Mining Journal

Altura’s lessons for everyone

The collapse of lithium concentrate producer Altura Mining pulls the rug from under still more widely accepted fallacies about investment success in the mining industry.

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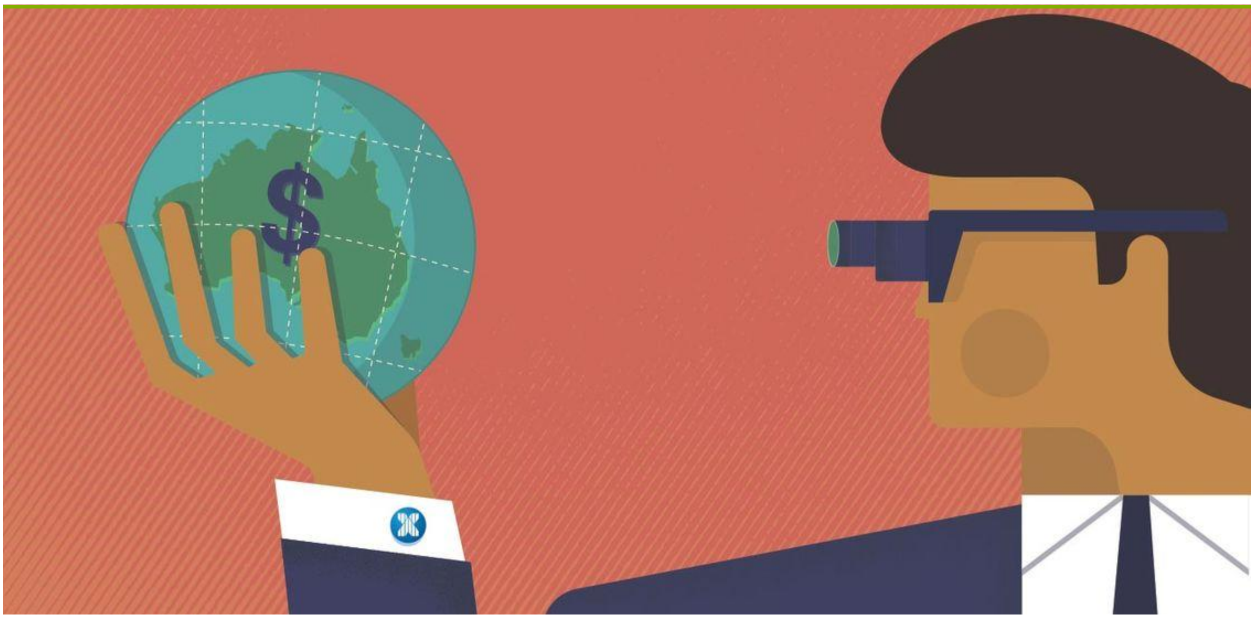

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Recent ‘From the capital' columns have highlighted how investment shibboleths, nurtured by constant repetition, remain perceived strategic wisdom. So, an experienced board, skin in the game, plenty of news flow, a tier one jurisdiction, a future-facing commodity, a tight capital structure and assertions of ongoing market deficits are usually enough to get started. Never mind the evidence, slogans alone can suffice.

Unfortunately, the list of catchphrases fooling investors about financial prospects does not end with this small selection, as the Altura Mining experience is showing.

On October 26, Altura directors reported the company had been placed in the hands of receivers after having been unable to generate sufficient cash to service a A$235 million debt. The company had been producing commercially since early 2019 with firm agreements from customers and plans to expand from the 175,000 tonnes a year concentrate production rate achieved during the first nine months of 2020.

Mining Journal correspondent Tim Treadgold, writing from Australia, recently related the plight of Altura (Altura's collapse and other lithium lessons) after Richard Wachman in London had described the perplexing inconsistency between warnings of a supply crunch and poor corporate profitability (The inconvenient truth about lithium prices).

In addition to the handicaps described by Treadgold and Wachman, adoption of several pieces of unreliable conventional wisdom common among mineral explorers and mine developers weighed on the Altura predicament.

Metals with the greatest demand growth are widely portrayed as having the strongest prices. Unfortunately, the world has little experience of a metal such as lithium arising from obscurity to assume a central position in the industry's activities. But there is one from which to draw parallels: aluminium.

At the start of the twentieth century, aluminium was little used but would have been the model for a future facing metal with an impact on economic well-being at least the equivalent of what battery metals might currently offer. Production was a paltry 7,000 tonnes or thereabouts.

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Aluminium use rose tenfold over the following dozen years and, over the last 120 years, primary metal output has risen at an average annual rate of 8% to well over 60 million tonnes. Future demand prospects for aluminium in 1900 would have strongly resembled today's version of the future of lithium, at its best.

Aluminium's price trajectory subsequently did not align with modern day preconceptions of what should happen. The highest aluminium prices in history occurred within a few years of the first commercial production. Since 1900, the real price of the metal has been on a constant downward trend. The angle of decline is less dramatic than over the first 50 years but remains negative.

Lithium could prove different. But neither wishful thinking nor aggressive assertion make that happen.

The aluminium example poses an interesting strategic question for anyone looking to lithium or a similarly high growth metal near the beginning of its life cycle. Is it preferable to buy into a metal investment proposition with relatively slow growth prospects but facing historically modest rates of price decline in its more mature phase, or a new metal with large near-term demand expansion opportunities but a potentially dramatic reshaping of the price trend after a brief settling in?

A second misconception plaguing the lithium industry, but also experienced more widely, is linked to exaggerated expectations about price sustainability. A so-called incentive price is supposed to be a level to which markets gravitate to ensure adequate supplies.

Incentive prices, in practice, are not realised prices validating an investment decision but expected prices which stimulate spending. It is enough for capital providers to expect a sufficiently attractive price, but whether or not it happens is another matter, and unnecessary.

Financiers, prepared to believe that prices will track demand, will be particularly vulnerable to the incentive price argument.

Those occupying the lithium space have been especially prone to exaggerated forecasts. Hardly anyone talks about the subject without drawing on some analyst's elaborate extrapolations showing that, within a few years, more lithium could be used than exists.

Such analysts are content to leave their impossible conclusions unexplained for others to ponder without a hint of shame at their uncompleted task. Company directors are happy enough to raise money on the proffered impossibility.

If the amount used cannot outstrip supply, what is actually going to happen? That is too tough for analysts and not a question in the interests of anyone to ask. Even the Altura shareholders who are walking away penniless did not want to have that discussion, lest the fantasy be spoiled.

Altura succumbed to yet another unsafe industry convention. A February 2016 so-called independent mining study for the Pilgangoora lithium project purported to demonstrate "robust financial returns".

Completion of the 2016 study coincided with the highest yields on risky corporate debt since the depth of the 2008-9 financial crisis. The study assumed that the company's cost of capital would be a low 8%, consistent with the industry's deeply ingrained cultural habit of undervaluing equity no matter what the market circumstances. Against the backdrop of existing market conditions, the proposal appeared far stronger than it was

As it happens, the finance costs on which the company is defaulting during an era of unprecedentedly cheap money, is 15%. Presumably, any reward for equity finance should have been thought more expensive than that and never as low as 8%. However technically robust the work might have been, the study proved financially flimsy.

Of course, Altura sported other common hallmarks of the modern miner with stridently ambiguous claims to a tier one location and a globally significant resource. And, not forgotten, directors dedicated part of their regular reports to "sustainability" which, it turns out, is different to survival.

As part of the industry, Altura embraced many of the analytically faulty rhetorical features so popular among today's miners. Worryingly, hundreds of others are similarly inclined.

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