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Reward's Disappointment

Newly-appointed Reward Minerals chief executive Greg Cochran confronts a familiar trap as he switches his development efforts from uranium to agricultural minerals.

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Reward Minerals faces a challenge growing its SOP story into one worthy of development funding

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Reward Minerals wants to develop "potentially the world's largest" sulphate of potash (SOP) brine deposit at Lake Disappointment (LD) in central Western Australia, in an area with one of the highest evaporation rates and lowest rainfalls in Australia.

Cochran joined the company in December 2017 after a period of enforced 'gardening leave' following his exit from Namibian uranium aspirant Deep Yellow in October 2016.

The appeal of SOP as a fertiliser has been widely canvassed within the investment community with Paul Donaldson from Danakali having led the way in his bid to garner support for the giant Colluli SOP project in Eritrea.

Cochran is ramping up his efforts to replicate the Danakali path to capital as he leaps from the uranium frying pan into the SOP fire.

Reward is less advanced in its plans than Danakali. Last week, Danakali released the results of a front-end engineering design to help secure project financiers and binding offtake agreements.

Reward continues to rely on a scoping study from April 2015 although a prefeasibility study for its 1,241km2 playa project is scheduled for completion over the next eight-10 weeks.

The LD scoping study anticipated SOP production of 400,000 tonnes a year with an

FOB operating cost of A$328/t (US$256/t) over 13 years. At a US$600/t selling price, the project would generate an annual cash profit of A$154 million, according to study estimates.

With 100% ownership, the expected annual operating cash flows, if realised, would amount to 4.5 times the current market value of the company.

“ **SOP supplies are sufficiently abundant for eventual buyers to baulk at backing new projects presently**

The study placed a value on the project of A$534 million or 16 times Reward's current market capitalisation.

Reward has demonstrated the existence of a resource with commercial potential but further work must be completed to offer the requisite degree of confidence about the economics of the LD project.

This transition between resource definition and the point at which development is underway often becomes a value trap for investors. Companies have typically passed the point at which exploration outcomes can force a reassessment of market value. At the same time, they may not yet have made a formal commitment to development or may display insufficiently convincing project economics, without further test work or customer recruitment, for investors to assume progress.

The transition between exploration and development can extend well beyond an acceptable investment time horizon. In some extreme cases, the transition may traverse multiple cycles over many decades. This is one of the highest-risk phases for investors in mineral development.

Resource quality will be a compelling influence on whether the development logjam will eventually be broken. Other factors, though, may affect the actual investment return and its precise timing.

Sometimes, even steady progress is not eye catching enough. Without a single catalyst causing investors to reassess the capacity of the company to move forward, returns may languish as capital seeks out more faddish opportunities.

The extent to which investors have previously lost faith in company progress may also dictate how much leverage investors can expect from a future change in business circumstances.

Reward shows signs of potential leverage to a milestone event. The Reward share price remains at the lower end of its 10-year trading range, slightly above the 2013 nadir and 90% below a cyclical high price in 2008. Investment outcomes over the past five years have been in the lower half of returns (58th percentile) available within the sector.

The underlying dynamics of the SOP market are similar to those for uranium and even lithium. Rising populations craving lifestyle-quality improvements uncorrelated with industrial growth patterns are drivers for greater use of all three commodities.

Anticipated SOP demand growth of around 200,000tpa is strong enough to warrant expanded capacity within a few years.

Like uranium, however, SOP supplies are sufficiently abundant for eventual buyers to baulk at backing new projects presently.

SOP does have an advantage over uranium, and metals generally, insofar as recycling is not a sourcing option and the industry is unable to dip into inventories to cushion any urgent need for fresh capacity.

Existing producers are also constrained in meeting rising demand with two thirds of current potassium sulphate production coming from reprocessing potassium chloride using sulphuric acid. The bulk of existing SOP production comes with larger tonnages of by-product hydrochloric acid for disposal than quantities of saleable SOP.

Both Reward and Danakali estimate their production costs at only one third of those producing SOP through the acid intensive Mannheim process giving the new entrants a long-term strategic advantage that should prove hard to shake.

Reward's development progress will depend on the backing of financiers and customers. Corporates wanting to make the switch to lower-cost SOP extraction to retain their market positions may also be a source of development impetus.

Ironically, the strongest investment appeal of Reward is likely to rely on these same groups failing to offer ready assistance.

Equity market excitement is usually created by mistimed investment decisions forcing panicky buyers to drive prices higher to source sufficient raw material. There would be no lithium frenzy if car or battery manufacturers had invested sufficiently far in advance.

Until then, the investment landscape is far less inviting.

Deep Yellow has produced a zero net return for its investors over the past 38 months while it awaits a change in uranium market conditions and while broader sectoral market indicators have risen by as much as 60%.

Danakali produced a zero net return over 48 months, before it received its needed environmental and social approvals in December 2016. That critical step toward development seemed to be a catalyst for a long-awaited revival in investor interest.

No matter how sound its development proposition, Reward might need another two years or so before it reaches a similar point from which it can relaunch its investment appeal.

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