Handling caribou a key to MMG's Izok Corridor

NICKEL DEPOSITS

International miner MMG Ltd. is looking to Canada for growth with its Izok Corridor zinc project in the far north, and keeping an eye out for more acquisitions. While attending his first Prospectors and Developers Association of Canada conference, Troy Hey, MMG's general manager of stakeholder and investor relations, said it was important for the company to be at the meeting. "With our Izok Corridor project moving into feasibility and approvals and our long-term aspirations to be a major player in Canada, it's time for us to put our shingle out and make sure people know who MMG is," Mr. Hey said Monday. Mr. Hey said MMG, which is majority-owned by China Minmetals Corp., is looking for growth in Canada and abroad. "We've spoken about other commodities, such as nickel, as being in our base metals universe and we've also spoken about being very focused on growing our business and we probably can't do that all by growing our own projects," he said. "There's probably going to be some mergers and acquisitions that we will need to undertake to meet our growth ambitions." In Canada, the Izok Corridor project in Nunavut includes deposits at Izok Lake and High Lake in the western part of the territory. Key to the approval of the project will be how it deals with the caribou herd in the region. The company expects a decision later this year on whether the project will face a territorial or federal review. Sahba Safavi, MMG project manager for Canada, said the company is continuing to collect data for the environmental permit process and work on its feasibility study for the project. *The Canadian Press*

COURTESY BHP BILLITON

Flow-through shares contributed to the development of the Ekati diamond mine in the Northwest Territories.

MORE THAN AN INTREPID STORY

Junior miner's fight in Indonesia a dangerous new twist on a familiar story

By Peter Koven

Unfortunately, it is a familiar chain of events in the mining industry: Junior makes discovery in faraway land. Junior sinks oodles of capital into the ground to establish a world-class resource. Discovery draws the interest of powerful local business concerns and/or governments. Deposit is seized under suspicious circumstances. Miner's shareholders are annihilated.

That story has played out all over the world in the last five years, from Venezuela to Mongolia to the Democratic Republic of Congo.

But the case of Toronto-listed Intrepid Mines Ltd. has introduced a new nugget: a shady proxy fight to take over the junior company's board, which could eliminate any legal challenge to the usurping.

The astonishing move still stuns Intrepid Chief executive Brad Gordon, who has spent his career chasing mineral deposits around the world and has never seen anything quite like it.

"What is disappointing is these Indonesian businessmen think they can act outside the law with impunity," he said. "That's the disappointing aspect for foreign investors like us."

The Intrepid story has flown under the radar in Canada, as the company moved its headquarters to Australia from Toronto following a 2008 merger with Emperor Mines Ltd. But it retains major Canadian links — the miner raised $112-million in a 2010 offering that was led by RBC Capital Markets and Wellington West Capital Markets (now National Bank).

At its peak, Intrepid's market value was around $1.4-billion; today, it is not worth much more than the $106-million of cash on its balance sheet. It is not clear what future value the miner would have if the proxy fight succeeds and leads to a "soft" takeover, but Mr. Gordon promises to do everything in his power to prevent that from happening.

Intrepid's misadventures in Indonesia began in 2007, when it signed an agreement with a local company called PT IMN, which owned the rights to the Tujuh Bukit copper-gold project. The deal allowed Intrepid to earn up to 70% of the project by spending A$8-million on exploration and up to A$42-million on a feasibility study for what was then considered to be a relatively small deposit.

Everything changed in July 2008 as Intrepid drilled a 630-metre intercept of very high-grade copper and gold. Further drilling established that Tujuh Bukit holds 19 billion pounds of copper and 28 million ounces of gold, making it one of the largest discoveries of its kind in decades.

The problems started in 2011, when Intrepid was having trouble negotiating a new shareholder agreement with PT IMN (which was required following changes in Indonesian law). Mr. Gordon started to notice delays and obfuscations coming from his joint venture partner, so Intrepid stopped paying IMN's salaries in Jakarta while continuing to fund work at the site. It was a pointed message that Intrepid would not spend money forever without a deal.

The relationship deteriorated in the months after that, and Intrepid became suspicious. It did some digging and discovered that 80% of IMN's shares were sold to two individuals and two companies, all linked to a high-profile Indonesian billionaire named Edwin Soeryadjaya.

"We asked to go see him," Mr. Gordon recalled. "He didn't admit outright that he was involved, but he knew all about it."

But none of that prepared Mr. Gordon for what happened on July 19 last year. He was sitting at a board meeting in Jakarta when his general counsel interrupted and told him he needed to take a phone call immediately. He learned that two truckloads of armed police showed up at Tujuh Bukit and ordered all of Intrepid's expatriate employees to leave the site.

> It was quite frightening that something like that would happen

"It wasn't a pleasant day," he said. "It was quite frightening that something like that would happen. We were obviously concerned for our people. Nothing like that would ever happen in North America or Australia."

The shock soon turned to anger as the deception of Intrepid's joint venture partner became obvious. By that point, Intrepid's total investment in the project was around A$100-million, and now it had almost nothing to show for it.

The company launched several complaints with the Indonesian police, and a criminal case is ongoing. It has also engaged a group of law firms that are prepared to fight civil, criminal or arbitration cases if necessary. Intrepid also partnered with its own high-profile Indonesian businessman, a media mogul named Surya Paloh, to help fight its case. In a country where billionaires like Mr. Soeryadjaya are able to exercise undue influence, it made sense to get a powerful business figure on its side as well.

But none of that may matter if the proxy battle replaces Intrepid's board and management team. The company learned a month ago that a Hong Kong-based hedge fund called Quantum Pacific Capital is calling investors and trying to gather support for a proposal to overthrow the board. Intrepid assumes that Quantum Pacific is working hand-in-hand with Mr. Soeryadjaya, and the reasoning is obvious: if Mr Soeryadjaya can get control of the board and call off the legal battle, he would have a clear path to the project.

He is also confident that his shareholders will reject the proposal.

"I'm very hostile to what Quantum is trying to accomplish," said one major Intrepid investor, who asked not to be named. "I have zero respect for people who want to do business on this basis."

Mr. Gordon said he is open to a negotiated settlement of the dispute, but promised it will only happen if the other side recognizes that Intrepid has legal rights to 80% of the project. If that doesn't happen, this ugly battle could run for a while and set another ugly precedent for the junior mining industry.

"It's not just an Intrepid story," the investor said. "It's a story about risk capital, about a junior going in and finding a world-class deposit, and then the billionaires attempting to usurp their rights. This should send an extraordinarily dangerous message to the international mining community, foreign investors and financiers."

Financial Post

pkoven@nationalpost.com

Canada's quirky tax innovation

'ASSIST COMPANIES'

By Drew Hasselback

The flow-through share entered the Canadian tax code just over 25 years ago. Looking back, mining executives, lawyers, bankers and accountants believe this quirky Canadian tax innovation has generated billions for mining exploration and contributed to the development of some of the country's most notable mines, such as the Ekati and Diavik diamond properties in the Northwest Territories.

Indeed, statistics compiled by *Financial Post* Data show Canadian mining firms have raised $2.5-billion over the past five years using flow-through shares.

In 2012, Canadian companies raised $536.8-million through 94 deals, not far off the five-year annual average of $500-million and 93 deals a year. The peak year in that five-year period was 2011, when miners raised just under $698-million through 120 deals.

Kevin Wong, a chartered accountant who is regional leader of the tax practice in the Vancouver office of MNP LLP, says flow-through shares are an instrumental part of the Canadian junior mining industry. "Flow-through shares assist the companies that wouldn't otherwise be able to raise the money to explore," Mr. Wong says. "To the extent they hit pay dirt or find the gold, the benefit to the government is several-fold through the taxation on the [capital] gains and through the taxation on the production of the resource."

Canada's Income Tax Act allows issuers to agree that they will transfer or "renounce" their exploration expenses to individual investors. Companies that have revenue may not wish to do this, since they'll want to apply those expenses against their income to reduce or eliminate their own tax liabilities. But a junior exploration mining company, which usually has no significant revenue, won't need those expenses because they're likely not profitable and won't be facing any income tax. It therefore makes sense to pass on those expenses to individual investors, who will happily apply them against their personal incomes.

Flow-through shares keep a coterie of advisors across the country busy. Kevin Zimka, a partner in the Vancouver office of national Canadian law firm Blake, Cassels & Graydon LLP, says he works on at least a couple flow-through share deals each month.

"The flow-through share regime is designed to provide an incentive for financing qualifying exploration ventures in Canada and effectively shift the tax deduction from the company doing the exploration to the purchasers of the flow-through shares," Mr. Zimka says.

A common misconception is that flow-through shares are a special class of equity. Not true. According to the Income Tax Act, they have to be ordinary common shares, lawyers say. The process of transferring the exploration expense to the investor is done by an agreement that is separate from the documentation that creates the shares.

"A flow-through share must be a 'garden variety' common share and the investor must be fully at risk for his or her investment," says Nigel Johnston, a partner in the tax group of McCarthy Tétrault LLP in Toronto.

"It's all done by agreement," adds Leonard Glass, a partner with Lawson Lundell LLP in Vancouver. "The company agrees that if you give it the money, it will give you the shares. But it also agrees, on top of that, that it will give you these expenses."

The devil, as they say, is in the details. Canadian rules require that a company renouncing an exploration expense must get out in the field and spend those exploration dollars within 24 months. Even then, a so-called "look-back" rule might shift that period backward in time to give investors the opportunity to claim the expenses on their prior year's tax returns. That can force exploration companies to hit the dirt as fast as possible. "As soon as you renounce, the clock starts ticking," Mr. Glass says.

Flow-through shares are also common in the oil and gas sector. Edmund Gill, partner in the Calgary office of Osler, Hoskin & Harcourt LLP, works on lots of flow-through share deals, most involving oil and gas companies.

Recently, business has been tough as the deal flow through Calgary has diminished. "The juniors are having a tough time raising money, even if they're throwing in the perks of a flow-through," Mr. Gill says.

A lot of Mr. Gill's work is on a popular structured product known as a Limited Partnership. These are entities that assemble a portfolio of companies with flow-through shares. These companies agree to pass the exploration expense up to

> A flow-through share must be a 'garden variety' common share

the partnership, which then distributes it to the unitholders.

Tax lawyers point out that the Limited Partnership helps make the whole flow-through share system tick. Once the partnerships are formed, they're obligated to invest in flow through shares.

"It's a huge amount of money. Historically you had these flow-through limited partnerships, which is the way most of the money is raised," says Chuck Spector, a lawyer with FMC Law in Montreal. (The firm will be known as Dentons following a trans-Atlantic merger scheduled to close at the end of March.)

Mr. Spector adds that flow-through shares are also popular with provincial governments, particularly Quebec.

Indeed, according to tax rates analyzed by PDAC for 2011, the after-tax cost of a $1,000 investment under the "super flow-through" program would vary between a low of $284 in Quebec to a high of $519 in Alberta. "Super" flow-through includes the regular 100% deduction that's available under the Income Tax Act, along with a federal program that provides another 15% non-refundable tax credit for grass roots exploration completed by Canadian companies. The temporary super flow-through program has been extended several times. The 2012 federal budget extended the expiry date to March 31, 2013.

Financial Post