Ingo Hofmaier (left) and Andrew Chubb of Hannam & Partners

HANNAM & PARTNERS DIGS DEEP WITH KENMARE DEAL

Team of the month

Faced with a plummeting share price as the commodities slump set in, Kenmare Resources called in some proven experts for a daring $275m restructuring project. Edward Russell-Walling looks at what happened next.

With natural resources outperforming almost all other equity sectors this year, it is clear that investor appetite for commodities is returning. This reversal in attitude has allowed embattled Kenmare Resources to pull off a $275m capital raising and restructuring, thereby avoiding an unwanted takeover. Hannam & Partners, an independent self-styled 'merchant bank' specialising in natural resources, was financial adviser to the company.

In 2012, Ian Hannam and Neil Passmore acquired advisory boutique Strand Partners and renamed it. Mr Hannam is a former chairman of global capital markets at JPMorgan, while Mr Passmore had been in natural resources corporate finance at JPMorgan Cazenove. They were joined by partners including seasoned mining financier Tim Hoare. Since its inception, the firm has advised on deals worth upwards of $6bn – most of them in the metals and mining or oil and gas sectors.

Clients and mandates include Asia Coal Energy Ventures in its successful $208m hostile bid for Asia Resource Minerals, Kuwait Energy in its $250m debut high-yield bond and Petropavlovsk in the restructure of a $310m convertible bond.

There's been something of a deal drought in natural resources over the past few years, as slowing Chinese growth has dampened enthusiasm for commodities. "A lot of human resources have been withdrawn from the sector, with law firms, investment banks and others seeing a material reduction in headcount," says Hannam partner Giles Fitzpatrick. "Most mining and oil and gas groups have been degearing and fresh investment of capital has been hard to find. But recently we have seen a proper rally across metals and mining, and in Brent and West Texas International [oil prices]."

The connection between Hannam and Kenmare goes back a number of years, with links to some of the partners' previous careers. Ireland-based Kenmare is listed in Dublin and London. It has only one asset of note, the Moma Titanium Minerals Mine on the north coast of Mozambique.

TWO-STAGE PLAN

Moma's mineral sands contain perhaps 60 years-worth of iron-titanium oxide, or ilmenite. This can be processed into titanium dioxide, which is then used as a whitener in paints, paper and plastics. The sands also contain smaller quantities of rutile, which has similar applications, and zircon.

Kenmare had got itself in a classic, cyclical predicament. As ilmenite prices appeared to recover after the financial crisis, the company embarked on a two-stage expansion programme. To finance this it raised debt from a consortium of banks, including South Africa's Absa, Germany's KfW and a number of other development banks. At the time of the recapitalisation, its gross debt stood at $392m.

Phase one was completed in 2009 and phase two in 2012, but by then ilmenite prices had started to slide. At their all-time high that year, Kenmare's shares traded at a little over 60p (78 cents), making the company worth $2.3bn.

"Natural resources investment peaked in 2012," says Ingo Hofmaier, a Hannam partner and the firm's head of mining. "Prices had started to soften a year to one-and-a-half years before, and the fall accelerated just as the new capacity was coming on stream."

CIRCLING SHARKS

Having been as high as $450 per tonne, ilmenite prices would plunge to about $80 per tonne. But that was not Kenmare's only problem. "Just as phase two was getting ready to ramp up, there were electricity and construction issues," says Hannam partner and head of corporate finance Andrew Chubb. "This combination of a fixed level of debt, falling commodity prices and operational issues put pressure on the share price."

An intrinsically good business with a falling share price is likely to attract predators, and in June 2014 Kenmare received an all-share takeover offer from Australian miner Iluka Resources. Worth about 17p a share (a 40% premium to the prevailing price of 12p), the offer valued the company at about $800m. The board rejected the offer, saying it did not recognise Moma's value as a long-life, low-cost asset. Its stance was supported by investment manager M&G, which held 19% of Kenmare's shares.

"It was a bear hug," says Mr Chubb. "During the offer period, the company couldn't talk to investors. The price of commodities was still going down, and no news in a falling market exacerbated the share price fall."

At the same time, since Kenmare was not paying the interest on its debt, this was accruing at the rate of $35m a year. In May 2015, Iluka was back with a much-reduced offer of 6.8p a share, valuing the business at $295m. It came with a number of preconditions, including the pre-approval of major shareholders. Given the seriousness of Kenmare's situation, and in the absence of other options, its board agreed to work towards satisfying the preconditions.

In the meantime, Hannam had been observing goings-on and decided that it should help. "We believed that, because of the quality of the asset, the scarcity of deposits of that nature and the size of the capital investment to date, this was a saveable independent business," says Mr Chubb.

At this point, the lenders thought the best chance of getting their money back was for Iluka to buy the business. Hannam was confident it could come up with a strategic investor-driven solution, and began to have meaningful conversations with private equity houses, trade and financial investors.

"Our strong focus on Africa meant we were able to speak to people who could see this not just from a financial perspective but also from a geopolitical point of view," says Mr Hofmaier. Hannam was looking for a cornerstone investment of $100m in return for a post-injection stake of about 30%.

THE GERM OF AN IDEA

It found a private equity investor prepared to sign a term sheet as a cornerstone investor, but full agreement proved elusive and the investor withdrew. Nonetheless, it had planted a seed. "It put the possibility of an alternative into the minds of the lenders and shareholders," Mr Chubb says.

An alternative was needed rather desperately. Kenmare shares hit a low of 0.31p, valuing the company at $13m. Iluka had again revised its offer downwards, to about half the previous level. Kenmare had breached its banking covenants and been forced to accept an interim restructuring, which stepped up the interest on its loan and insisted on a resolution by January 2016. Resolution was provided in the shape of Kenmare's 'material deleveraging transaction'.

"We introduced the cornerstone concept to the State General Reserve Fund [SGRF] of the Sultan of Oman," says Mr Chubb. "SGRF is a large sovereign wealth fund with an outward-looking mandate, interested in investments that diversify the Oman economy and have long-term potential."

Oman has a historical connection to Zanzibar and the east coast of Africa, so SGRF was comfortable with the jurisdiction. It signed a term sheet in November 2015, saying it would pay $100m for a 29% stake. After accelerated due diligence, the deal was presented to lenders as part of a $275m recapitalisation which the shareholders would now support with new money.

SAFETY IN DOLLARS

"The timing couldn't have been more important," says Mr Chubb. "Iluka wanted shareholder consent or it was going to walk. On the back of the term sheet, the major shareholders rejected its offer."

With the ilmenite market improving, the other parts of the deal now fell into place. Three major shareholders promised to take up at least $115m of a firm placing, which eventually received commitments of $146m. The lenders underwrote the ensuing open offer to the tune of $29m, which took total commitments to the $275m threshold.

The open offer was conducted in US dollars to counter any lurches in Brexit-sensitive sterling. Had it raised the maximum possible $123m, it could have paid off the debt in full. It only managed $8.9m in gross proceeds, reducing the lender underwriting to $20.4m. The $392m debt has now been reduced to a more manageable $100m after a repayment of $200m, a $68.5m write-down and debt equitisation of another $23.5m. The remaining $75m raised goes to working capital and expenses.

The government of Mozambique was keen to participate, so state-owned miner EMEM is paying $1m for warrants that can convert into up to 5% of Kenmare's equity within five years. "This was key in showing government support for the project and its existing management and shareholders, to soothe the lenders," says Mr Chubb. TB

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