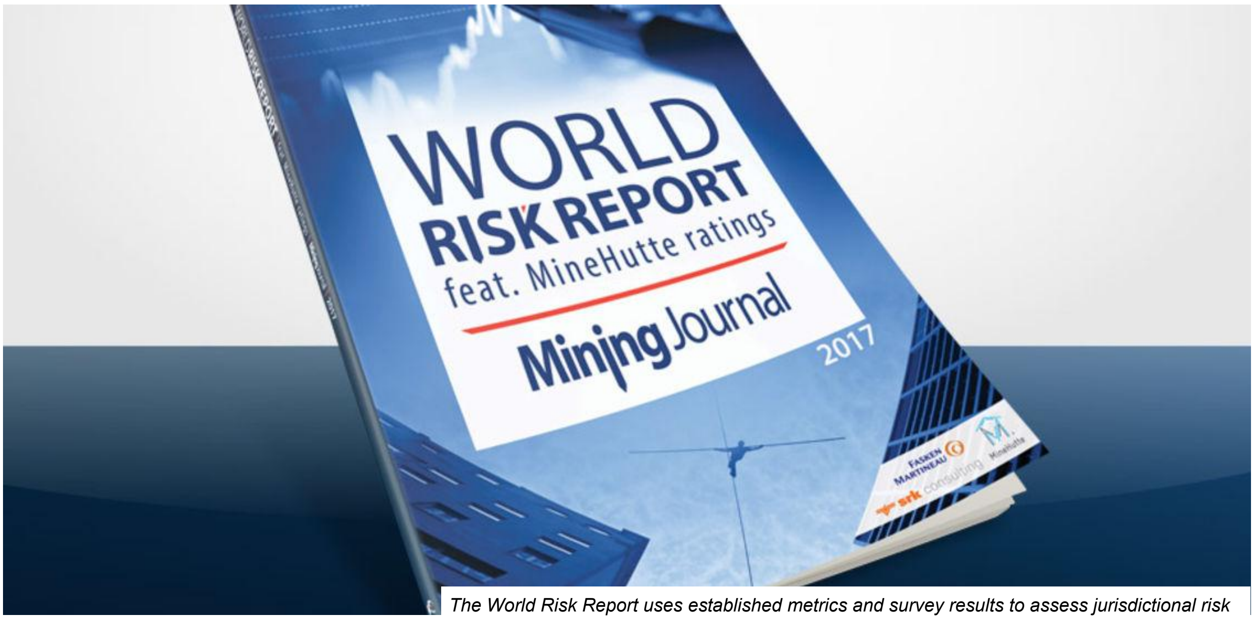
Mining Journal

Viewpoint > From-the-capital

Risk denial makes life easier

Mining Journal has ploughed a huge amount of intellectual capital into the recently published Mining Journal 2017 World Risk Report (feat.MineHutte ratings). What a pity the mining industry will turn a blind eye.

John Robertson*



The World Risk Report uses established metrics and survey results to assess jurisdictional risk

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The report includes the Investment Risk Index, which provides ratings for 85 national and provincial mining jurisdictions. The ratings summarise a range of macroeconomic, political, governance, regulatory, fiscal and business-support characteristics impacting the value of mining assets.

'Hard' scores combined with surveyed perceptions are graded from AAA to D in much the same way as bond risks are ranked.

The bond ratings of well-known firms such as S&P, Moody's and Fitch are neither buy nor sell recommendations. Their measures of default risk are designed to assist in the pricing of securities. Either AAA or CCC-rated instruments may be acceptable investments if priced to take account of their respective risks.

Financial market issuers and their investors explicitly admit risk differences into their investment calculations. Miners, in contrast, are more likely to display overt risk denial about the jurisdictions in which they operate.

Potash projects underway in localities as diverse as Eritrea, the Republic of the Congo, Saskatchewan, Spain, Utah and Western Australia illustrate most starkly the absence of jurisdictional risk calculations in the way miners present projects publicly.

Eritrea is ranked among the bottom 10% of analysed countries in the Investment Risk Index hard ratings, slightly worse than the Republic of the Congo. Spain comes in around the 35th percentile. The main Canadian mining provinces top the order. Mining districts in the US, along with Western Australia, are among the upper 20%, although Utah has not been rated explicitly.

Based on the Mining Journal analysis, investors should be paying less for each dollar of value anticipated from the Eritrean project than from any of these other more highly-ranked jurisdictions.

> **The industry prefers to maintain the myth of an abstracted world in which neither location nor track record matters**

When queried about the relative risk profile of Eritrea, the Danakali chief executive heading development of the Colluli potash deposit has said the country's business environment is badly misunderstood. The most widely-levelled criticism about doing business in the country - widespread corruption - does not exist, he asserts.

In contrast to financial markets in which risk is objectively assigned and assets priced accordingly, it is commonplace for mining industry executives facing apparently high jurisdictional risks to complain that their situations are poorly understood. Where risks are admitted, many will claim they are more adept than others at skirting the difficulties.

The Mining Journal analysis bears out this difference in viewpoint. While the ‘hard' data ranks Eritrea at a lowly 79, the perception data based on the views of those engaged in the country ranks Eritrea 41 places higher and better than, or little different from, five out of seven Australian locations.

The Eritrean example also highlights an important shortcoming in surveys of commercial risk. Questions about the reliability of existing mining laws and governance practices largely ignore the risk of regime change damaging future investment returns.

A company like Danakali could be highly confident that an agreement with the current Eritrean regime, which has already grabbed 50% of its project, will be honoured. But that assurance can last only as long as the incumbents retain power.

After nearly three decades of one-party rule under a single, now aging, leader who has never permitted elections, a smooth and inconsequential handover of political power may prove a heroic assumption.

From an investment standpoint, the greater danger to a company in these circumstances is not currently poor governance practices or capricious application of existing laws but regime change. Even when change is accompanied by pro-democratic reforms, greater administrative transparency and mining code improvements, a loss of previously conferred entitlements is possible.

Preparers of mining project valuations studiously ignore localised risks such as these as they seek to put the best possible gloss on their own circumstances.

Danakali's most recent Colluli project valuation uses a 10% discount rate. Potash Ridge uses a 10% discount rate in valuing its Blawn Mountain project in Utah. Highfield Resources has used a 10% discount rate in connection with studies for its Muga project in Spain. Australian Potash has used a 10% discount rate in assessing its Lake Wells project in Western Australia. Kore Potash has used 10% for its Sintoukola project in the Republic of the Congo as has Ecanto Potash for its project in Saskatchewan.

The typical industry valuation methodology pretends that projects exist in an abstracted world in which the country specific risks identified by Mining Journal do not exist and financiers are oblivious to differing risk characteristics.

Jurisdictional risks of the sort highlighted in the report are not the only risks to impact country outcomes.

When serious investors are asked what they regard as important in assessing a mining investment, the most common response is ‘management' or ‘track record'.

Occasional industry awards for the best chief executive put a positive spin on industry competence but the quality of management - apparently the most important ingredient for an investor - is not surveyed comprehensively and rated from top to bottom.

The industry prefers to maintain the myth of an abstracted world in which neither location nor track record matters. Skills from one location are supposedly transferred seamlessly to others.

Conflicted service providers fearful of losing clients help to embed risk denial more deeply in industry behaviour in the way they also ignore locational and competence risks in reports prepared for investment markets.

Before the Mining Journal framework, or anything comparable, is adopted within the industry for investment decision-making purposes, executives and their advisers will have to change their ways. They will have to embrace explicitly the inclusion of jurisdictional and competence risks in project appraisals.

Only after that Damascene conversion will directors feel a need to seek out Mining Journal for objective measures of the risks they confront.

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