KING&WOOD MALLESONS

Benefits payable under future act and ALRA agreements: what is the best model?

Native Title Conference 2016: Nick Testro and Rob Sowerby

Context

- Native Title Act future acts regime:
  - Right to negotiate
  - ILUAs
- Aboriginal Land Rights Act (NT) 1976
- The quantity and timing for the payment of benefits is determined by the model agreed by the parties

Benefits payable

- Fixed fee
- Unit based royalty
- Ad valorem royalty
- Profit-based royalty
- Project equity

Fixed fee

- Fixed fees that are stipulated in the agreement
- Paid at agreed intervals (any or all of the following):
  - agreement signing/commencement
  - at specified milestones or periods, eg. on grant of a tenement or annually
- No variation to payment based on project's profitability, proponent's costs or change in value of commodity

Unit based royalty

- Fixed charge based on the volume of mineral extracted from a mine
- No variation to payment based on project's profitability, proponent's costs, or change in value of commodity
- *Payment = $[agreed rate] x tonnes of mineral produced*

Ad valorem royalty

- Fixed charge based on the value of the mineral
- No variation to payment based on project's profitability
- Can account for some project costs (eg. transport), though not usual
- Payment fluctuates based on market value of mineral
- *Payment = [agreed rate]% x value of mineral x tonnes produced [– agreed costs]*

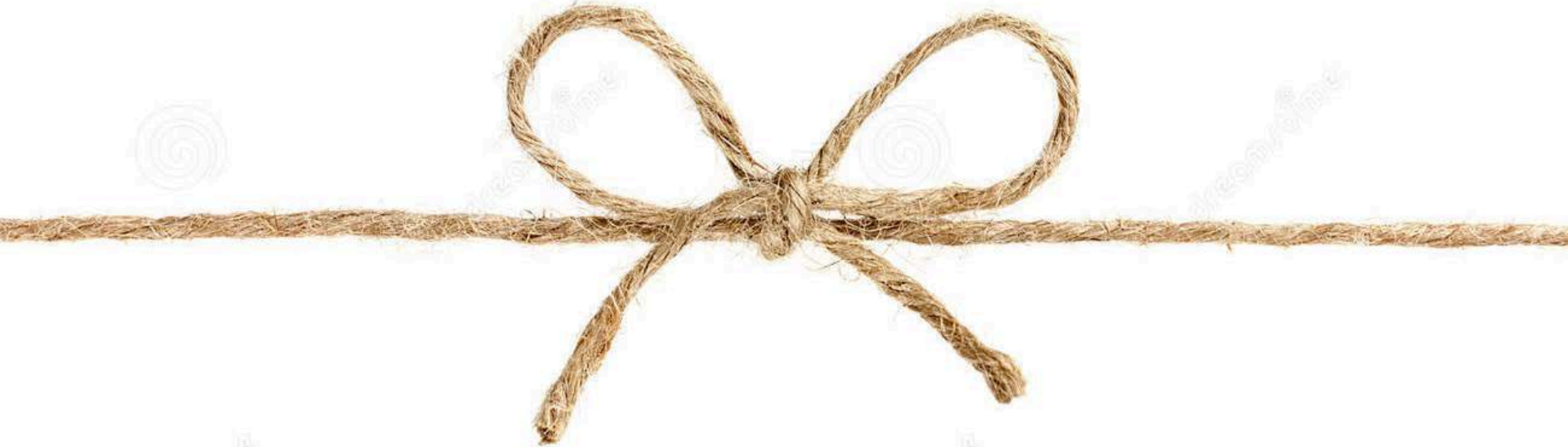
Profit based royalty

- Applied to the profits of a project
- Profit calculated by deducting costs of production (can include exploration and interest for loans)
- Rate will normally be higher than other models to compensate for higher risk and payment delay
- *Payment = A% x profits – allowable costs*

Project equity

- Traditional owners' interest in the project can be by way of:
  - an unincorporated or incorporated JV
  - equity (shares) in the proponent company
- Proponent 'free carries' traditional owners' share of costs until an agreed milestone (for JV) or grants equity in company at no cost
- Traditional owner benefit – dividends, share in profits in accordance with their share of the JV, or proceeds of sale of interest in company/project

So what's the best model?



Pros and cons

	Admini-stration	Value of benefit	Tied to value of mineral	Requires miner profit	Risk to TOs	Risk to investor/miner	Timing of payment	Accounts for project costs
Fixed fee	Simple	Lower	No	No	Low	High	As agreed	No
Unit based royalty	Simple	Lower	No	No	Low	High	Start of production	No
Ad valorem royalty	Simple	Variable	Yes	No	Low	Medium	Start of production	No
Profit-based royalty	Complex	Higher	Yes	Yes	High	Low	First profit	Yes
Equity	Complex	Higher	Depends	Yes	Depends	Low	First profit	Yes

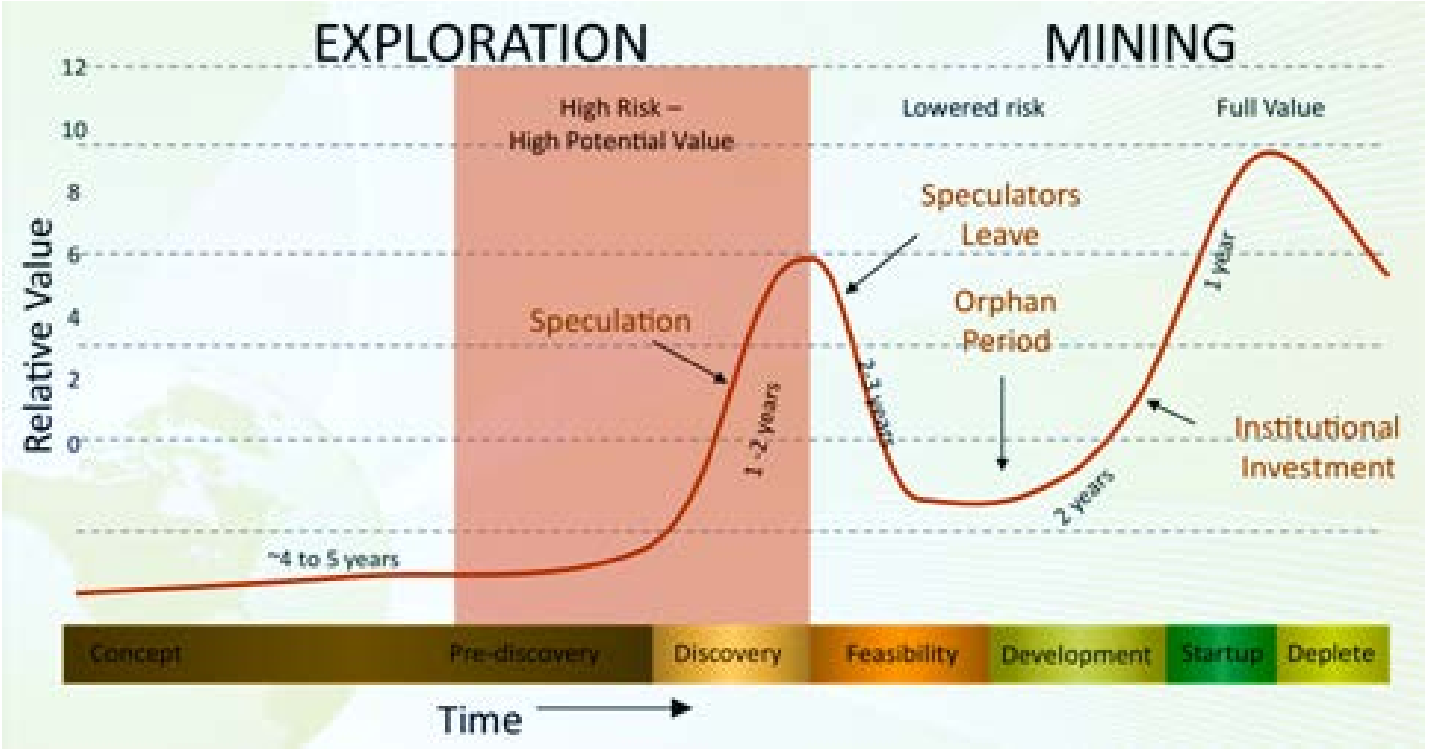
Factors in structuring benefits

- Experience of parties' legal/other representatives
- Size (value/term) of the project
- Traditional owners' appetite for risk/certainty and intangible aspirations
- Parties' desire for administrative simplicity/complexity
- State of the market

Best model: hybrid approach?

- Meets parties' aspirations on various factors identified
- Provides a sufficient return to meet Traditional Owners' aspirations while minimising risk to the viability of a project
- A combination of the different models at different stages of the project to create a multi-faceted model could balance the risk taken by each party and require only a modest adjustment to aspirations

The Value cycle - Risk vs Return



Strategic Value of Undeveloped Resources

Value realised despite sentiment or development status…

Frieda River Project – Feasibility stage project in PNG – $90M for 80 % of Copper deposit. Scoping Study completed.

Northern Mining - $10M for 49% of gold exploration concession area in China

Mantra Resources Ltd – Listed at 20c in 2006, Takeover in March 2011 for **$1.03 billion** on back of Mjuku River discovery. **Still Undeveloped**

Economic Volatility and Risk

Key Point – Economic Drivers for Resource Development are highly volatile

5 Year Volatility	
Copper	62%
Gold	45%
Iron Ore	78%
Uranium	46%
AUD/USD	35%

Capex costs for significant projects are very high.

Only projects which show strong returns on investment with payback periods 3 years or less are likely to be financed.

Forecast returns of at least 15% and over are generally required

In a conjunctive process, economic parameters are unknown when an agreement is negotiated.

Possible Outcomes

Roper Bar mine wind-up: native titleholders seek royalty payments

THE AUSTRALIAN | JULY 3, 2015 12:00AM

SAVE

Matt Chambers
Resources reporter
Melbourne

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Western Desert chairman Rick Allert, far left, at the Roper Bar mine opening.

Decreasing Probability

	Equity Model	Royalty Model
Value Realisation		
– No discovery	Maybe	No
– Discovery of sub-economic deposit	Yes	No
– Discovery of Marginal economic deposit	Yes	No
– Discovery of economic deposit	Yes	Yes

Ideal Model Outcomes

Minimise risk and maximise returns by:

- Benefiting from Value Cycle of Resource Projects
- Minimise volatility risk
- Maintaining viability of the project
- In a conjunctive system, provide optionality at Feasibility stage.

Conceptual Cash Flow Modelling

Cost Assumptions

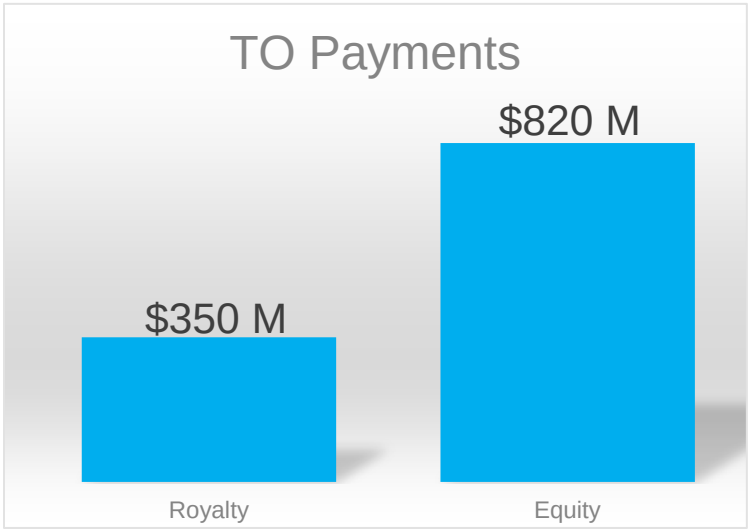
Ore Value/t	$250
Production costs/t	$60
Mine life	20yrs
NT Royalty	20% Profits

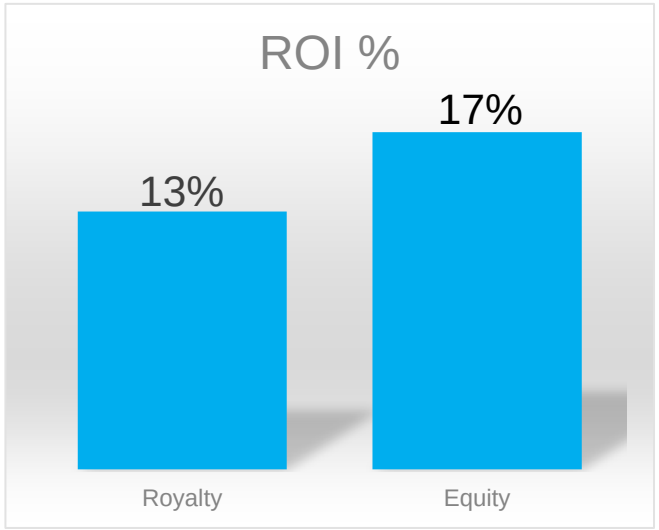
Royalty Case

Royalty Rate 5.5% gross

Equity Case

TOC Equity	40%
% of TOC Net proceeds to repay	80%





Economic Capacity

Capacity in a business sense is derived from:

- Quality assets (physical or intellectual)
- Cashflow
- Reputation

Provides the leverage to attract:

- Investment
- Expertise
- Opportunity
- Influence and ….
- New opportunities

Questions