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Moment of truth for Altech

Altech Chemicals shareholders had to give up A$13 million (US10 million) to raise A$17 million last week even as the company nears a destiny-defining fork in the road.

Altech chief executive Iggy Tan is looking to deliver maximum value through strategic financing solutions

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Altech Chemicals got off relatively lightly in its trade-off of near-term shareholder wealth against the promise of longer-term gains.

A current Havilah Resources rights issue to raise A$5.4 million has already cost pre-existing shareholders in the South Australian base metal mine developer A$19 million. Western Australian explorer Thundelarra's A$4.2 million rights issue in September came with a A$6.4 million wealth loss for shareholders.

The Thundelarra price implies the explorer will be no further advanced after having spent its additional capital than it was prior to the share issue.

Such a judgement seems implausibly harsh but is not an entirely unpredictable stance by investors becoming increasingly used to the treacherous market conditions accompanying long-term investment commitments.

After years of capital-market drought, few companies have adequate funding cushions to carry them to project funding, let alone construction or completion.

The threat of repeated modestly-sized capital raisings accounting for disproportionately large increments in shares on issue looms large in market dynamics. Rather than a completed raising being a sign of strength warranting a higher price, it often elicits nervousness and kneejerk selling in anticipation of unusually large surges in market supply.

The Altech placement involved a 41% increase in the number of shares on issue. The day after, the company's stock turnover was over 20 times higher than the daily average since the company listed in 2010 and as its share price tumbled 22%.

At the end of June 2017, the company had cash assets of A$1.4 million with budgeted spending in the just completed September quarter of A$1.5 million. Topping up its cash reserves last week was an essential step forward.

Altech has spent prudently. Of A$13.5 million over the 12 months to the end of June, less than one quarter of its spending was on staffing and administrative costs as it focused on bedding down its flagship, high-purity alumina project.

Altech chief executive Iggy Tan is no novice when it comes to foreseeing emerging mining trends. The chemical engineer was in charge at Galaxy Resources during the start up of its Mt Cattlin spodumene mine and lithium carbonate plant in China, well before the lithium frenzy commenced.

His latest venture is a similar blend of straight-forward mining, speciality chemical production, and technology forecasting.

In his most recent endeavours, Tan is counting on expanding applications for high-purity alumina with a particular emphasis on its use in the manufacture of synthetic sapphire glass for LED lights and scratch-resistant smartphone display screens and lenses.

The market is small with global demand of around 25,000 tonnes but, like the now well-known lithium story, potentially growing strongly.

Presently, high-purity alumina comes from expensively converting refined aluminium feedstock. Altech intends to take high-quality kaolin from an orebody in Western Australia through an acid-based processing route after calcining to produce 99.99% alumina. A product costing US$9.90/kg to produce could sell for US$25-40/kg, according to the company's feasibility analysis.

As in the case of lithium and graphite, product acceptance will depend on meeting the exacting standards of eventual users. Altech already has a deal with Mitsubishi Australia to take the entire 4,500t per annum planned output over the first 10 years of operation from a proposed processing plant in Malaysia.

The plant could have been built in Western Australia closer to the kaolin mine near Meckering but Malaysia offered lower-cost material and energy inputs and more favourable rates of tax.

Like so many others, Tan has a feasibility analysis that shows a project valuation well ahead of the recent market value of the company - US$506 million versus US$39 million.

Brought down to basics, the Altech investment proposition involves an outlay of at least US$340 million (in equity and development funding) in exchange for cash of US$2.2 billion over 30 years. That outcome would be equivalent to buying a bond today with an annual yield a little short of 18%, well ahead of the company's cost of capital.

On one point, at least, Tan deserves praise. Unusually, he uses a realistic measure of the cost of capital against which his investment decisions are benchmarked and valuations calculated.

As this column has discussed before, valuations inflated by unrealistically low cost of capital assumptions, including some as low as 5%, even after far costlier funding arrangements have been finalised, are used as marketing tools.

Two aspects of the company's funding legitimately help boost the Altech valuation. Prior to last week, the company had a low A$26 million in contributed equity since listing in 2010 on which a return was needed. It also anticipates cheap project funding via German government-backed export-credit financing.

The company could validly use a 7.5% weighted cost of capital for its published valuations although that should be edging higher. On my calculations, the average cost of funding will rise by 0.5 percentage points for each US$10 million in additional equity raised.

The German funding is not locked in, yet. Tan has foreshadowed an announcement by December 14 after due diligence, already well underway, has been completed and submitted for a final decision.

Tan is so highly confident about getting the German backing he has confessed to not having a Plan B. Shareholders can look forward to investment glory or a giant market belly flop.

That binary result, amid already very cautious markets, goes some way to explaining the extent of the divergence between the project valuation and Altech's current market price.

Tan's shareholders will not have to wait long to learn their fates. Within six weeks, they will know whether he has a uniquely undervalued investment proposition driven by demand for high quality consumer technologies and ripe for strong market returns or a rather uninspiring kaolin mine.

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