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HudBay facing rising costs as it takes on more debt

Miners are turning to the bond market to plug shortfalls as costs soar and a slump in metal prices makes equity less available.

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(BLOOMBERG) -

[HudBay Minerals Inc.](#) faces rising costs as it takes on more debt to develop copper and zinc mines in Peru and Canada, running afoul of loan terms and triggering downgrades to its already-junk credit rating.

HudBay, which entered the bond market in September, is selling \$150 million of seven-year notes today as it borrows more to meet project overruns. Standard & Poor's cut its rating yesterday one level to B-, six steps below investment grade, following a similar action by Moody's Investors Service last week. S&P cited the company's "intention to increase its debt load" through the bond.

Miners are turning to the bond market to plug shortfalls as development costs soar and a slump in metal prices makes equity less available. [Barrick Gold Corp.](#), the world's biggest producer of the precious metal, raised \$3 billion in April to bolster liquidity as legal challenges pose further delays to the multibillion project in the Andes mountains.

"There is concern that, in the midst of market skepticism about the commodity complex generally, that they may not be able to bring on the Manitoba and Peruvian expansions smoothly," Kevin McSweeney, portfolio manager at Toronto-based CI Investments Inc., which oversees about \$74 billion of assets, said of HudBay. "Noise around covenants, no matter how ample liquidity is, does not help the company's case to the marginal market participant, either."



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Junk Spreads

Relative yields for miners in HudBay's rating category have jumped 60 basis points to 5.88 percentage points since May 22 on concern rising interest rates will erode future gains as U.S. policy makers consider scaling back stimulus that ignited a four-year rally in credit markets. The extra yield investors demand to hold U.S. dollar bonds of junk-grade miners fell to 528 basis points on May 22, the lowest since 2011, according to Bank of America Merrill Lynch data.

HudBay plans to set final prices today on its bonds, increasing its 9.5 percent issue due October 2020 to \$650 million. The existing securities yielded 689 basis points more than the asset-swap rate today, after recovering from a five-month wide of 700 basis points on June 5.

The Toronto-based miner will need about \$400 million of additional capital and "will at least partially fund this requirement with debt rather than equity," Moody's said June 5 when it downgraded its credit to B3 from B2.

HudBay received a commitment from Caterpillar Inc. to provide about \$130 million of equipment financing for the Constancia project, the company said today in a statement. Loans under the facility will have a term of six years and will be secured by the Constancia mobile equipment fleet.

John Vincic, a spokesman for HudBay, declined to comment on the bond sale or the downgrade.

Bank Facility

The miner said it will use proceeds of today's bond sale to develop mines and that the financing will enable it to reduce a bank facility by \$200 million to \$100 million.

HudBay renegotiated the credit line for three years and expects to remove or revise loan restrictions, the company said in a statement yesterday.

Elsewhere in credit markets, the extra yield investors demand to own the debt of Canadian investment-grade corporations rather than the federal government was unchanged yesterday from June 7 at 116 basis points, or 1.16 percentage points, according to a Bank of America Merrill Lynch index. Yields increased to 2.98 percent, from 2.93 percent.

In the provincial bond market, relative yields dropped one basis point to 68 basis points. Yields rose to 2.73

percent, from 2.69 percent, according to Merrill Lynch data.

Bond Returns

Canadian corporate bonds have returned 0.9 percent this year, compared with losses of 1.1 percent by the nation's government bonds and 1 percent by provincials, the data show.

Bank of Montreal and Toronto-Dominion Bank raised their mortgage rates today, following a move on June 7 by Royal Bank of Canada.

To meet cash needs to keep up with inflation and wage increases from Peru to Mongolia to Burkina Faso, first-time borrowers pushed up the tally of speculative-grade mining deals to \$5.7 billion in 2012 from \$434 million in 2011, according to data compiled by Bloomberg.

HudBay expects to more than quadruple copper output by 2015 through the Constancia project, which it acquired when it bought Norsemont Mining Inc. in 2011 for C\$305 million (\$299 million).

Taking on new bonds without renegotiating its loans would have put HudBay in breach of a covenant in its credit facility requiring it to limit net debt to a maximum of three times cash flow, according to Royal Bank of Canada analysts.

Covenant Breach

"We estimate the company will be in breach of this covenant throughout 2013-2014," analysts led by Patrick Morton said in a June 5 note to clients. The miner's debt as a ratio of earnings before interest, taxes, depreciation and amortization will rise to about 7 times through most of next year, S&P said.

Royal Bank estimates the company's costs to develop its key project at Constancia in Peru will overrun by \$250 million. The mine will cost \$1.5 billion and is scheduled to start first production late next year and reach full production in the second quarter of 2015, the company reiterated May 2.

HudBay also owns the 777 zinc and copper mine and processing operations in Manitoba and is developing the Lalor mine and a smaller project, Reed, in the Canadian province. HudBay increased the cost estimate for Lalor by 13 percent to C\$794 million Feb. 21, and said it was "uncertain" that its 10-cent semi-annual dividend can be maintained until the new mines reach commercial production levels.

"HudBay will look to avoid issuing equity at current levels and we think this option is a relatively low likelihood," Morton wrote.

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