FROM THE CAPITAL

The rising cost of a fresh start

Three gold producers with unfortunate recent histories are looking to the future

John Robertson*

Blackham Resources' Matilda gold mine in Western Australia

Blackham Resources, Red 5 and Sumatra Copper & Gold are all facing happier times at the start of 2015, but their change in fortunes contains a message for investors about the balance of power in capital markets.

Red 5 received a slightly belated Christmas present in early January when the Philippines government confirmed it would lift a cease and desist order on the Siana gold mine after nearly two years. An already fraught start-up verged on the catastrophic in April 2013 when subsidence was detected on the wall of the mine's tailings dam. Having worked successfully with Philippines authorities to implement a remediation plan, the company is back at square one and ready to go with US$13 million in the bank.

Along the way, to rejuvenate its prospects, Red 5 was forced to issue an additional 524 million shares, or 460% more than it had on issue at the time production was stopped. Having bought out earlier stage financiers threatening to close the project permanently, the Red 5 market value has declined from A$170 million to A$84 million (US$65 million). Even adjusting for a fall of slightly over 20% in the All Ordinaries gold index would not have dented the losses confronting Red 5 shareholders.

Those shareholders who stuck with the company are looking at a sadly depleted value proposition. Investors coming on the scene more recently have more to smile about. Since mid-2014, the Red 5 share price has added 77% while the broader market has put on 16%.

Sumatra Copper & Gold is looking to start production at its Tembang property in Indonesia with an opening output rate of 40,000oz in 2016. A change in background market conditions was the source of a delayed production start. It suspended work near the end of 2013 as lower gold prices required a reappraisal of the economics of the project and after US$20 million out of a US$68 million budget had been spent.

In April 2014, the company foreshadowed a mid-year construction restart with fresh funding negotiations described as being at an advanced stage. In the end, and consistent with the experiences of many others, these were not completed for another seven months.

The Tembang project is now well advanced with two feasibility studies, partial construction and committed funding for the bulk of the remaining capital requirement, although an additional equity raising in the first half of 2015 will be needed to meet the terms of the funding package.

Some of the value proposition for a mine with all-in costs estimated at US$745/oz after silver credits has been eaten up by the rise in capital costs. The newly approved US$45 million debt-funding facility with a base cost of 7.5% a year rising to 10% and a 3.5% fee also requires warrants for the debt providers. If exercised, the warrants will result in the number of shares on issue rising by 58%. Sumatra equity holders look like they will have to subsidise incoming debt providers to get the project moving.

Whatever the cost, Sumatra can count itself lucky that it can get on with its project when others in a similar situation are stymied by adverse market conditions.

Blackham Resources had a stroke of luck in January 2014 when it took advantage of the liquidation of Apex Minerals to acquire a processing plant with a replacement cost well in excess of A$100 million (US$78 million) and within 20km of its Matilda mine in Western Australia. The cost was a meagre A$2 million upfront payment and a A$2.6 million deferred production charge.

The company seemed on track to fulfil its ambition to be one of the emerging players in the WA industry when it received funding commitments of A$13 million in 2013 from Great Central Gold, which is headed by mining entrepreneur Joseph Gutnick. Optimism about the outlook plummeted subsequently when Gutnick reneged on the deal leaving Blackham financially stranded by mid-2014 and facing a worrying share overhang in a weakening gold market.

Blackham had to find investors to take out Gutnick's interests in the company. Investors who had been cultivated to fund development took up the slack, but did not have enough appetite for more, leaving the company short of what it needed as the Blackham market value slumped 80%.

Finance is flowing a little easier for the moment, giving managing director Bryan Dixon the chance to field enquiries rather than chase down reluctant partners. Blackham's relatively compelling investment proposition is based on an existing resource, a plant with a proven operating record and the potential for resource extensions. Even so, the experience of others says the cost of funding for Blackham is now likely to be 12-15% a year with existing shareholders facing additional dilution in coming months as the company looks to secure the $35 million it now needs to fulfil its 100,000oz-a-year production ambition by early 2016.

The worry reflected in a still flagging Blackham share price is how much of the value being created will go to the new project financiers and how much will be retained by current supporters.

The market is what it is and each of these companies is having to pay what it takes or forego their ambitions to produce. In each case, they are electing to pay up now to leave open the option to build value later. Later extensions of their resource bases enabling longer mine lives are likely to add disproportionately to the market value of Red 5, Sumatra Copper and Gold and Blackham Resources.

None of these companies may ever adequately compensate their shareholders for their losses, but new financing arrangements offer something approaching a fresh start. They offer braver investors a chance to take advantage of the market rehabilitation of these companies as they shake off their uncomfortable histories to stake a place among the more solidly positioned operators in the sector.

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