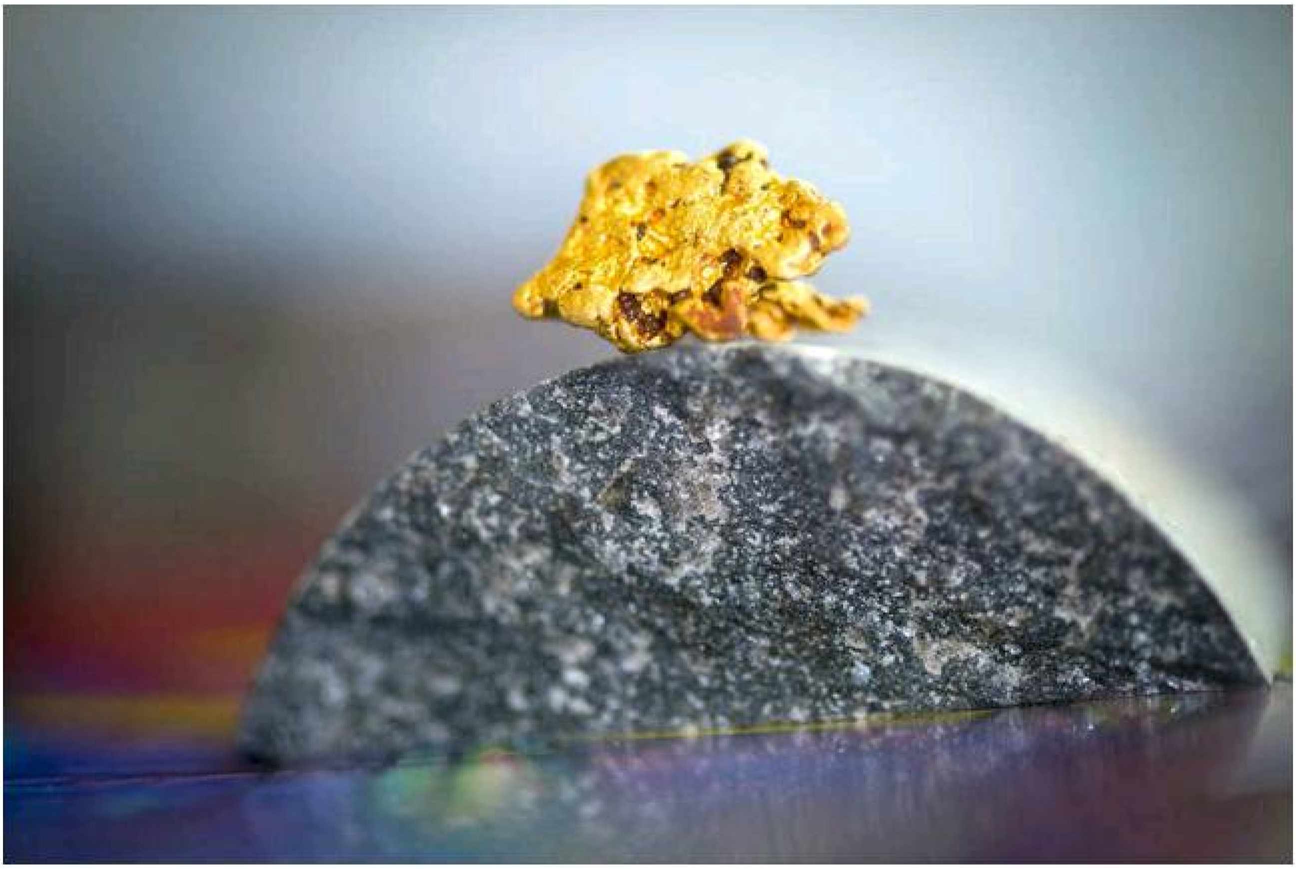
Mining Journal

Investors back Gold Road ambitions

Gold Road Resources is already planning for multiple large-scale discoveries while pushing toward its first gold production in early 2019.

John Robertson* | 12 Oct 2017 | 10:51 | Opinion



Gold Road's next challenge is living up to its market capitalisation by delivering further exploration success

With discovery of the Gruyere prospect revealing the Yamarna greenstone belt in Western Australia as a new gold producing province, Gold Road has done what few explorers achieve.

In an industry battling to source growth, Gruyere is an extraordinary discovery with anticipated annual production averaging 270,000 ounces over 13 years.

Chief executive Ian Murray exudes quiet confidence in addressing investors about what comes next. He says the company will replicate the Gruyere discovery not once but twice in the next few years.

In openly canvassing his ambition for multiple discoveries, Murray is voluntarily putting his credibility on the line and setting new benchmarks against which future corporate success will be judged.

Murray seems plausible enough in his claims about what might be possible with one commercial discovery already under his belt. He boasts the backing of several investment institutions with a history in the space, which account for one quarter of the shares on issue, and Murray says he has 10 analysts following his endeavours with research.

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With 50% joint-venture partner Gold Fields taking over development, the project has access to the necessary skills and finance, the absence of which so often retards others.

"The challenge for Gold Road is to sustain its market price while it builds a productive asset base to match investor expectations"

Gold Road also has an unusual monopoly over the greenstone belt on which its attention is centred with tenements covering around 5,500km^2.

Far better known gold mining regions in Western Australia have histories going back 120 years or more. In these older mining regions, new finds of size are rare and asset trading or recourse to historically worked areas are used more frequently for corporate building.

Modern exploration in the Yamarna region is in its infancy. That means a heavier dependence on greenfield exploration success but also more numerous opportunities for laying down long-lasting corporate foundations.

The company has already benefitted financially. It translated its A$10/oz (US$7.82/oz) discovery cost into a A$200/oz price tag in selling a 50% stake to its joint venture partner.

Even while the fully funded Gruyere construction project is getting underway, Gold Road has committed A$30 million to exploration in 2017, currently funding 38 exploration camps dotting the region.

In addressing an audience in Melbourne recently, Murray likened his multi-pronged search for standalone mines to having many small companies under the one corporate roof.

Gold Road completed a feasibility study for the Gruyere development in October 2016. Based on market conditions at the time, the study estimated that a pre-production capital outlay of A$507 million would generate some A$1.41 billion after tax over the project life. That would have been equivalent to buying a bond with a yield of 12% (or 17% before tax).

Adjusted for today's US$1,275/oz gold price and US$0.78 exchange rate, the investment proposition boils down to exchanging the revised A$532 million development capital estimate for A$1.75 billion in future cash flow, raising the bond yield equivalent return to 15%, or 21% before tax.

Of course, ordinary investors are not being offered a stake in the project. They must buy shares in the listed company, if they are attracted by the project economics. That changes the investment arithmetic.

For a start, the company only retains a 50% interest in the Gruyere project. Also, investors buying in at this stage through the listed entity must outlay A$634 million, the current market capitalisation, rather than the A$204 million contributed by way of equity from investors to date.

Those that came in early stand to gain handsomely with an after tax cash yield on their investments of 23%. In contrast, with the price tag for a half share now exceeding A$600 million, the yield equivalent has fallen from attractive double digits to less than 3% or a far-from-compelling 5% before tax.

Considerable future success is embedded in the price of the company. Murray appears to have done an outstanding job persuading investors about its future direction but the biggest investment gains, higher gold prices aside, look like being in the past.

Two more Gruyeres by 2024, say, on exactly the same terms as the first Gruyere suggests investors would be outlaying A$1.1 billion (to buy the company and fund the half shares of the pre-production capital) for a post-tax cash flow of A$2.6 billion. Over a 20-year production horizon, that would represent an annual yield of 6% (or 9% before tax).

The returns are far less compelling for today's equity investor, even after the company completes multiple developments.

Of course, even those more modest returns are not adjusted to take account of a range of risks including the possibility the company's discovery rate is less than advertised or that deposits found are smaller or mines more costly to operate.

Gold Road is in an unusual position for an industry in which large numbers of development companies face a daily challenge to get market recognition for undervalued resources.

The challenge for Gold Road is to sustain its market price while it builds a productive asset base to match investor expectations.

Without higher gold prices at its back, Gold Road faces the possibility of a lengthy period with minimal market returns (such as has occurred since mid 2016) as the company builds its underlying asset value sufficiently to validate the prevailing price.

This may not bother a range of institutional investors who value size, because of their portfolio management needs, or relative performance, due to the nature of their mandates. Those looking for a reliable gold bullion proxy may also be satisfied.

Retail investors or anyone with a greater emphasis on absolute returns, on the other hand, will have to ponder whether the balance of risks still favours the Yamarna pioneer with so much success already embedded in its market price.

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