Mining Journal

Not just another sheep

Mustang Resources has proposed a radical departure from conventional industry practice to compensate investors supporting development of its ruby prospects in Mozambique.

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Mustang Resources is breaking with the standard junior company structure by returning capital to investors

Mustang Resources has not always had a gemstone focus. After listing in 2002 under a different name and with an earlier management team, it bounced between base metals in Western Australia and Permian Basin oil and gas before looking for diamonds then graphite in Africa.

In October 2014, it acquired six graphite exploration licences close to known occurrences in Mozambique. Drilling has shown wide high-grade intervals containing up to 26% total graphitic carbon.

In February 2016, the company backed away from the popular battery ingredient by acquiring tenements in Mozambique within 2km of those on which Gemfields has been mining rubies.

Mustang's Montepuez tenements ostensibly cover the same geological formations as those being mined by Gemfields.

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Mustang Resources

The company's obvious opportunism was hardly unusual. Hundreds of cash-strapped wannabes with exaggerated estimates of their abilities to handle multiple projects in the search for a winning bet have been on similar tracks.

Despite such an undistinguished corporate history, current chief executive Christiaan Jordaan, appointed in February 2016 and leading a team with a background in the Mozambique mining industry, insists he will not succumb to this common industry malady.

Once Jordaan has demonstrated more clearly the quality of the graphite resource, he expects others to fund and develop the prospect allowing Mustang to concentrate fully and solely on its ruby assets.

"Investors of all shapes and sizes should applaud the freshness of the company's approach"

The company's focus on upper-end consumer markets will be another important differentiator in a China-centric industry dominated by the outlook for industrial raw materials.

Rather than tallying industrial production statistics to assess the fortunes of the company, analysts will have to infer trends from the likes of Tiffany & Co, LVMH Moet Hennessy-Louis Vuitton, Hermes and Prada.

A third important mould-breaking effort is the way in which the company is interacting with artisanal miners currently spread over its tenements.

Mustang does not intend to exclude the artisanal miners digging out a subsistence income from the occasional gem discovery.

Right now, the locals are selling to dubiously connected middlemen peddling undocumented gemstones to unquestioning buyers.

Mustang can run a profitable business paying the artisanal miners regularly and more than they currently receive. By giving their support, local community leaders can fulfil their ambitions for higher community living standards. The ethics of the industry will have improved with the opportunity to enhance the transparency of the market.

For sure, necessity is the mother of invention. The alternative would have been costly deployment of dozens of burly security guards to intimidate the locals into leaving and police the boundaries, resulting in commercially damaging friction between the company and surrounding communities.

Mustang's approach may not suit others and will require some peculiar workplace relations management skills. In any case, the employment model is evolving as the company is still understandably cautious about structuring a long-term arrangement before commencing full-scale production.

For the time being, Mustang directors are satisfied that the strategic advantage from building a lasting rapport with the local populace compensates for the short-term costs being incurred.

The company's most radical break from the investment herd is an unusual determination to reward shareholders.

Mustang has said it will return the entirety of its operational cash flows from the Montepuez project to investors.

The March 2, 2017 'From the Capital' column described how the widespread practice of using cash flows from an initial project to fund subsequent exploration or mining efforts hobbles investment returns. White Rock Mining was the example cited in the column.

Professionals funding the first of the company's projects will receive a guaranteed share of revenue. For run-of-the-mill investors lacking the financial muscle of a New York institution, returns will depend on trading around news flow while waiting for successful completion of an Alaskan zinc project perhaps 10 years away, all going well.

Even then, there is no commitment presently to compensate equity adequately for risk. A third or more ventures could be funded until, possibly, eventual failure permanently eliminates the prospect of any benefit.

The only surprise in such scenarios is that executives so readily express dismay when investors heavily discount prospective cash flows from the starting project when deciding the price they are prepared to pay for a company today.

As Mustang abandons the industry's dominant returns model, it is not beyond the pale to believe it could be generating A$50-90 million (US$38-68 million) a year of distributable cash within two or three years.

With a current market value just under $50 million, the investment return would be enough to cheer the most demanding of investors.

Jordaan is not scared to relinquish control of the capital. He maintains that, if he gets it right and then comes up with fresh investment opportunities, he will have no trouble getting funding.

On this point, he is almost certainly right. Unfortunately, there is no record to back him up as those in the industry have had insufficient confidence in their own abilities to put their executive longevity at risk by implementing such a scheme.

The instinctive reaction of anyone with even a brief history of contact with the industry will be scepticism, perhaps even outright disbelief, about the willingness of Mustang Resources to break with the conventional treatment of investors.

Whatever the history, investors of all shapes and sizes should applaud the freshness of the company's approach, give it every encouragement and even pray for its success.

If Jordaan and his fellow directors can change the returns model in the way they espouse, they will have genuinely created value, earned investor support and left an indelible benchmark against which everyone else will be judged.

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