

Insight: From the capital

Capital strategy will drive Altona mining share price

Decisions about asset values reflect (often different) views about the future



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Altona Mining Ltd is reacting to investor scepticism about its value delivery potential by selling its Kylylahti mine and other assets in Finland. The attempt to close the gap between what the market is prepared to pay for a project and its intrinsic worth comes at a cost. The company will have forgone a chance to prove its operational credentials.

Altona chief executive Alistair Cowden did not mince his words at an investor briefing in Melbourne recently. He claimed the market had got it wrong. It was acting irrationally. As a result, he contended, directors were forced to sell the company's Finnish assets.

It is hard to believe investors would sabotage their own interests in the face of strong evidence of what a company might be worth. Usually, there is a bigger picture to be seen, although Cowden's complaint was not as empty as most whinges about the market.

At the beginning of July, when the company's market value was A\$91 million (US\$85 million), directors received an offer from Sweden's Boliden group to sell the Kylylahti copper-gold mine in Finland for US\$95 million (A\$101 million). The share price leapt 24% after the transaction was announced and the company said it would return A\$80 million (US\$74.5 million) of the proceeds to shareholders.

This, according to Cowden, was the clearest sign the market had failed to properly price the company. With some A\$15 million (US\$14 million) already in the bank, its remaining Australian assets, including a permitted copper development, effectively came with a zero price tag.

Altona had been trading well short of the value the Finnish mine was expected to generate over its life. In August 2010, the company told investors to expect an annual EBITDA of US\$29 million for eight or nine years with 8,000t/y of copper and 8,400oz of gold for a capital cost of US\$39 million.

The mine started on time in the middle of 2012. The mining rate has recently exceeded the original plan. Up to 10,000t of copper in concentrate were expected in 2013-14 but the financial outcome has fallen short. Copper production costs have been as much as a



Changing course ... Australia's Altona Mining has sold the Kylylahti mine in Finland to capture and distribute returns to investors, and give it a new platform for growth at home

dollar above the US\$1.33/lb originally targeted.

Over the six months to December 2013, the company reported an EBITDA of A\$14 million (US\$13 million) but ongoing capital expenditures took A\$11 million (US\$10.2 million) of this. Sustaining capital expenditure amounted to A\$4.8 million (US\$4.5 million) in the March quarter and is expected to remain elevated until 2016.

If Altona had been hitting its financial targets, a market value approaching A\$150 million (US\$140 million) might have been realistic without any improvement in cyclical conditions). When Boliden offered US\$95 million, Altona directors faced a choice between the bird in the hand and the prospect of a higher market value once the mine was hitting its straps and pushing out the expected cash amounts.

Cowden intimated in his briefing that directors were surprised at the size of the offer and felt they had no choice but to give it very serious consideration. Quite appropriately, Altona directors are making a clear effort to consider all the strategic alternatives and do what most benefits shareholders. Not all boards would have opened up the option to sell, let alone adopt it.

Ultimately, decisions about asset values reflect a view about the future. The Altona decision raises the spectre of an MIM Holdings scenario in which directors succumb to pessimism about their prospects near the weakest part of the cycle.

Often implicit in selling is some scepticism on the part of directors themselves about

being able to get the job done. Now, we will never know whether Altona's financial objectives were going to be met or just how skilled company operatives could be. The opportunity to create a track record from successfully developing and operating a mine will have been lost. This is a cost to the company with a longer term impact on its value proposition.

After the capital return, the company will have cash of A\$40 million-A\$45 million for a 38,800t/y copper mine development 70km northeast of Mount Isa, Queensland. The capital return is proposed despite the Little Eva mine being slated to cost A\$294 million.

Some Altona shareholders have criticised directors for not investing the Finnish sale proceeds in the Queensland mine. Again, the directors have weighed up the options and taken a view about value. They have decided to fund the development in part by selling a stake in the project.

The prospective share price of the company should be higher, they have reasoned, if they sell 20% of the project based on the feasibility study parameters than if they raise the equivalent amount of capital through the issue of new shares or the retention of cash from any asset sales. In the extreme, they could replicate the Finnish strategy and sell the entire project if a buyer was to offer something approaching an objective valuation.

The prospect of periodic capital gains from asset sales could create positive investment risk if investors begin to fear missing out on a distribution. The more realistic the threat of asset transactions being used to demonstrate value, the more investors should be prepared to pay at any point in the cycle. More widespread adoption of the Altona strategy within the industry might support higher industry valuations generally.

While asset trades may have their place in sustaining investment returns, equity markets price one-off capital gains differently to a similar level of sustainable cash flows. Greater value will usually come from markets capitalising ongoing cash flows as long as investors can be confident about future operational outcomes.

Premature sales of assets hinder the accumulation of evidence about the operational skills of a company. Markets are less likely to assume operational success in valuing assets if the evidence to support that possibility is missing. To do otherwise would be irrational. ▼