Opinion

FROM THE CAPITAL

Post-study blues dent returns

Well-worn path is fraught with difficulty for would-be mine developers

John Robertson

One could easily get the impression that the last thing an aspiring miner should do is produce a feasibility study. There is a well-defined path from exploration to production via resource definition and a series of studies that sequentially build to a document that underpins financing and serves as a blueprint for development.

As a company moves through each stage, confidence should build as the number of unknowns is reduced and the eventual financial outcome given greater clarity. In theory, de-risking projects should be a source of extra value.

The clearest manifestation of value potential and the extent to which projects have been de-risked is a feasibility study, which brings together all the available information of relevance to an investor at a point in time.

Companies will frequently use the impending release of a project study, whether final or preliminary, as a marketing tool citing release as a potential catalyst for a higher share price.

Strangely, such a widely held view about the beneficial role of a feasibility study flies in the face of day-to-day experience. Companies are rarely getting the market kick they say they are expecting. In many instances, the reverse is true.

The table below highlights the experience of 10 companies in the one month immediately after the release of feasibility studies between May 2011 and May 2015.

The studies on which the table is based are not all definitive or bankable studies but, in each case, they were intended to encapsulate an improved investment proposition.

Without exception, at some point in the month following the feasibility study release, share prices were lower than on the day before the study was released.

Feasibility study market outcomes /one-month share price changes

Orocobre	-7.1%
Base Resources	-1.8%
Sandfire Resources	-4.8%
Aurelia Metals	-24.5%
Kasbah Resources	-34.6%
Pilbara Minerals	-21.4%
Sirius Resources	-6.5%
Northern Minerals	-12.8%
Danakali	-2%
Sheffield Resources	-40%

Danakali, née South Boulder Mines, is trying to develop a potash mine in Eritrea

The selected companies are not necessarily representative of the industry. The opposite is probably the case. The companies have been chosen because they have proven themselves to be among the most capable in the Australian market.

The extent of the post-release loss varies, as one would expect in an investment market, depending on individual circumstances. Danakali (or South Boulder Mines as it was known until the beginning of June) fits the pattern least. It suffered only the slightest of losses before its share price subsequently doubled. This was one instance in which a feasibility study probably did convey information that warranted a market repricing of the company.

Danakali is attempting to develop a potash mine in Eritrea, a country judged by the World Bank as having the worst regulatory quality of any of over 200 countries in the world. While there are still hurdles ahead, the study helped persuade investors that prospects were not as bleak as they had surmised.

New or transformative information about development prospects is uncommon. Companies have usually worked hard to create an awareness of their development potential before any study is published. The key investment parameters have been publicised sufficiently widely that prices already reflect (as much as they are going to do in the current market) what the company is trying to do.

Since a better than expected feasibility study outcome is rare, publication risks are tilted heavily to the downside. Even a feasibility study confirming everything a company has foreshadowed may leave no incentive for fresh buying. In theory, risk will have been reduced but selling might ensue as investors who have held a position for many years look to refresh a portfolio.

Current cyclical positioning, it must be said, is aggravating this problem. With fewer investors interested in the sector, the tendency to sell can easily encounter a market vacuum in which there are not enough sellers to sustain the price, let alone take it higher.

Feasibility studies are, in any case, prone to disappoint. Pressure to publish often means incomplete resource estimates at the time a study is completed. Conservative standards applied by risk averse external consultants called in to do the job are often at odds with what a company may have been prepared to claim as possible.

Pluton Resources remains the benchmark for what not to do. It released a study completed by a consultant in June 2011. The study barely resembled how the company had been describing its project. Immediately on its release, the managing director was at pains to emphasise how operating costs had been overestimated in the study, how it had failed to fully take account of the resource size, had underestimated the life of the operations and exaggerated the capital requirement. Directors were stunned that the promised study failed to give them an expected share price lift even as they simultaneously debunked its contents.

Expectations are the key to whether a company suffers from post-study blues. Companies continually presenting at conferences and pitching to investors and capital market intermediaries have usually used up their ammunition by the time a study is available.

Too frequently, by the time a study is released, company executives will have become hostage to their own rhetoric about its content.

Disappointment becomes more likely than pleasant surprise. Since markets are driven by new information, a feasibility study with nothing new is more likely to bring share price grief than enhanced wealth.

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