News alone not enough to keep investor attention

Companies need to raise the bar on returns to impress a more taciturn audience


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The Kasbah Resources Ltd definitive feasibility study (DFS) for the Achmmach tin project in Morocco seemingly fell on deaf ears despite the company confirming a technically viable and commercially sound tin project. Equity investors appeared to want something more than the company could offer, if the share price reaction was any guide.

It is not uncommon to see investment presentations with a page headed 'Investment Proposition' followed by a list of anticipated news items. The conventional wisdom is that news flow is a necessary and sufficient condition for higher share prices in the mining sector. A DFS, according to industry mythology, is one of the more potent share price engines.

To some degree, the reaction to news will depend on prevailing market conditions.

In any event, markets rely on surprise. To move, they usually need something unexpected. A study that has been foreshadowed for two years and which confirms what people had expected is unlikely to produce a knee-jerk bout of buying.

In theory, the process leading to finalisation of the Kasbah feasibility study should have reduced the underlying project risk. Investors should now be prepared to pay more than they were before the study was released. This reaction could become more evident in coming months as fresh investors mull the opportunity.

That said, Achmmach still needs customers and financiers. Kasbah is one of the best positioned companies at this point in its development cycle to conclude deals quickly with both stakeholder groups. It already has investors who can contribute financially as well as take product. Others are in the wings wanting more of a metal that is in relatively short supply.

The March 21 edition of *Mining Journal* contained a summary tin market outlook from Peter Kettle of the international association of tin producers. His analysis suggested prospective prices of US$30,000-35,000/t were needed to bring the market into balance in coming years.

Prices might not have to reach this level. As markets usually work, the expectation alone may prove sufficient to deliver the extra supply. Kettle himself was able to point to identifiable new production in Brazil, Bolivia, Peru, Australia, Malaysia and Africa with the potential to make a difference. Argentina, Egypt and the UK are also possible sources of additional by-product supply.

Drilling at Achmmach in Morocco

The Kasbah announcement refers only to valuations based on current and higher tin prices. The released Achmmach DFS data imply a net present value decline from US$126 million to around US$70 million in the event the tin price was just 10% lower.

Amid market conditions in which tail risks still loom large in the minds of investors, even the slightest possibility of lower tin prices would affect judgements about how much to pay.

Perhaps another reason for the initially sluggish share price response is that equity investors feel inadequately rewarded for risk. An Australian equity investor could obtain a gross yield of 5% from an investment in one of Australia's major banks. The implied 8% cost of capital used to value the Achmmach project appears skinny in this real life context of competitive investments in which retail and institutional funds are up for grabs.

Based on the study numbers quoted by the company a discount rate of, say, 12% could cut the appraised project value from US$126 million to something around US$80 million. At 15%, not an unreasonable target rate of return for a project currently unfunded and several years from production, the valuation could drop as far as US$55 million. In other words, equity investors are being asked to pay A$50 million (US$46 million), the market value at the end of March, for something that might be worth little more.

The other factor that plays on the minds of equity investors in this market segment is how, in reality, they can access the value that is generated on paper. If Kasbah follows the typical industry model, cash flows will be deployed to find and exploit new mineralisation either within the boundaries of its existing tenements or beyond, even in a different continent.

Delaying any potential return in preference to the constant pursuit of more mineralisation and development opportunities further erodes the value proposition that might otherwise attract investor interest. This is not to say Kasbah is committed to following this path but, without serious examples to the contrary, it becomes a reasonable working assumption for anyone approaching an investment in the sector.

The possibility of an opportunistic future exit defined by a combination of new production and cyclically strong market conditions might be more attractive than a 'buy and hold' strategy.

Let's say that forecasts of higher tin prices are correct and that the company could produce an EBITDA of as much as US$90 million by 2018. Let's also assume the market values the company at four times the 2018 profit, a generous assumption for a company with a currently anticipated mine life of nine years. If the project has been totally debt funded, another generous assumption, the implied equity value would be near US$180 million and the implied investment return for today's buyer looking to sell within five years could fall just short of 30%/y.

At current tin prices, on the other hand, the prospective market value on the same set of remaining assumptions would only be in line with what the market is currently paying. Of course, a slightly higher multiple would make a big difference but, in the opposite direction, so would dilution of existing shareholders if some of the development funding had to come from equity as, almost certainly, it will.

Whether these possibilities are enough to get investors interested depends very much on the interaction of individual investment objectives, risk tolerances, views about the future directions of commodity prices and opportunity costs. These considerations go some way to explaining why news alone is not always going to be enough to encourage greater investor interest. ▼

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