Insight: From the capital

Keeping investors in touch

How Red 5 has lived to fight another day

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Red 5 Ltd could be among the unluckiest and cheapest gold stocks on the market. For all that, it still offers some lessons to other troubled companies about the value of effective investor communications.

At the end of 2010, ASX-listed Red 5 was in the midst of spending just US$70 million to produce 75,000oz of gold a year with average cash costs of less than $400/oz. The then A$220 million (US$206 million) company was well funded and looking beyond the Siana start-up in the Philippines six months later to other exploration interests in the vicinity.

In January 2011, Red 5 directors reported that 1,515mm of rain in the first 27 days of the month had slowed construction. By March, the gauges had recorded 3.5m of rainfall and the company had been unable to complete concrete pours that would permit the installation of heavy equipment. This was the beginning of a torrid three years in which little would go to plan.

"The company kept the communications channels open and retained a conduit to capital encouraging some of the sector's most astute investors to back it to fight another day"

By May, the rain had eased enough for construction to restrat, but the accumulated water was a problem. The company had already pumped over 10,000Ml from the mine pit.

In July, the company foreshadowed that it would be in a position to complete its inaugural gold pour in November 2011, but, in December 2011, had to report that "normal commissioning events" had caused a further delay. The start-up had also been complicated by the use of sodden stockpiled ore from historical workings for which the new plant was not suited.

In February 2012, the company reported that operations were heading satisfactorily toward full-scale production as freshly mined

Troubled Siana start-up in the Philippines has left Red 5 under-valued by the market

material was processed. The company affirmed a A$325/oz cash cost target for production in the year ahead. Confidence was high enough to attract another A$15 million (US$14 million) to cover working capital. The Red 5's market value was just under A$300 million.

The legacy of the heavy rainfall remained an impediment to smooth production. In October 2012, the company had to admit the effort required to remove the accumulated silt at the bottom of the pit had been significantly underestimated.

In December, it announced that it had fully drawn a US$25 million Credit Suisse prepaid gold-swap facility. This was at once a vote of confidence in the company's operations after the funding provider had completed an operational due diligence, but also a warning that delays were taking a financial toll.

Stephen Norregaard, the newly appointed managing director, had barely had time to put on his wellies when, in April, Siana workers detected signs of subsidence on the wall of the tailings dam, apparently unrelated to the weather.

Norregaard acted quickly to prevent the chance of a spillage, engage with the government and suspend operations. His quick reactions prevented a potential environmental calamity.

Directors quickly initiated plans to re-engineer the tailings handling processes, but the financial pressures were intensifying. Threats by Credit Suisse to enforce the terms of its financing facility raised the prospect of the company being liquidated. An insurance payout would help eventually but would be too slow to meet the immediate financial needs.

Faced with such a dire predicament, the company had to price itself to cover the evident risk including a chance the government would never let it resume production. The company eventually raised just under A$50 million (US$47 million) to put its financial survival beyond doubt, but at a price that was a 20th of what it had been in 2012.

Many invested on the assumption of a readily forthcoming government operating permit. Expecting an early re-start turned out to be a misreading of official risk appetites. This was going to be a time for official belts and braces. And so it turned out. The government sought assurances about the work to be done, including an independent certification before it would grant a renewed operating licence.

Finally, in April 2014, the company reached agreement with the government on all the conditions under which mining could resume. The requirements were largely in line with what the company and its advisers had been proposing as the longer-term solution. To its credit, the company had not been forced to take actions contrary to its original intent or been caught out cutting corners.

A few days ago, on June 26, Red 5 outlined its redevelopment activities in more detail. Once more, it is about six months away from production with enough capital to get the mine opened again. It has clear guidelines from the government about what it must do.

Larger gold producers are valued at A$3,000/oz or more of production. At the smaller end, valuations around A$1,500/oz are more common. The latter would make Red 5 worth A$115 million in mid-2015 compared with its current A$68 million market price.

Government approvals could be delayed again. And, then, there is the irrational fear that something more can go wrong; that this might be a company so plagued by bad luck that it will never deliver on its promise.

Most likely, there will be a swift share price adjustment as soon as Red 5 is given permission to produce again but, after that, a lengthy period of operational success may be needed before investors put the memories of the past three years behind them.

In navigating these obstacles, Red 5 appears to have done one thing especially well. All along, it kept investors aware of what was happening. It followed the investor relations golden rules: say what you are going to do, say what actually happened, explain why there were differences and outline the plan of action in response.

The company kept the communications channels open and retained a conduit to capital, encouraging some of the sector's most astute investors to back it to fight another day. ▼

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