A New Way to Finance Mining

Michael W. Scherb, founder of Appian Capital, tells us why private equity is a better way to finance mining projects...

LatAm INVESTOR: *What is Appian's strategy for investing in the mining sector?*

Michael W. Scherb: Appian is a unique blend of long term patient and collaborative capital combining with a technical team which has built 60+ mines into production and a financial team which has overseen nearly $200bn of mining deals. My background is working for JP Morgan's mining team in London and during that time I realised that in the mining industry you have a lot of short-term money financing long-term projects, so there was a clear disconnect. Appian represents long term capital matching a long term industry.

You see retail or institutional investors trying to invest in mining with a short-term mindset looking for quarterly returns. So you end up seeing the same mistakes throughout the mining cycle – everyone is too bullish during the upturn and too negative when things get difficult, exactly what we are witnessing now.

But when you have a ten-year investment horizon it allows you to invest through the cycle and ignore groupthink. Another characteristic of our fund is that we focus on small to medium-sized opportunities where we believe our focus on technical aspects allows us to differentiate ourselves as true partners with mining groups.

LAI: *What are Appian's competitive advantages?*

MWS: To build value in mining, it requires in-depth financial and technical skills. Private projects in Latin America often get their money from public markets as there are very few private equity funds operating in this space. We offer a better source of capital because our team has experience in developing some of the best known projects globally, so these companies get advice from people who have built some of the largest and most complicated mines on the planet.

We place a big emphasis on our team which has built up more than 60 mines into production across a range of geographies and geologies. People like Tony Redman, an ex Technical Director of Anglo American who built Anglo Coal into a 100mt producer as CEO, and Robin Mills, who was Executive Director for Mining for Anglo Platinum, DeBeers and AngloGold, bring a lot to smaller companies looking to develop projects. Anyone can give you money but we provide our portfolio clients smart money and work together to build the project into a larger one as a collaborative partner.

Another key difference is that we do not outsource the due diligence, unlike most other funds, which get that completed by a third-party. We can evaluate a project and then quickly work with management on how to improve the efficiency of the operations.

Our financial team come from some of the top global investment banks, so an owner or management team of a project in Latin America not only gets a capital and operating partnership, but true top level financial advice, for example on opening up the international capital markets of London, New York or Toronto or in securing debt financing from leading global banks, or M&A advice on acquiring a neighbouring project.

Michael W. Scherb, founder of Appian Capital

LAI: *How does Appian structure its deals?*

MWS: We are flexible about deal structure. We often take a majority position or earn-in over time, but our partners have an attractive profit sharing mechanism which allow them to profit from the upside also. However, we do have minority positions, for example with the Antas copper mine in Brazil and with a goldmine in Colombia which we have now successfully exited after a value-build process.

Latin America continues to be a main focus for us and we have just expanded into the region with a presence in Lima, Peru, which shows that Latin American mining is firmly on our radar and we would encourage mine owners, stakeholders and governments in the region who are interested in having Appian as a partner to reach out to us for a discussion of our objectives in the region.

LAI: *How do community and environmental issues impact mining projects in Latin America?*

MWS: It varies. Even in pro-mining countries there are issues that have to be handled sensitively. Take Colombia, for example. I always found it bizarre that Colombia likes large open pit coal mining projects but objects to underground gold mines because of the use of cyanide in the leaching process. So there still needs to be learning curve in terms of mining. However, despite a bureaucratic permitting process we managed to get our Colombian gold project, Red Eagle, up and running, so it can be done.

Ultimately, wherever you develop a project it is important to have complete certainty that you won't have community issues. However, we have a good track record, with a team that has built mines across the world. You need to be upfront and honest with communities and governments from day one, get them involved and make them a stakeholder so that you jointly tackle issues when they arise. It's more than just putting up a few community buildings; you need them to feel part of the whole production life-cycle of the mine. Our formula has worked so far. Of our five investments, three are already into production and they have not had serious issues.

LAI: *Your launch of the fund coincided with a downturn in commodity prices; how has that impacted Appian?*

MWS: Actually the down cycles in mining are not a bad thing in general because it means the bad habits picked up during the upcycle are shed. When prices are on the way down everyone watches their spending. The fact is there are a lot of projects that went public way too early in their lifetimes and shouldn't be public companies. Of the thousands of mining projects that go public, about half should go bankrupt.

Another effect of lower prices is that the risk profile of retail investors has changed. Projects are getting funding but not the blanket funding that we saw before. Any old exploration play that needs $10million or so finds it difficult but better projects have more options. Fortunately our competition in the private deal sector is still rather limited because there are only a few private equity mining funds. Again it comes down to due diligence, if projects have scrappy information then it's difficult for a retail fund to evaluate, whereas Appian's ability to carry out diligence in-house means that we can evaluate more projects.

I think people are seeing through the marketing and the nonsense that comes when you have a mining CEO who spends most of his time going cap-in-hand to investors to keep his project afloat. If you look at oil and gas, PE is very established but in mining it's brand new. But when you think about it, it is strange that the existing model for mining funding has an almost venture capital approach. Early stage exploration is financed with a couple of million of growth capital, but going public brings with it all of the bureaucracy and constant shareholder updates. It is better to keep it private so the management team can focus on building the project, build up the value and then when it is closer to production you go public.

LAI: *What is Appian's exit strategy on its investments?*

MWS: We will either take the projects public or, if we think that doesn't offer fair value, we will hold it and stream the dividends back to our investors over the lifetime of a mine. We have a flexible and supportive investor base that has a long-term approach and understand the cyclical nature of the industry. The understanding is to return capital in 10 years but we can extend if needed, which would allow investors to share in the profit over the life-span of a mine.

The Appian backed Antas North copper and gold mine, Carajas, Brazil