to acquire an outstanding minority interest stake and retire certain bank debt facilities, thereby providing operating flexibility. Although both of these transactions happen to be purchases of the mine's primary metal, by-product streams still represent the most predominant form of transaction.

## § 16.03 Overview of Financing Models

### [1] Traditional Lending Facilities

Debt financing in its many forms—bonds, term loans, revolving credit facilities—continues to be the principal source of financing in the mining industry. However, while many senior producers may be positioned to raise debt financing on the strength of their overall balance sheets or the demonstrated asset value of specific producing projects, the restrictions and cash costs to traditional debt financing are generally prohibitive for many junior mining companies.

#### [a] Accessibility of Debt Financing

Lenders will not invest in a mining project unless they are confident their loan will be repaid. Unlike stream or royalty companies, debt lenders do not partake in a project's upside and are generally characterized as risk averse. They will typically avoid investing in speculative projects and usually require that their money be the last into a project. Furthermore, many banks and lending institutions have implemented risk management frameworks in order to assess the social, political and environmental risk of investments they are considering. The adoption of such policies creates an investment threshold that mining companies must meet before they are eligible for financing. Accordingly, debt financing is more readily available (and available on better terms) for producing mining companies with assets in stable jurisdictions than it is for exploration companies and junior producers with projects in more volatile locations.

#### [b] Structure of Debt Financing

##### [i] Security

In the context of debt financing, the question of whether the assets of a mining company can support the debt financing obligations is paramount. While senior resource companies may have the option of securing

financing on the strength of their balance sheets, junior companies will, at best, be able to secure financing only on the strength of a robust project. Corporate debt will generally be secured by a broad set of security liens over all of the assets of the borrower. When the general assets of a mining company do not support a corporate facility, as is often the case for a junior mining company, project level financing remains an option.<sup>5</sup> However, at the very least, until completion of the project is achieved, project lenders will generally look beyond the assets of the project for collateral protection by requiring parent company guarantees that will allow them to recover at the corporate level.

### **[ii] Covenant Package**

Debt financing will often impose a number of covenants on a mining company, the significance of which will increase in direct correlation with the speculative nature of the project. Often lenders will require mining companies to provide open access to their books and records, and scheduled reporting on finances, as well as development and construction progress reports, and will require restrictions on other indebtedness and certain forms of payments. In addition, certain financial covenants will undoubtedly be required, including debt service ratios and leverage and equity ratios. These covenants are all in addition to a rigid repayment structure, designed to ensure the lender is repaid in full by the anticipated maturity date. For mining companies with smaller or less experienced management teams, these covenants can be incredibly burdensome.

To avoid the restrictive nature of bank covenant packages and to decrease borrowing costs and take advantage of longer terms to maturity, a mining company could turn to the debt markets to raise financing, though this is not common for junior mining companies. Senior producers may have the option of raising investment grade debt, which typically carries fewer covenants beyond the covenant to pay the principal and interest amounts.

Companies such as BHP Billiton Ltd. and Goldcorp Inc. have secured long-dated corporate bonds at very attractive rates, especially when taking into account the maturities of 10 to 20 years and longer, and the fixed-rate nature of many of the issues. This has enabled debt maturities to be pushed out and moved more in line with the life of the mine to which they relate, and for the balance sheets to be restructured to provide greater financing strength and a lower cost of capital.

Another option may be high-yield debt markets. Unlike investment grade debt deals, high-yield debt deals are based on indentures with a

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<sup>5</sup>Depending on their needs, senior resource companies may structure their debt at both the corporate and project level.

covenant pattern that often includes restrictions on the incurrence of additional debt, asset sales, and various payments, all of which may impact operations. Nevertheless, high-yield debt covenants are generally more flexible than bank loan covenants and provide the borrower with more operating flexibility.<sup>6</sup>

In general, loan payment terms, as well as the covenant packages lenders impose on mining companies, clearly demonstrate the risk averse nature of lenders. Senior mining companies with strong balance sheets will have funding options that include raising investment grade debt and taking on corporate and project level debt. In contrast, mining companies with speculative or pre-development projects should expect to pay high interest rates, be subject to restrictive covenants, and be required to cover the costs lenders incur in entering into loan agreements, including legal fees and the costs of any due diligence.

## **[2] Royalty Transactions**

Historically entered into to provide sellers of mining properties with continued upside to future development of the mining property, royalty agreements are now an important form of funding for resource companies. Funding by way of a royalty sale typically will have no impact on the mining company's balance sheet and will result in limited earnings dilution.

In their general form, royalty agreements are contractual agreements, whereby a royalty company makes a one-time up-front payment to a mining company in return for future payments, typically based on a percentage of revenues after deducting agreed costs generated from a specific project. Although the royalty is most often paid out in cash, the agreement can be structured to satisfy the royalty obligation with commodity in kind. Significantly, royalty agreements may create an interest that runs with the land, akin to a mortgage or lien against a property.

### **[a] Accessibility of Royalty Financing**

Generally, royalty agreements that involve up-front payments (as opposed to royalties entered into in the context of a sale of the mining property itself) are employed to bring a project toward production or to expand an existing mine. In all cases, royalty funding is most often available, and perhaps best suited, to mining projects with proven reserves that will ultimately produce consistent and anticipated returns.

### **[b] Structure of Royalty Agreements**

Royalty agreements can be structured in various ways, depending on how the revenue generated from the project is calculated, i.e., what operating

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<sup>6</sup>See generally "Global Mining Finance Guide 2014," *Mining Journal* (2013).

costs are taken into account when calculating the royalty. The type of structure that is chosen should be considered carefully, as the required calculations can become quite complex, and a higher percentage royalty with certain net cost calculations may not translate into a higher return. Structures of royalties include:

- **Gross Proceeds Royalty:** Gross proceeds royalties measure revenue with few, if any, deductions. For this reason, they are more common in the oil and gas industry and seldom employed in the mining sector.
- **Net Profit Interest Royalty:** Net profit interest (NPI) royalties measure profits from operations after deducting all exploration, development and capital costs, together with all operating costs (including interest thereon). Given the extensive deductions, NPI royalties may attract significant controversy and allegations of miscalculation.
- **Net Smelter Return Royalty:** Net smelter return (NSR) royalties measure revenue as the amount paid to the mining company by an offtaker (not restricted to smelters, notwithstanding the commonly used name), after certain straightforward deductions, which often include transportation, sampling and assaying. Production costs and capital and operating costs are not deducted from the revenue owed to the royalty company. Given the relative ease of calculation, NSR royalties tend to be more common.

### [i] Payment Structure

Royalty agreements are generally for the life of the project. As such, unless the amount of royalties to be paid is capped or the royalty term is fixed, royalty companies will benefit from any unexpected upside to a project. The question of whether the aggregate royalty is capped or has any minimum deliveries is situation specific and determined through negotiation. As is the case with streaming transactions, uncapped royalty agreements can offer significant upside to an investor if a project produces more revenue than initially expected. However, it must be recognized that to the extent there are no minimum delivery requirements, the streaming company has significant potential downside as well if the project does not produce expected revenue. Often, the question of whether a cap or minimum is inserted into a royalty agreement is negotiated against the percentage of a royalty. In other words, a royalty company may accept a lower percentage royalty in lieu of a cap on the total amount of royalty to be paid, and vice-versa.

### [ii] Covenant Package

A royalty company's primary focus is the revenue generated from a project. The up-front payment is not required to be repaid, so royalty

agreements do not include covenant packages similar to debt structures. Specifically, royalty agreements generally do not include penalties for construction delays or completion tests that must be satisfied before funding, and contain fewer financial, legal and informational covenants than traditional lending facilities. That said, royalty companies will customarily require regular reporting and certain access to the books and records of the mining company to ensure they are receiving their full share of a project's output.

### [3] Streaming Transactions

Streaming transactions are contractual agreements, structured as purchase and sale agreements that provide for the purchase and sale of the applicable commodity, as opposed to the acquisition of an interest in the resource property. In its most basic form, a streaming transaction results from a streaming company making an up-front payment, structured as a pre-payment or deposit, to a mining company in exchange for the right to receive deliveries of a fixed percentage of mineral that is equal to a percentage of the mineral extracted from a specific project, for a pre-determined fixed cash payment for each ounce of mineral delivered (generally the lesser of a fixed price or the market price). Although royalty and streaming transactions have many differences, it is the physical purchase of future mine production, as opposed to the purchase of a portion of the revenues of a mine, that most clearly distinguishes streaming transactions from royalty transactions.

#### [a] Accessibility of Streaming Financing

Generally, streaming companies invest in development projects that need additional financing to fund development and construction, or in-production projects that need financing to expand production or are being used by the producer as a form of portfolio optimization to raise capital.<sup>7</sup> In almost all cases, streaming companies invest in projects with established mineral reserves or mineral resources. Streaming transactions can be structured for any size project, from small-scale juniors to Vale S.A.'s \$1.9 billion streaming transaction with Silver Wheaton. Streaming companies often are more willing to enter into purchase agreements with respect to speculative projects at an earlier stage than traditional lenders.

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<sup>7</sup>This is not to say that streaming companies are limited to only near-production or in-production projects. As was demonstrated by the streaming transaction entered into with Sandspring Resources, Silver Wheaton was willing to invest a portion of the initial payment prior to the point in time when it would normally do so as an early deposit, to facilitate the completion of a feasibility study by Sandspring Resources. This type of agreement is referred to by Silver Wheaton as an "early deposit stream." See Salma Tarikh, "Sandspring jumps on Silver Wheaton's streaming deal," *The Northern Miner* (Nov. 27, 2013).

The up-front payments may be paid in full on execution, but for projects under construction such payments are often staged over the development of the project, based on particular construction and financing milestones. In some cases, the streaming agreement may provide for repayment obligations when construction milestones are not satisfied or if completion of the project is not achieved. By structuring their up-front payment as a deposit, streaming companies ensure a return of that portion of their investment either during the term of the agreement or upon termination of the agreement, or in the context of certain events.

### **[b] Structure of Streaming Transactions**

Generally, streaming transactions are structured to ensure that the interests of the mining company and the streaming company are aligned as much as possible. This may be achieved by negotiating the type of metal that is subject to the stream or specific covenants that are incorporated into the agreement, and the size of the stream will generally be negotiated to achieve the purpose for which the funds are intended. Indeed, although a general form of streaming transaction has emerged over the past decade, the terms of the agreements are negotiated to fit the specific circumstances of the project and the mining company. A streaming agreement will generally address the following:

#### **[i] Metal Purchased and Sold**

The primary matter for consideration is whether the metal that is being purchased and sold is a primary or secondary material at the project, i.e., whether the metal is being produced as a by-product of the main extraction process. Notwithstanding the recent gold streaming transactions of Silver Wheaton and Franco-Nevada, by-product transactions dominate the market.

Generally, streaming companies negotiate for the purchase of the by-product metal extracted from a project as this offers an arbitrage opportunity to the mining company: a base metal mining company's value is more directly tied to its primary base metal mineral reserves and production profile, not its by-product precious metal mineral reserves and production profile. In addition, a base metal mining company generally does not receive the same valuation for precious metal by-product revenue that a precious metal mining or streaming company would. Mining companies are less interested in entering into metal streams on their primary metal, as they more directly affect the value of the mining company. As a result, transactions involving primary metal production have historically been structured as low percentage royalties or streams.

The quantity of metal, both as a percentage of the annual output and as a total amount over the life of an agreement, that the streaming company

is able to purchase will be heavily dependent on whether the metal is a primary or secondary metal. Like so many other aspects of a streaming transaction, this can be negotiated to suit the specific development and risk profile of a project, including by way of top-up obligations or buy-back rights.

### **[ii] Fixed Term or Life of the Project**

Typically, streaming transactions are structured with long fixed terms (between 20 and 50 years) with renewal options that effectively result in life-of-mine contracts. The longer the term of the transaction, the greater the opportunity for potential exploration success to become relevant and for the streaming company to recover any shortfalls in expected deliveries at the outset of the transaction.

### **[iii] Covenants**

Streaming agreements on a mine in construction typically include conditions that need to be satisfied before the up-front deposit is paid, such as permitting or securing construction financing. Additionally, streaming agreements generally include operating covenants that are designed to ensure that offtake terms and conditions are commercially reasonable (because they typically trigger delivery obligations), that the processing (or commingling) of ore from mines outside the scope of the project is limited, and that the mining company extracts resources as if it had a full ownership interest in all resources being extracted. In particular, covenants are intended to protect the streaming company by ensuring it is not prejudiced by operating decisions that may disregard its interest in the metal that was the subject of the stream.

### **[iv] Representations and Warranties**

Streaming companies will look to receive general representations and warranties from a mining company, as well as representations and warranties with respect to ownership of project assets in respect of any security the stream purchaser is taking in the project.

### **[v] Use of Funds**

Where a stream is entered into on a development project, the stream agreement may include a requirement that the up-front deposit be used towards construction and development of the project. However, this may not be necessary depending on the financial capacity of the mining company and its ability to access other sources of capital to complete the project.

### **[vi] Reporting Requirements**

During the development period, streaming companies will want to ensure that project development is underway and ongoing. To monitor

this, they may require special reporting. Likewise, during production, streaming companies will often require ongoing reporting and site visits to verify they are receiving the amount of metal to which they are entitled.

## **§ 16.04 Comparison of Structures (Pros and Cons)**

### **[1] Advantages of Streaming Transactions**

#### **[a] Non-Dilutive to Shareholders**

As discussed above, the recent contractions in equity markets have made equity an undesirable source of financing as the lower market prices would result in significant dilution. As the mining industry waits for equity markets to rebound, companies are increasingly looking to streaming transactions as a source of non-dilutive financing.

#### **[b] Capitalize on Proven Reserves**

Both royalty and streaming transactions provide an opportunity for mining companies to unlock value from their projects before they come into production. Although debt financing may be available, securing such financing would likely come at a high price for a non-producing mine and impose significant negative and financial covenants.

#### **[c] Increase in Investor Confidence**

Markets typically respond positively when a third-party royalty or streaming company invests in a mining company. This is because the expertise of streaming companies and the extensive due diligence they perform on mining companies before agreements are executed are viewed as endorsements of the value of the project. Further, the disclosure and investor relations activities of the streaming company expose the mining company to a broader investor base than it might typically attract. This effect is often more pronounced on non-producing projects.

#### **[d] No Required Deliveries/Payments**

Unlike virtually all forms of debt financing, royalty and streaming financings do not bear interest and, if structured properly, are not considered debt on a company's balance sheet. This is in part because there are typically no required minimum deliveries under the streaming transaction. In other words, there is only an obligation to deliver metal if the mine is producing metal. This provides mining companies with much less risk and greater flexibility when compared to debt financing.<sup>8</sup>

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<sup>8</sup>Standard and Poor's recently indicated that it will treat streaming transactions that contain certain attributes as debt when considering credit ratings.

### **[e] Retention of Ownership and Control; Mutual Interests**

Joint venture financings result in a transfer of ownership and debt financings involve financial and operational covenants that may severely restrict management's decision making. Generally, neither is true in a streaming transaction. This is because streaming companies have minimal input in respect of project management other than to ensure the mining company is not making decisions that would prejudice the streaming company. Further, the ongoing purchase price payments for deliveries of metal, plus the obligation to return any uncredited deposit, align the interests of the mining company and the streaming company.

### **[f] Transaction Mechanics**

Depending on the project, royalty and streaming transactions generally can be put in place in four to six weeks, less time than a traditional credit facility. The reduced length of time results in lower transaction costs. In addition, streaming and royalty companies generally bear their own due diligence and legal costs, while banks generally structure these costs into a financing package. However, as discussed below, the negotiating process may be significantly protracted (and costs increased) when there is another secured creditor, although this would be the case with any two secured creditors.

## **[2] Disadvantages of Streaming Transactions**

### **[a] Dilutive at the Asset Level**

At the most basic level, streaming companies are acquiring a share of the future metal produced at a project for consideration that has been fixed under the terms of the streaming agreement. This is metal that would otherwise be available for the mining company itself to sell, and that may otherwise positively impact shareholders' net asset value. However, as discussed above, the impact of this dilution is less significant in the context of by-product streams where the mining company typically is not getting full credit for its resources. The project-specific nature of streaming transactions provides an opportunity to mining companies to dilute assets on a project-by-project basis, rather than burdening the company at the corporate level.

### **[b] Transfer of Exploration Opportunity**

As discussed above, most streaming agreements extend for a period that is effectively the life of the mine and over the entire project. To that end, the streaming company will benefit from any exploration upside although it does not typically contribute to any additional costs over and above the fixed production payment. In essence, the streaming company is taking

production risk—when actual production exceeds the originally expected production level, the streaming company benefits; when it is less, the mining company benefits (at least in the context of the streaming transaction itself).

### **[c] Negative Cash Cost Impact**

Streaming transactions may have a negative impact on cash costs. In particular, by-product streaming transactions may reduce by-product credits, which typically are deducted from operating costs when reporting a mine's cash costs. So, a mine's cost structure may appear higher going forward.

### **[d] Fixed Price of Streaming**

Over the life of a project, the market price of a specific metal may increase or decrease disproportionately in relation to the implied price paid under the streaming agreement. When the spot price of the streamed metal decreases, it is a benefit to the mining company. When the spot price increases, it is a benefit to the streaming company. In some cases, streaming transactions have included continued exposure to the mining company of a portion of future metal prices.

### **[e] Transfer Restrictions**

Given that stream agreements are not interests in land that continue with any purchaser of the mining properties, they usually have restrictions that either (1) require consent for the mining company to transfer the subject mineral project or undertake a change of control transaction, or (2) otherwise codify the circumstances in which such transfer or change of control is permissible. In most cases, a change of control of the ultimate parent of the mining company is not restricted.

## **§ 16.05 Allocation of Risk**

A streaming company typically takes production risk and metal pricing risk. It does not typically take operating cost or capital cost risks at the mine as the streaming company does not have any control over the operations of the mine. However, streaming companies also attempt to eliminate, or at best mitigate, any of the other risks to which their deposit payment may be subject, and certain of these are discussed below.

### **[1] Security**

Generally, a streaming company will look to ensure that the counterparty to which it is providing the up-front deposit has the financial resources to perform the obligations under the stream as production occurs. In some cases, the counterparty is the mining company itself, in which case there is a natural alignment between the obligation to deliver metal under the stream and the ability to pay (i.e., there is only an obligation to deliver

metal if the mine produces, in which case the mine should have the ability to pay). In other cases, the counterparty may be a holding company or special purpose entity. In such cases, greater protection is required through the use of parent company guarantees or other mechanisms.

The streaming company will look to the financial covenant of the particular counterparty to the stream and any applicable guarantors, and consider whether additional security is needed in the form of charges against all or a portion of the assets of the mining company. The greater the financial capacity that the streaming company can look to (whether by way of investment grade parent company guarantee or significant security package, for instance), the higher the up-front deposit it will be willing to pay to the mining company as it has greater confidence that downstream delivery obligations will in fact be performed. The jockeying that occurs among the various financing parties in securing their investment and the obligations owed to them is manifested in an inter-creditor agreement, discussed below.

## [2] Development Risks and Completion Tests

Investing in any development stage asset presents risks, and stream companies will seek to protect their investment in any number of ways.

- **Staggered Deposits:** The risks associated with development delays and disruptions may be allocated among the parties to a streaming agreement by negotiating staggered payment of the deposit or reimbursement of costs incurred by the mining company in developing the asset.
- **Completion Test:** In some cases, there may be a completion test that requires a partial or full return to the streaming company of the deposit if certain performance criteria are not satisfied.
- **Term Extensions:** Fixed terms may be extended to compensate a streaming company for development or production delays.

## [3] Political Events

### [a] Expropriation

The risks that streaming companies seek to mitigate include expropriation and other political events that involve loss of mining rights. In some cases, a streaming company can terminate the purchase agreement in such circumstances and receive some form of compensation.

### [b] Insurance

In a typical stream agreement, the streaming company shares in any insurance proceeds for produced metal lost before the risk of loss or damage is transferred to an offtaker.

**[c] Tax**

As discussed below, streaming agreements (and particularly the parties to the streaming agreement) are often structured to take advantage of certain structuring efficiencies that may exist for both the mining company and the streaming company. Allocation of the risks associated with a particular transaction structure is often negotiated and should be one of the primary discussion points in the early stages of considering a streaming transaction.

**§ 16.06 Tax Implications of Various Structures****[1] Tax Structure**

Generally, streaming transactions are structured as agreements of purchase and sale of refined metal (or other commodity) and not as royalties subject to withholding tax. As stated above, the streaming company typically advances funds up-front as a deposit. As metal from the mine is produced and refined, the refined metal is sold to the streaming company at a purchase price equal to the market price of the streamed metal. This purchase price is satisfied in part as a credit against the deposit and in part by the additional fixed cash payment by the streaming company. Once the deposit has been fully credited, the purchase price is reduced to be equal to a fixed cash payment, rather than the market price of the metal.

Streaming transactions typically allow mining companies to reduce or defer taxation on the up-front payment under the streaming agreement. For Canadian income tax purposes, the mining company is required to include the up-front payment in income, but claims a reserve in respect of metal to be delivered to the streaming company in subsequent years. Although the mining company will be required to include in its income for the following year (Year 2) the amount of the reserve claimed in the previous year, it will be able to claim another reserve in Year 2 (and in subsequent years) in respect of that portion of the up-front payment still not earned (i.e., metal still not delivered). This reserve mechanism effectively allows the mining company to recognize the up-front payment in income as metal is actually delivered, notwithstanding the advance receipt of the up-front deposit.

For the streaming company, the cost of each unit of metal delivered under the streaming agreement is equal to the amount of cash paid on delivery plus the portion of the up-front payment credited on delivery. The net result for Canadian income tax purposes is that the mining company has revenue and the streaming company has cost in respect of the purchase and sale of a unit of metal based on the purchase price specified in the streaming agreement.

Royalties are taxed differently in Canada. Very generally, to the extent that the royalty is in respect of a resource property owned by the mining company, the up-front payment is deducted from its resource pools. To the extent that the mining pools are reduced to a negative number, an income inclusion will result (but may be sheltered from tax by other tax attributes, if available). As royalty payments are made, the mining company generally can deduct these payments, and the payee, if Canadian, must include them in income. If the payee is not Canadian, the payment will be subject to withholding tax.

Where the mining company is located in a jurisdiction outside of Canada, it may be necessary to modify the structure of the streaming transaction to accommodate local tax laws. The principal issues usually involve confirming that the tax laws in that jurisdiction do not re-characterize the streaming transaction as a royalty, and that the mining company can defer tax on the up-front payment. If this is not the case, it is often still possible to structure the streaming transaction efficiently. For example, a special purpose company incorporated in a tax friendly jurisdiction may enter into the streaming agreement. The special purpose company would purchase metal from the mining company under a separate forward agreement, and deliver the product to the streaming company under the streaming agreement.

## **[2] Withholding Tax**

Many payments made under other types of financing transactions by a Canadian resident to a non-resident, such as royalties, dividends, participating interest, or interest paid to a non-arm's length lender, are subject to withholding tax at a rate of 25% of the amount paid, unless that rate is reduced by an applicable tax treaty. The cost of such withholding tax may be mitigated if the recipient of the payment is entitled to a foreign tax credit in its domestic jurisdiction. Conversely, where a Canadian mining company monetizes its mining production through a streaming transaction, no withholding tax arises. Accordingly, streaming transactions offer an opportunity to manage withholding tax costs.

## **[3] Structuring the Streaming Arrangement**

The best option for structuring a metal stream in a tax efficient manner often depends on the residence of the mining company, the mine, and/or the streaming company. Although perhaps the simplest example is a Canadian mining company entering into a metal stream in respect of a Canadian mine with a streaming company that may or may not be resident in Canada, Canadian mining companies typically hold foreign mines through companies located in foreign jurisdictions. As a result, the structure of the metal stream will seek to defer foreign tax on the up-front payment.

#### **[4] Mining, Commodity, and Sales Taxes**

Notwithstanding the significant income tax advantages that streaming transactions may offer, it will be necessary to consider any mining, commodity and sales taxes that may arise as a result of the sale of production under the streaming agreement. Although it may be difficult to minimize or eliminate such taxes, the income tax advantages will generally outweigh the incremental mining, commodity and sales taxes that may result from a streaming transaction.

### **§ 16.07 Interplay of Creditors**

#### **[1] General**

Mining companies should be conscious of the effect a streaming or royalty transaction will have on raising debt in the future, notably what type of security a debt financier will be looking for from the mining company. Whereas a royalty agreement will generally only involve a security interest in the land (and is commonly acceptable to traditional lending institutions), a streaming agreement may, as noted above, include more extensive security over all the assets of the project in favor of the streaming company. Negotiating the priority arrangements among secured parties adds complexity (time and costs) to a streaming arrangement, which is otherwise viewed as a flexible and faster financing option. In particular, the negotiation of a senior lender's obligation to realize on the assets in a manner that protects the mine as a going concern is often highly contentious.

#### **[2] Inter-Creditor Agreements**

As mining projects typically involve multiple parties, which can include many investors and financing parties, inter-creditor agreements can provide a certain amount of clarity as to priority of interests and rights of parties in the event of a default. For example, in the case of Donner Metals Ltd.'s default under a metal purchase agreement between Donner and Sandstorm Gold Ltd., and certain related parties, the inter-creditor agreement among Donner, Sandstorm and Glencore Xstrata plc governed how notice of default was given, and how each party's rights were to be exercised.

#### **[3] Priorities on Enforcement**

Traditional lending institutions expect to have first priority to the assets that are the subject of their security interest so that they have complete control over the realization process in a default situation, and for such process of realization to be effected efficiently. As such, banks will often be concerned with how a secured streaming company will affect any enforcement on their security, as they would with any other party that had security on the same assets. Because streaming companies view themselves

as having purchased, and being the owners of, the metal subject to their streaming agreement, they will want to ensure that a project continues to operate and that they continue to receive delivery of the purchased metal.<sup>9</sup> It may be difficult to reconcile a streaming company's expectation that the mine will continue to operate with a bank's desire to efficiently liquidate the mining company's assets to cover any outstanding debt. Negotiation of "who runs the show" (i.e., which secured party manages enforcement and realization) and the obligations of such party is one of the critical aspects of any inter-creditor agreement.

Given the complexity of this relationship, many streaming agreements or bank loans are conditional on the execution of an inter-creditor agreement among the various secured parties in a project. Although each situation is unique, streaming companies will often agree to defer control over the enforcement process to the bank lender and agree to a significant period of time during which the streaming company will "stand still" from taking any enforcement action in return for the lender agreeing that in a post-default situation the streaming company will continue to receive the percentage of production due to it under the streaming agreement while the mine remains operational and that, in an enforcement or insolvency scenario, the lenders will not sell, or agree to a sale of, the mining company or its assets without the purchaser agreeing to assume the streaming agreement. The existence and precise scope of such standstill periods and such covenants by lenders are often the most heavily negotiated aspects of inter-creditor agreements.

#### **[4] Priority of Security and Payment Waterfalls**

As project revenues will fluctuate with time, secured parties may set out the order in which revenues are allocated both during normal course operations and on an event of default. Structuring payments in such a way may ensure that the operating expenses are met, while creditors receive payment based on the priority of their debt/stream obligations, as negotiated in an inter-creditor agreement. As a primary matter, an inter-creditor agreement will establish the priority of payment as between the streaming company and other secured parties with respect to the purchased metal not yet produced, particularly if a mine is not continuing in operation.

In a default/enforcement situation, this may very well be the most contentiously negotiated aspect of an inter-creditor agreement. As stated above, streaming companies consider themselves to be the owners of the metals which they have negotiated the purchase of, while bank lenders' security

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<sup>9</sup>Royalty companies will also want to ensure that an enforcement on the mining assets does not result in a sale of the mine without the royalty attached.

operates as a general charge over all the assets of the mining company. Consistent with the streaming companies' view that they are the owner of the metals, they will primarily seek to ensure that they have priority over those metals—both in terms of the metals which have already been extracted and may remain with the mining company (either in original or proceeds form) and in terms of the proportionate value of the mining property itself which represents the purchased metal to be extracted in future production.

Inter-creditor agreements attempt to achieve a delicate balance between the interests of the streaming company and the bank lender, which will often include intricate and complex rules on when and how any one creditor may take enforcement action, when a creditor must stand still from taking enforcement action, when one creditor may be obligated to support (or at least not object to) the actions and positions of the other creditor, and if and how each creditor will be protected from negative consequences of the enforcement actions of another creditor. Achieving such a balance of interests requires each of the parties to make projections and assumptions as to how the other will react to a future default and as to the processes that may or may not be available to each of them in those situations. That becomes increasingly difficult in situations where the mining assets are located in foreign jurisdictions with enforcement and insolvency laws that may be significantly different from those in North America which the creditors (especially North American-based banks) may be more accustomed to.

### **§ 16.08 Future Developments**

Despite the growth in alternative financing and disadvantages associated with raising equity and debt, royalty and streaming transactions make up only a very small percentage of the financing raised each year in the mining industry. However, it is likely that this form of financing will continue to rise, in part because of the flexible approach brought by streaming companies. In fact, we have recently started to see innovation in this area.

#### **[1] Syndication**

In late 2013, top executives at both Franco-Nevada and Sandstorm stated their willingness to enter into multi-billion-dollar syndicated streaming transactions. This development comes at a time when streaming companies are investing in increasingly larger projects, such as Silver Wheaton's \$1.9 billion streaming transaction with Vale and Franco-Nevada's \$1 billion stream with Inmet (now First Quantum). As the size of transactions continues to increase and metal streaming companies seek to mitigate exposure across assets, streaming agreements are beginning to provide for the flexibility to syndicate participation in transactions on agreed terms. In cases where syndication is desirable, the seller will seek to establish

minimum and maximum percentage interests that can be transferred to other metal streaming companies.

The increased prevalence of streaming transactions has led many to believe that sharing both the upside and downside of billion-dollar transactions is the only way for streaming and royalty companies to become consistent major players in this segment of the metals financing market. As stated by David Harquail, CEO of Franco-Nevada, “[a]t some point, we should be acting like commercial banks. We could do multi-billion dollar syndicated deals and share the risk.”<sup>10</sup>

## [2] Acquisition Funding

To date, the vast majority of metal streaming transactions have been carried out by the direct or indirect owner of the mineral project. The business model has the potential to be applied to acquisition transactions to provide a potential acquiror with a competitive source of financing to be used to fund a portion of the purchase price of the target mineral project. The same arbitrage that drives the basic business model allows a metal streaming company to fund a portion of an acquisition at a higher NAV multiple than both the NAV multiple used in the purchase price allocation and the NAV multiple attributable to the acquiror. The additional value created by the metal streaming transaction provides a competitive advantage to an acquiror in a competitive bidding process.

In April 2014, following a hostile takeover bid by Goldcorp Inc., Osisko Mining Corporation entered into a \$3.9 billion friendly transaction with Yamana Gold Inc. and Agnico Eagle Mines Limited. A portion of the purchase price paid by Yamana was financed by a \$275 million gold streaming agreement with Montreal-based Caisse de dépôt et placement. To stave off Goldcorp’s hostile offer, the deposit paid pursuant to the gold streaming agreement was combined with traditional debt financing provided by the Canada Pension Plan Investment Board and cash from Yamana itself to comprise a \$1 billion cash distribution to Osisko shareholders.

## [3] Non-Precious Metals

The market for transactions involving minerals other than precious metals has been slower to develop. One company, Sandstorm Metals and Energy Ltd., was successful in acquiring two copper streams (one of which was subsequently converted into an NSR royalty), as well as an NSR royalty on base metals, but was ultimately rolled into Sandstorm Gold Inc., a metal streaming company focused on gold assets. Recently, the first diamond streaming transaction was announced by Stornoway Diamond

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<sup>10</sup>“Sandstorm & Silver Wheaton Back Syndicated Deals,” *Global Mining Observer* (Nov. 2013).

Corporation, with a private investor and a pension plan, as part of its financing package to fund construction of its Renard diamond project. The Renard diamond stream involves the forward sale of 20% of production for C\$250 million and represents the most significant streaming transaction outside of silver and gold.

### **§ 16.09 Conclusion**

The funding gap created by contracting equity markets in recent years is not generally expected to narrow in the near future. Even if it does, the adaptable nature of streaming may encourage the continued evolution of this financing source for both earlier stage junior development companies and more senior producers looking to diversify their capital portfolio. As discussed above, while issues of risk allocation, tax efficiencies, and priority of secured lenders must be considered in the context of any streaming transaction, the retention of a full control and ownership interest in the project and the ability to reduce balance sheet debt without diluting equity holders, as well as the independent endorsement brought by senior mining companies such as Silver Wheaton, Franco-Nevada and Royal Gold, make streaming transactions an attractive option for the future of mine financing.