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China's Growing Impact on Canada's Natural Resources Sector

by Brett Kagetsu

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It's an exciting time for China and for those industries directly impacted by its economic emergence, such as the Canadian mining and energy sectors. With massive stimulus spending, the PRC government has boosted demand for commodities and helped Canada (and many other natural resource trade dependent countries) avert a prolonged economic downturn. Recently, China has drawn on its large foreign currency reserves and cash to acquire stakes in Canadian-traded natural resource companies. We expect that these investments, which have been facilitated by recently-improved political relations and stronger economic ties to China, will accelerate over the coming years.

Several recent high-profile transactions involving investments by Chinese state-owned enterprises in Canadian mining and energy interests have both sectors abuzz with excitement. In April 2010, the state-owned enterprise China Petroleum & Chemical Corporation (more commonly known as Sinopec), one of the largest integrated energy and chemical companies in China, offered to acquire from ConocoPhillips Company its 9 per cent stake in Alberta oil sands producer, Syncrude Canada Ltd. for US$4.65 billion. This followed PetroChina's August 2009 agreement to buy a 60 per cent stake in two oil sands properties held by Athabasca Oil Sands Corp. for $1.9 billion, and preceded the $817-million acquisition by China Investment Corp. (CIC) of a 45 per cent stake in an oil sands project held by Penn West Energy Trust, and a concurrent $435-million investment for a 5 per cent stake of Penn West. CIC had already made its mark in the Canadian mining sector earlier this year when it acquired a 17 per cent interest in B-class shares of Teck Resources Limited for $1.74 billion.

Other significant transactions include:

- The signing of a memorandum of understanding between TSX-listed Quadra Mining Ltd. and a subsidiary of State Grid Corporation of China, the largest Chinese utility company and a major end user of copper, to form a joint venture with respect to two of Quadra's properties which represent $900 million in assets;

- The offer by Jinchuan Group Ltd., China's largest producer of nickel, cobalt and platinum, to acquire all common shares of Crowflight Minerals Inc., a Canadian junior nickel producer, for $150 million; and

- The successful joint takeover bid by China's Jilin Jien Nickel Industry Co., Ltd. and Goldbrook Ventures Inc. of the junior nickel explorer Canadian Royalties Inc. This was the first hostile takeover bid by a Chinese company in Canada.

This past March, Gowlings sent a delegation to the Prospectors and Developers Association of Canada conference (PDAC), the world's largest mining conference. Judging from the level of attendance by PRC investors, it seemed that Chinese interest in the Canadian mining sector was at unprecedented levels. Through discussions with PRC investors, we learned that Canada is a very popular destination for Chinese investment because of our stable political regime and a sense that there is less risk associated with making significant investments here. There is also evidence of heightened Chinese interest in transactions involving Canadian mining companies holding base and precious metals properties, and metallurgical coal properties.

Canada is well-positioned to capitalize on future Chinese investments, especially in light of our relative economic stability over the global downturn, and considering our improved political relations with China and our abundance of natural resources and players in the sector. Canada's position is further improved as competing natural resource rich countries such as Australia experience increased friction in their relationships with China. Also, the proposed mining tax in Australia may shift investor attention to other politically stable, resource-rich countries, such as Canada.

Investors from other Asian countries such as South Korea, Japan, India and Singapore as well as commodities and energy consumers from around the world, are also actively reviewing acquisitions and investment opportunities in Canada, as are larger mining and oil and gas companies looking to replenish their reserves.

We foresee a trend of increased strategic investments, mergers and acquisitions, and spin-out transactions where natural resource companies hive off non-core assets into newly created public companies as a means to "package" them into separate vehicles to facilitate their eventual sale. Over the coming years, Canada's natural resource companies and their Chinese investors will be well advised to seek the legal expertise of Canadian M&A professionals with significant knowledge of the natural resource sector and experience in working with Chinese acquirers.