Mining Journal

Investors flee as Blackham grows

Blackham Resources, now a fully-fledged gold producer with increasingly well-defined expansion opportunities, has produced a 10-year share-price return close to zero.

John Robertson* | 08 Jun 2017 | 6:44 | Opinion

First gold was poured at the Wiluna operation in October 2016 but share-price performance has failed to flow

The Western Australia gold miner poured the first gold at its Wiluna mining property in October 2016. Even with expanding production, Blackham Resources has since been the worst-performing gold stock among the 27 in the ASX All Ordinaries share price index.

Despite tripwires along the way, Blackham was gifted one distinguishing advantage: the company was able to buy processing infrastructure adjacent to its tenements from a corporate liquidator. The bargain basement A$2 million (US$1.5 million) initial payment in 2014 could have saved the company over $100 million in up-front capital.

To date, Blackham has needed to commit only $115 million in equity and debt as it closes in on its targeted gold production of 100,000 ounces a year.

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After falling short in the March quarter due to unforeseen wet weather, the company has flagged production of 16,000-21,000oz in the June quarter, keeping it on a rising production trend although still short of the targets investors had been counting on for the past several years.

Since a high point in August 2016, and even as the company has edged closer to capacity production, the Blackham share price has fallen 74%, wiping out any long term investment gains. Since the start of 2007, long term investors have received a negative annualised investment return of 0.2%.

Some of the negative returns have a macro context. The ASX All Ordinaries gold index fell 21% as the Blackham price was tumbling. The Philadelphia gold/silver sector stock index was down 26%.

"Overshooting, as investors adjust to changes in the development stage, is not unusual in these markets"

That still leaves the majority of the Blackham performance attributable to company-specific influences.

When commenting at the end of May on the price action, the company was not able to offer any reasons for the apparent discrepancy between its business outcomes and the market reaction.

Trading volumes in the past two months have been running 70% above average – equivalent to one third of the company's currently outstanding shares.

The market movements could be due to one or more large dissatisfied shareholders. It would not be the first time one of the company's major shareholders has jettisoned its holdings.

Whether it is one large investor or hundreds of individuals with a meeting of minds, perceptions of value are likely to have underpinned their decisions.

In October 2015, Blackham directors were telling investors they could spend $28 million to produce 100,000ozpa for four or five years to generate operating cash flows of $185 million. At the time, the company had a market value of $44 million.

The Blackham investment proposition was equivalent to buying a bond with a 27% yield. On these numbers, the company was reasonably valued for its stage of development with potential capital appreciation of 80% as the project risks fell away.

By August 2016, the company had tweaked its production intentions but its market value had rocketed to $294 million. In exchange, an investor would be entitled to operating cash flows of just $234 million, according to the company's analysis at the time.

The overly exuberant expectations implied in the prospective negative return signalled a company ripe for re-pricing.

By late 2016, the company was talking more explicitly about pushing production up to 200,000ozpa.

The company has said recently that it will have to spend another $104 million to reach its higher target by 2021. A nine-year operating life, based on what the company has disclosed, would now imply a bond yield equivalent of 26%, little different from the 2015 investment proposition.

Higher production would justify a steeper price tag. As the company moves closer to achieving its production aspirations, investors should be willing to pay more as risks dissipate and they settle for a lower yield.

A fair value for the company by the time it is producing successfully at the higher rates could be in the vicinity of $215 million, an increase of 125% from its market value at the end of May.

The prices ascribed to gold stocks may not always reflect such absolute value considerations.

My statistical modelling of prices highlights a range of possible value metrics as explanatory variables including output, growth potential, resource size, costs, capital requirements and location, among others.

How markets weight the factors potentially contributing to the value of a gold stock varies continually.

Very frequently, executives will refer to a single measure of valuation – usually one which most exaggerates the extent of their investment upside – but never address why their adopted measure is the one markets will embrace to re-price their stock.

At the end of March 2017, my relative pricing model had identified Blackham Resources as one of the most overvalued stocks in the sector, given the weighting being attributed by the market to the potential value drivers at the time.

The latest modelling update, based on prices at the end of May, suggests that Blackham Resources remains overvalued by the standards of the rest of the ASX-listed gold stocks.

The Blackham experience throws some light on pricing dynamics within the sector.

Overshooting, as investors adjust to changes in the development stage, is not unusual in these markets.

Expectation effects tend to inflate prices leaving them vulnerable to underperformance once production is underway, even if business targets are being met.

Blackham is on the right path in trying to move quickly to a higher production platform. My modelling also suggests the market is prepared to pay a premium for the incremental production.

With a more realistic starting point, albeit after some suffering, a doubling of production capacity should more than double what investors are prepared to pay.

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