Mining Journal

Where's the cash?

White Rock Minerals chief executive Matthew Gill claims unique positioning with a fully-funded gold-mine development on the back of a promising scoping study but still faces one of the most common strategic dilemmas for executives in the industry.

John Robertson* | 02 Mar 2017 | 8:02 | Opinion

The Mt Carrington gold project has the benefit of low-cost entry but the returns are unlikely to find most shareholders

White Rock Minerals is developing a gold property in northern New South Wales. The Mount Carrington deposits sit within a historically active mining region and were themselves mined until the 1990s.

With access to existing pits and associated infrastructure on granted mining leases, A$25-30 million (US$19-23 million) will be enough, according to the company, to produce 111,000 ounces of gold and 6.7 million ounces of silver.

An initial gold mine becomes a silver mine over the last three years of an anticipated seven-year mine life.

More recent exploration activity and modelling hints at a longer mine life or higher production. The company has talked of annual gold-equivalent production reaching 40,000oz.

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Cash operating costs of A$754/oz will generate pre-tax cash flows of A$100.2 million, according to a March 2016 scoping study.

The scoping study attributed a pre-tax value to the project of A$60.6 million using a 10% discount rate and A$1,600/oz and A$22/oz prices for gold and silver, respectively.

Based on the numbers published by the A$13 million-market cap company, an investor willing to pay A$43 million (in existing equity and development capital) could get back a little over A$125 million over about nine years. This equates to buying a bond with an annual yield of 22%.

"Holding back the cash depresses the market prices of the primary development assets"

That sounds a compellingly attractive proposition, although, when these numbers were compiled, financial hurdles were tougher to beat than they are now.

A year ago, for example, the Merrill Lynch index of yields on corporate bonds rated CCC or lower sat at 22%. In other words, the prospective White Rock Minerals return was nothing special.

Since then, conditions have changed dramatically with the Merrill Lynch index of yields having tipped below 10% in the past few days.

As discussed in 'From the Capital' last week, prices of small miners have changed minimally despite, in this case, the swing in financial market conditions being enough to validate a better than doubling in the market value of White Rock Minerals.

A financial package negotiated with Cartesian Royalty Holdings, while subject to preconditions such as a completed definitive feasibility study, adds a degree of certainty missing from investments at a similar stage of development.

Cartesian will receive shares, options, bullion and fees with a value of A$66 million in exchange for its US$20 million equity contribution and project funding. The numbers suggest a return for Cartesian and a cost of capital to the company of about 12.5%.

The implied cost of capital exceeds the discount rate being used in valuations designed to attract day-to-day investors.

As discussed before in this column, using concocted discount rates is akin to knowingly using an inflated ore grade or unrealistically-low operating costs to ginger up valuations.

Australian mine developers have almost universally conspired, with the tacit approval of regulators, to use standardised discount rates well below typical equity costs no matter what their peculiar circumstances and no matter how great the risk of investors being hoodwinked.

That said, the deal with Cartesian appears to add value. The previously prospective 22% cash return is boosted to nearly 30% for non-Cartesian investors, on my reckoning. If right, the market has blundered badly in setting a price.

The implied value gap would be a convincing reason to buy the shares of White Rock Minerals if the cash flow analyses typically used to demonstrate value did not contain a fatal flaw.

Valuing cash flows presupposes an investor will actually receive the cash stream being measured. Cartesian does. Its principals have structured a deal in which the largest part of its 12.5% goes into their bank or bullion accounts.

Everyone else is shunted onto a different ride.

The remaining cash being generated from the Mount Carrington project, after Cartesian has taken its cut, will go into regional exploration and a central Alaskan zinc exploration project called Red Mountain acquired by the company, subject to spending commitments and staged cash payments, in 2016.

Presumably, too, if the Alaskan venture is successful, cash proceeds will go to the next project and so on until the balance of probabilities leaves the company with insufficient capital to sustain another development as it fights the effects of a cyclical downturn or resource exhaustion.

Even a series of against-the-odds technical successes throws up the possibility of greatly delayed financial benefits and possibly never more than a 2-3% annual cash return.

Asking investors to price a company on the basis of cash flows from the first of a succession of projects when all of those flows are put at risk immediately is asking them to suspend sound judgement.

Those calling the shots may hold out the prospect of growth or diversification but retaining the funds even with the best of intentions comes at a cost. Holding back the cash depresses the market prices of the primary development assets.

For the most part, this strategic dilemma goes unrecognised or is ignored.

White Rock Minerals has the chance to convincingly differentiate itself from others if it can quickly realise the value from its Alaskan property or somehow quarantine Mount Carrington from the capital needs of the US mine.

Without that, the benefit of Mount Carrington's unique positioning will disappear and White Rock Minerals will join the hundreds of other companies offering, what history says, is a slim chance of long-term exploration and development success.

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