

FROM THE CAPITAL

Segue confirms low chance of success

Since Nova-Bollinger discovery, the Fraser Range has been a highly coveted exploration address

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Segue Resources has effectively conceded that its chance of making a nickel discovery in the Fraser Range was less than 2%.

In August, Segue was wooing investors with its status as one of the largest ASX-listed tenement holders in the Fraser Range. Its exploration licences covered around 4,000km². It was also free from any farm-in commitments or joint ventures diluting its interests.

Since Sirius Resources made the Nova-Bollinger discoveries in 2012-13, the Fraser Range has been one of the most highly coveted exploration addresses in Australia. Segue is one of about 20-listed companies with exploration interests in the region aspiring to replicate the Sirius Resources success.

In August, Segue chief executive Steven Michael spoke of the company's 15 drilling targets. These, he said, would be reduced to two or three over six-to-nine months as the company narrowed in on the ultimate prize.

Like so many others, Segue has not had the budget to match its aspirations. At the end of June 2015, it had cash reserves of A\$502,000 (US\$350,000) to cover a quarterly spending rate of \$450,000.

In August, after the company raised an additional \$928,000 through a share purchase plan for existing investors, it was still confronted with a tight budget.

Unsurprisingly, the company has now agreed to a farm-in arrangement that carves out the majority of its extensive landholdings and relinquishes control of the exploration efforts. The deal with a subsidiary of MMG covers eight exploration tenements at its Plumridge nickel project, which had been the centrepiece of the company's exploration efforts.

By spending \$6.5 million on exploration between September 2015 and December 2019, MMG can earn a 51% stake in the properties. MMG can subsequently raise its interest to 70% by spending an additional \$7.5 million over two years.

Investors will have gained some sense after Nova-Bollinger of the potential from an investment in Segue. Immediately prior to its Nova discovery in July 2012, Sirius Resources had a market value of \$7.8 million.

That leapt to \$495 million initially before racing to \$1,120 million after the Bollinger discovery became public in February 2013.



Companies seeking to replicate the Sirius experience would have something similar in mind.

Coincidentally, the market value of Segue Resources at the time of writing is identical to the Sirius Resources price just before the Nova discovery. The parallels are strong.

In taking decisions about funding future exploration activities, Segue directors would have been conscious of the trade-off between the proposed deal and the possibility of a \$1,100 million market value at some later stage.

Even with the Sirius experience to boost confidence about the possibility of another discovery in the neighbourhood, directors and investors more generally would have had reason to be wary.

Sirius itself was on the verge of giving up when it made its discovery. In a July 2015 paper entitled, "A review of Australia's discovery performance over the last 40 years", Richard Schodde, of MinEx Consulting, shows that an average of 10-15 significant mineral discoveries have been made each year in Australia, with the number declining in more recent times. That puts the likelihood of exploration success in any year for an ASX-listed company at around 1.5%.

We now have some empirical evidence as to how low Segue directors rated their probability of success. They have been prepared to take \$14 million and a 30% project share rather than the chance of \$1,100 million sometime in the future. This, one can calculate, equates to a judgment that the chance of a successful exploration programme is around 1.7%.

Admittedly, that is a slightly wobbly number. Equally reasonable sets of the assump-

tions might make it 1.3-1.5% or as high as 2.5-3%. In any event, by any investment standards, the implied chance of success could be characterised as very, very low.

In August, directors of Segue were doing what hundreds of explorers were doing at any time: rattling the can to fund the next round of drilling. To do that, they had to emphasise without crossing the boundaries imposed by regulators the unusually high potential of their properties.

When confronted with their own decision, on the other hand, Segue directors had to make a realistic judgment about the likelihood of success. This, they seem to have concluded, was around 2%.

Did Segue directors underprice their exploration potential? Probably not. The available evidence points to the likelihood of exploration success being every bit as low as the Segue directors have judged it to be.

The Segue outcome simply highlights the gulf between judgements about value among professionals, on the one hand, and the way companies position themselves to attract retail investors, on the other. Some of the appeal to investors would be lost, company executives would fear, if they were to concede up-front a 2% chance of success.

The MMG arrival has not spurred investors to reassess the Segue value proposition. The market reaction to the deal has been muted. Retail investors might have had a sound intuitive understanding of the risks and value all along.

That is why they have been prepared to pay no more than \$8 million – until a discovery – despite the chance of an \$1,100 million windfall. They are saying implicitly that so much hangs on the slight chance of success that the deal is of little consequence.

Meanwhile, some will point to the MMG move into the Fraser Range as the beginning of an influx of larger companies into an emerging nickel producing region of global significance. That would, if it happened, ease many of the financial pressures on the other underfunded companies congregated in the region.

Most would happily grab similar deals, recognising the uncomfortably low probabilities with which they are dealing.

They should not count on this beneficence. Bigger players may not follow quickly for the same reason retail investors lack interest. Big and small investors alike want something better than lottery-like odds. ▼