FROM THE CAPITAL

Are explorers really liars?

Poor corporate governance and a tendency to exaggerate are hurting juniors

John Robertson*

BlackRock fund manager Evy Hambro accused mineral explorers of widespread dishonesty at this year's Mines and Money conference in London. Strangely, no-one seemed to care.

Hambro was just one of the many money managers lamenting mining industry shortcomings at the conference last week but none voiced a more deep-seated criticism.

The manager of the world's largest resources fund was addressing whether growth opportunities for larger companies could be sourced from the exploration efforts of others. His answer was unambiguously negative.

According to Hambro, 90% of the companies he has met have been unable to validate the claims contained in the public filings of exploration companies during due diligence.

Hambro tried to mask the seriousness of what he was saying by describing exploration company executives as being "economic with the truth". Everyone knows this is a barely veiled euphemism for 'liar'.

Intriguingly, no one among the hundreds in the audience came to the defence of those in the industry whose integrity was being so severely maligned. Nor did anyone storm out of the auditorium in protest or disgust. Expectations are not especially high.

Hambro has a unique perspective of the industry. It is a pity he was not challenged but there is no reason to doubt his summation. He could have been misled by the companies with whom he is engaged but, again, there is no reason to question their truthfulness. So, the industry is confronted with the accusation that it is harbouring vast swathes of liars.

Hambro's depiction of the industry should be a source of considerable disquiet for its stakeholders. The alleged lack of honesty among mineral explorers raises profound questions for investors, regulators, governments and anyone interested in the survival of the mining industry.

Some of the industry's roughest edges should have been knocked off by the regulatory framework within which exploration companies must operate. ASX and TSX listing rules, the JORC code and NI 43-101 requirements have all been designed to encourage, if not ensure, truth in reporting.

Despite these efforts, here is a leading industry figure effectively alleging a massive regulatory failure. Finding out, through due diligence not available to ordinary investors, that filed reports are untruthful should send shudders through the corporate regulators in Canada and Australia. They have fallen asleep at the wheel if companies are wilfully thumbing their noses in their direction without them sensing the insult.

A propensity for stretching the truth is a practice that will ultimately hurt junior miners

Governments, more generally, should be embarrassed. Mineral-rich provinces like Western Australia, South Australia, British Columbia and the Yukon go to great lengths to promote the mining industry and its early stage exploration potential.

On November 30, the South Australian government announced a A$20 million (US$15 million) package to fund more intensive data collection to improve the prospects of mineral explorers. The Hambro allegation suggests such beneficence will have been misplaced to the extent it is used to help concoct spurious investment propositions while exposing overly trusting investors to fresh losses.

At the heart of exploration results is usually a technically qualified individual who hires out his post-nominals to enhance the credibility of company disclosures. Without that professional backing, exploration results would lose their commercial impact.

If the quality of the information being put into the public domain is suspect, this is where much of the blame should reside. Correspondingly, the industry's professional bodies have an obligation to haul their members into line. More than that, a cloud over the integrity of large numbers of their members should precipitate action by the professional associations to discern the accuracy or otherwise of the slur on their reputations.

Also speaking at Mines and Money, MSA Group managing director Keith Scott presented a wide-ranging analysis of the industry's propensity for exaggeration. He identified the failure of professional bodies to exercise their disciplinary powers as one reason business outcomes continually fall short of stated aspirations. There is work to be done on this front.

This leads to consideration of the role of corporate governance standards. Failures to maintain high standards of technical honesty reflect poorly on company governance.

If technical experts are not signing off on accurate reports, either they will have been insufficiently skilled to do the job or their judgments will have been compromised in some way. Senior technical managers in early stage companies commonly have little board oversight or may be directors themselves. With financial rewards linked to improved share prices, risks to objectivity are aggravated.

The Hambro allegation suggests, too, a reason investors are failing to receive an adequate return on the money they have invested. Whatever happens to commodity price cycles or equity markets, if the ore is not in the ground, investment returns will be damaged.

Companies may contrive to keep the dream alive but this will come at the expense of serious ongoing dilution for shareholders responding to a promise but unaware of their investment folly. Assuming that apparently strict disclosure rules will provide a protective barrier against unscrupulous or inept corporate behaviour will prove misguided.

Lies about exploration assets are akin to the short-sightedness displayed by drug cheats in athletics. The cost of any near-term gain is irreparable longer term reputation damage.

Lost credibility will be a continuing barrier to the industry's quest for funding. In particular, it will have jeopardised any chance to become a valid investment option for those pension funds and other investment institutions whose emphasis on governance standards and corporate integrity dictate their capacity to invest. Ironically, an industry whose lifeblood is equity financing will be cutting itself off from the biggest pools of investible funds. ▼

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