FROM THE CAPITAL

Superannuation funds miss out on pot of gold

Australian investors being short-changed by blinkered institutional view of sector

John Robertson

Blackham Resources has finally struck a financing deal that should let it start producing gold within 12 months, but everyday Australian investors are getting fewer of the development benefits as the capital market landscape changes.

Bryan Dixon, Blackham's managing director, has been knocking on investors' doors recently to let them know he is back on track with his plans to develop the Matilda gold project at Wiluna in Western Australia. According to Dixon, the company needs to spend only A$30 million (US$23 million) to start generating an annual $40 million EBIT by the middle of 2016.

Blackham has been a case study in the travails facing gold miners as they search for funding. Until May it had completed seven capital raisings since 2012 to raise $21 million. In February 2013 the company had embraced an offer of $13 million from the Joseph Gutnick-owned Great Central, despite having to hand over effective control of the company in exchange. Gutnick and Blackham parted company later in the year after an unseemly and credibility sapping public spat.

The Australian retail investment market has changed dramatically. The brokers on St George's Terrace, Pitt Street and Collins Street on whom the miners had relied for funding have been losing market share. Australians may have $1,953 billion in savings tucked away in their superannuation accounts at the last count - $755 billion more than just five years ago - but those funds are increasingly controlled by institutions whose trustees have largely spurned the mining sector.

A cultivated disdain for the sector's investment potential has become institutionalised. It may be impossible for miners to claw their way back into the attention span of those deciding how to invest the growing share of Australia's investible funds.

Simultaneously, a burgeoning financial advisory community has been targeting the lucrative high net worth and independent investors. This, too, has worked against the resources industry because of the anti-risk stance taken by the compliance bosses at the dealer groups increasingly dominating the advisory industry. Pursuit of lower cost bases has meant consolidation of advisory practices and a generic approach to investment using platforms and high volume products.

As the number of Australia-listed mining companies has been rising, access to funds has been shrinking.

Private equity has loomed larger as a funding source for the industry as some traditional sources have disappeared. Dixon's capital market experiences have highlighted, too, the disconnect between the industry and this group of investors.

Dixon relates how seven different private-equity groups descended on Western Australia at the beginning of 2015 looking for gold-equity investment opportunities. Being professionals, the PE folk knew exactly what they wanted: low cost, long life, quality people, low capital requirements, strong returns on capital, etc. All went home empty handed. The ideal investment did not exist.

The group Blackham subsequently dealt with had an informal connection with the current Blackham chairman. Conversations about what Blackham was doing had extended over many years before the more formal and intensive discussions culminated recently in the announced funding deal with Orion Mine Finance.

There were no special favours in the Orion deal. An $6 million initial loan will be available. It will go toward further drilling and to complete a definitive feasibility study. If satisfied with the study, Orion will advance an additional loan of $30 million.

The first $6 million does not come cheap, despite an era of globally easy money. There is an 11.5% funding charge. Orion also takes first priority security over all the assets of the company. Additionally, Orion will receive 33,333,333 options expiring at the end of 2017.

The options are frequently treated as if they come at no cost. If a company pays an executive in options over its shares, the value of those options must usually be stated explicitly. The same is not true of options provided in exchange for finance, making them a tempting tool for sometimes surreptitious value transfer.

In the end, the number of options financiers receive depends largely on how aggressive they are and how desperate a company is to get their backing.

Using conventional valuation methods, the options granted by Blackham should be valued at about $3.2 million. All up, the $6 million, 31-month loan is costing the company about $4.9 million. Looked at another way, the $4.2 million that will have been paid by Orion for 33.3 million shares after the repayment of the loan is equivalent to a 30% discount to the current Blackham share price.

Either way, that is shockingly expensive, albeit what the market demands. Blackham probably had little alternative. Existing shareholders are better off with the deal than without the deal. They have a going concern where, otherwise, they may have had nothing.

Ordinary shareholders will hope that a $40 million EBIT equates to a market value of around $110-$120 million at some time over the next year or two. With a near tripling in the value of their shares, they may not begrudge the returns going to the pooled funds in London and New York.

However satisfied individual investors may be with their returns, they will probably not have been compensated adequately for risk or the time taken to realise their return. Being more sensitive to the risks, on the other hand, does not make the disdainful superannuation funds any smarter.

The Blackham case shows the mistake the biggest institutions in the land are making. They are neglecting the distinction between ASX share price movements upon which the returns of everyday shareholders are based and the actual price of capital being confronted by the likes of Blackham Resources.

That prompts an obvious question: how foolish are the Australian superannuation funds and large financial advisory groups for not pooling the capital of their investors to take advantage of the superior terms on offer outside the ASX bid and offer displayed on their office screens? ▼

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