Opinion

FROM THE CAPITAL

Mining could tempt back pension funds

Miners must bear responsibility in presenting an investible long-term proposition to institutions

John Robertson*

Franco Nevada CEO David Harquail had good news for miners everywhere in a recent Melbourne Mining Club address: he had the perfect funding tool for them in their hour of need. More objectively, he also held out hope of an industry rapprochement with pension funds.

The Franco Nevada chief addressed a packed Melbourne Town Hall late last month. Unsurprisingly, his topic was the outstanding benefits of royalty streaming as an industry funding source.

On his reckoning, royalty streaming was good for companies and good for investors. Companies got funding certainty and an understanding partner who was unlikely to interfere operationally. Investors received an "ETF on steroids". He claimed his investment offering could outperform any relevant investment benchmark or alternative gold-based investment medium.

Franco Nevada recognised early how it could strip out some of the more lucrative parts of a gold project's investment return from the mainstream equity outcome.

Since there is no magic pudding, any superior return inevitably comes at the expense of investors in other funding products such as ordinary equity. For shareholders in a gold mining company, royalty streaming can have the same dilutive effect on their interests as a never ending issue of new shares.

As operating costs rise, as history says they will, the royalty stream takes up a growing proportion of the profit base. The royalty stream take could rise dramatically as unit costs edge closer to prices leaving shareholders with a shrinking share of a declining profit.

No doubt, Franco Nevada has been in the right place at the right time. A shortage of capital for the industry has coincided with a rising appetite for gold exposure. Without its financing innovation, many companies may have been forced to forego development.

Backed by Harquail and others following his model, those developments could proceed while investors, looking for gold exposure, could relish the chance of effectively getting ownership of gold mining assets without the nightmare of operational responsibility.

While Harquail was at pains to present himself as a successful miner, he is above all a financial intermediary with a structured product. Royalty streaming is a smart idea with room to run but, like all investment products, it is underpinned by an implicit assumption on which its success depends. Like all structured products, it will thrive at a certain point in the capital cycle. At other times, better alternatives will emerge.

Photo: Air Sciences

Barrick Gold's Goldstrike mine in Nevada has been scalped by a Franco Nevada streaming deal

Harquail's presentation highlighted, perhaps inadvertently, how capital sources evolve in reaction to the economic cycle and the changing fashions of the industry.

In reviewing the predicament of the mining industry, Harquail lamented the loss of pension fund support for mining development.

This he attributed to the industry losing sight of the sources of long-term value in its search for near-term cash flows. He described the industry as having been pushed into liquidation mode as it increasingly ignored the long-term horizon preferred by pension funds.

At the same time, Harquail pointed out "the pension funds were getting a raw deal" from hedge funds, dark pools, high frequency trading and intermediaries playing favourites with stock issues. These were further reasons for pension funds to decide "this is not a game we want to play any further".

Harquail was optimistic about the prospects for a return of pension fund money to the industry but cautioned that "in the future, it needs to be in a different form".

"The pension funds want to avoid the casino of the equity market but they are very keen to do alternative investment in long-term assets," he said.

Harquail sourced some optimism from examples in Canada of "partnerships on even feasibility stage base metal projects" to hold out hope for "a very good marriage between the mining industry and long term capital".

Critical to such an evolution in Australia will be the attitude of the small band of consultants who hold sway over asset allocations by those pension funds, which account for a rapidly growing share of the accumulated savings of Australians.

Despite the importance to the Australian economy of the mining industry, the biggest superannuation funds have largely failed to back its development. They have been entirely absent at the earliest stages of project definition and planning.

When these institutions are asked directly why this is so, they typically respond by saying it is not something their consultants have raised as likely to make a worthwhile contribution to their investment outcomes. Most are loath to move without their consultants' imprimatur. When consultants are asked a similarly direct question, they will say that their pension fund clients have not expressed any wish to go down that route.

The resulting decision making logjam biases outcomes toward the status quo as each of the potentially influential parties looks to the other to make the first move. The reluctance to exit their respective comfort zones prevents speedy adaptation to changing conditions and freezes the mining industry out of contention for investible funds.

Australia's pension fund gatekeepers could probably argue cogently enough that they have served their clients by steering them away from recent mining industry equity-price outcomes. Nonetheless, it seems hard to imagine Harquail's predictions of a realignment between the industry and the custodians of the nation's savings coming true without a renegade institution breaking from the pack or consultants showing a previously hidden willingness to innovate.

But as Harquail himself accurately observed without speaking directly about Australia, the mining industry itself must also change the nature of its investment offering if it is to justify making a claim on a higher proportion of Australia's savings.

It must learn to construct more return-oriented security offerings to match the risk profiles and investment time horizons of the investors whose funds it needs to attract. Doing that would put the pension funds and their gatekeepers to the test. ▼

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