

Opinion

FROM THE CAPITAL

Orocobre's need for clarity

Lithium producer's handling of investors will determine its market value

Orocobre should be on the cusp of an exciting future as it stakes out a role in the lithium battery supply chain, but its credibility has suffered from missed production targets.

On January 22, Orocobre advised investors that production at its newly constructed Olaroz lithium carbonate plant in Argentina should hit capacity of 17,500 annual tonnes in September 2016. It left itself with some wiggle room: timing would be subject to "successful optimisation of operating practice and process controls".

A production update earlier in the month had shown a trending improvement in monthly production rates from a mere 26t in April 2015 to 427t in December, as the company tracked toward its target. Its forecast January production of 600-650t would result in operating cost break-even.

At face value, that seems plausible and creditable enough. The gripe many would have is that, a year ago, the company had confirmed it would reach its capacity production by the end of 2015.

The shortfall from its original plans raises an important investment question applicable to any company in this position: how much weight to put on new guidance when the historical track record raises doubts about the likelihood of its fulfilment.

Investors could cast aside any prior expectations or disappointments and simply take the new advice at face value. In real life, however, the failure to meet previously expressed goals will have taken its toll and nagging doubts will persist. Any company in these circumstances will have irretrievably lost some credibility and investor following.

More realistic than blind faith is scepticism. In this instance, the discount rate implicitly applied to cash flows will have been escalated as, at the same time, expected future cash flows will have been pared back. The value proposition will have shrunk. A meaningful adjustment in the company market price would have to await demonstrable evidence of sales and cost targets being met.

There is a third possible reaction from investors. Sometimes, they will agitate for management changes to ensure the job gets done and to minimise the time taken for the market to respond positively to eventual achievement of production targets.

Full realisation of the Orocobre value proposition will now depend on how the company communicates with investors to



Orocobre has failed to deliver either production targets or full transparency at Olaroz

minimise the credibility discount that inevitably comes with missed production targets. The company needs to nudge investors away from scepticism toward more ready acceptance of its revised goals.

A simple four-step investor relations process is critical to help any company retain the confidence of existing shareholders or broaden its appeal to others:

- ▶ Outline an investment proposition with clear guideposts against which investors can judge progress;
- ▶ Report explicitly on the achievement of previously advised guideposts;
- ▶ Describe any necessary or intended remedial action in the event of guideposts not being met; and,
- ▶ Confirm the investment proposition and state any new guideposts relevant for the next reporting period.

Underpinning the success of this process is a view that investors will more easily tolerate departures from expected outcomes if the sources of disappointment are admitted promptly and a coherent rectification plan implemented.

Orocobre has emphasised its efforts to remove bottlenecks in the new plant as it has described its rectification activities over the past year. In doing that, it has held out the prospect of better outcomes without explicitly tying rectification work to missed guidance.

Companies are understandably reluctant to resurrect bad memories. In shunting aside the earlier disappointments, Orocobre has not been in a position to put a cogent argument for why it will reach the new target when it has failed to do so before.

The subliminal message in simply shifting old targets to new, later dates is that the pas-

sage of time alone makes achievement of targeted production more likely. That is not always the case. Sometimes, plants never operate as intended.

Presumably, too, the company has learned some lessons and given itself more than enough leeway to meet the newly defined target in a timely manner. That is the hoped-for takeaway left unsaid in the company reports.

Sector investors are used to seeing a positive slant on even the worst possible news. Their jaundiced reaction is often muted. Sometimes, directors are tempted to infer support from the absence of a strongly critical reaction. In practice, investors may have simply tuned out, leaving the market value of the company forever short of its potential.

Orocobre has been lucky in having buoyant lithium demand to shore up its market value as it has scrambled to get started. Newly interested investors have been around to take the place of the disaffected.

If the company can get its act together, it stands out as a potentially very long life producer with strong operating margins and an attractive underlying value trajectory. Its business lines depend less than other mining products on the pace of global growth and economic conditions in China. The resulting portfolio diversifying attributes enhance its investment attractiveness.

An Orocobre, operating according to plan, could easily justify a core position in a sector portfolio but, for the time being, the question remains: where along the continuum between blind faith and intense scepticism should an investor position himself?

A drift toward scepticism is probably the more appropriate default position without more ready reassurances about future production and cost outcomes. ▼

*John Robertson is a director of EIM Capital Managers, an Australia-based funds-management group. He has worked as a policy economist, business strategist and investment-market professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia