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ALTERNATIVE TRANSACTION STRUCTURES FOR INVESTMENTS BY SOVEREIGN WEALTH FUNDS AND OTHER INVESTORS FROM EMERGING MARKETS

Sovereign wealth funds (SWFs) and other investors from emerging markets have become increasingly significant participants in the Canadian and U.S. M&A landscape in recent years. Notable examples in Canada include Sinopec's C$8.3 billion acquisition of Addax Petroleum and its US$4.65 billion investment for a 9% stake in oil sands producer Syncrude; the C$1.7 billion investment by China Investment Corp. (CIC) in Teck Resources; and Temasek's C$500 million investment in Inmet Mining. These transactions have been driven by a confluence of forces, including companies in the resources sector seeking access to capital, companies from emerging markets seeking to secure a strategic source of resources and SWFs seeking to capitalize on the expected long-term strength in commodity prices. Notable examples in the United States include CIC's US$1.58 billion investment in AES and its earlier significant investments in Morgan Stanley and Blackstone.

We expect this trend to continue in Canada and the United States, in particular with respect to transaction structures such as PIPEs (private investments in public equity) and other minority investments that are alternatives to the acquisition of 100% of a target company. In the resources sector, these types of investments often include innovative arrangements such as ownership participation in the underlying resource assets and offtake agreements (whereby investors obtain the right and/or obligation to purchase over a number of years a set quantity of the production from a specific project, typically at market or otherwise agreed prices).

PIPE transactions and minority investments

PIPE transactions offer significant flexibility and can take a variety of forms, including common shares, preferred shares, convertible debt and warrants. While most investments by SWFs and emerging market investors have involved common shares, one of the exceptions is CIC's US$500 million convertible debenture investment in South Gobi Resources. PIPE transactions can also allow for the acquisition of a controlling interest in a public company, as was the case in Pallinghurst Resources' US$175 million acquisition of a controlling interest in Platmin, and Severstal's C$56 million acquisition of a controlling interest in High River Gold (both transactions were completed without the need for shareholder approval under the TSX's financial hardship rules).

PIPE transactions and minority investments provide a number of key benefits for foreign investors, including these:

- There is increased speed, certainty and relative ease of execution compared with a 100% acquisition of a target company. Transactions can generally be negotiated and completed in as little as one month compared with a typical three- to four-month (or longer) timeline for a 100% acquisition.

- Investments involving the acquisition of less than a 20% voting equity interest can generally be completed without obtaining any shareholder approvals under applicable Canadian and U.S. stock exchange rules. In Canada, these investments can generally be completed without the need to obtain Canadian government regulatory approvals, including the "net benefit" foreign investment review under the *Investment Canada Act*. In the United States, these investments are generally less likely to raise political sensitivities and are typically subject to less intensive U.S. national security regulatory review.

- There is the opportunity to partner and share risk with the investee company and its stakeholders. This type of "on the ground" partnership and local presence can be a critical factor in making the investment a success for a foreign investor.

Special deal terms

A number of the major PIPE transactions involving the acquisition of an interest of between 10% and 20% in Canadian public companies have contained certain of the following notable terms:

Preemptive rights. In most cases, investors have been granted the right to maintain the initial percentage interest of their equity and voting rights in the event of future issuances of securities by the investee company, subject to certain exceptions.

Board representation. In many cases, investors have been granted the right to nominate one or two directors for election to the board of the investee company, provided that minimum securities ownership levels are maintained.

Registration rights. In many cases, the investee companies have undertaken to qualify or register the acquired securities for public resale.

Standstill restrictions. In the Teck and Inmet transactions, CIC and Temasek agreed to broad restrictions on acquiring additional securities of Teck and

Inmet or otherwise influencing control, subject to certain exceptions. Standstill restrictions were also provided for in a Japanese consortium's C$270 million investment to acquire a 19.9% interest in Uranium One.

Disposition restrictions. In the Teck and Inmet transactions, CIC and Temasek agreed that they would not dispose of the securities they had acquired for at least one year. In the Teck and Uranium One transactions, further disposition restrictions continued beyond one year.

Price protection. In the Teck transaction, CIC was granted the right to compensation in the form of a cash payment or issuance of additional shares if, during one year after CIC's purchase, Teck issued shares for a price lower than CIC's purchase price (subject to the maximum discount permitted under the TSX rules).

Innovative arrangements in the resources sector

In the resources sector, a number of PIPE transactions have included innovative features such as offtake arrangements and the acquisition of a joint venture stake in the investee company's underlying resource assets. These features allow the investor to acquire both a strategic stake in the public company and direct access to resources; the investment stake in the public company may effectively serve as the "price of admission" to share in the underlying assets.

As part of the C$240 million investment by Wuhan Iron and Steel (WISCO) in Consolidated Thompson Iron Mines, WISCO acquired 19.9% of the shares of Consolidated Thompson and received a 25% joint venture interest in Consolidated Thompson's Bloom Lake project, together with an offtake agreement providing for WISCO to purchase 50% of the first 8 million metric tonnes of iron ore produced from the project each year and an option to purchase additional amounts.

In the oil and gas sector, CIC's C$1.25 billion investment in Penn West Energy Trust included the subscription for newly issued trust units representing a 5% interest in Penn West and a 45% interest in a new joint venture to develop Penn West's oil sands assets in the Peace River area of northern Alberta.

Investors may also acquire a minority joint venture interest in the underlying resource project and offtake rights without acquiring an ownership interest in the parent company. One example is the earn-in agreement that Augusta Resources (listed on the TSX and the NYSE) entered into with a consortium of Korean investors. The agreement provided for the consortium to acquire a 20% interest in Augusta's Rosemont copper/molybdenum project in Arizona in consideration for funding US$176 million of the project development expenses. The arrangements included an offtake agreement providing for the purchase, at market rates, of between 20% and 30% of the annual copper and molybdenum production from the project. In the oil and gas sector, Thailand's PTT Exploration and Production recently entered into a US$2.28 billion agreement to acquire a 40% interest in Statoil's privately owned Kai Kos Dehseh Alberta oil sands development project.

Minority investments will continue to be popular

Given the flexibility and potential innovative features allowing for a transaction to be tailored to the specific needs of the foreign investor, together with a significantly lighter regulatory burden in most cases, minority investments such as PIPEs and joint venture arrangements are set to continue to be popular and successful investment structures for foreign investors in both Canada and the United States.

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