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# Boardroom neglect damages disclosure

Hardey Resources has given us another example of how companies neglect their continuous disclosure obligations.

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*Those who finance a resources company are entitled to know the good, bad and ugly developments that effect their investments*

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In July 2017, Hardey Resources (then known as Elysium Resources) reported that it had cash assets end-June of $922,000 (US$727,000) with expected spending in the then current (September) quarter estimated at $524,000. On the second last day of October, the company reported that it had actually spent twice as much - A$1.065 million.

The September-quarter cash flow report also disclosed that the company was going to spend A$690,000 during the last quarter of 2017.

The December quarter results were released on the very last day of the period allowed for reporting. They showed that Hardey had once again spent twice as much as it had foreshadowed one-third of the way through the quarter - A$1.4 million compared with the forecast of A$690,000 million.

The company's seeming failure to budget accurately also caught the eye of ASX, which asked for an explanation for the disparities between the company's budgeted amounts and actual spending.

In responding on February 27 to a letter from ASX dated February 21, the company gave no ground. There was no admission that it could have done better.

Apparently, the company was confronted by a series of allegedly unanticipated events to which it was compelled to react. Rather than poor budgeting, the differences could be put down to the prized virtue of strategic agility.

Some expenditures, directors said, arose from an opportunity to abandon their New South Wales copper-gold exploration focus to become a Pilbara gold producer with an eye on the recently publicised conglomerate-hosted gold potential of the region.

Higher-than-expected due diligence, legal, capital raising and public relations expenses were incurred in setting the new corporate direction.

> **Internal governance arrangements will affect how closely companies adhere to rigorous disclosure practices**

Directors did not say so but they had actually announced the Pilbara gold acquisition leading to these higher expenses six days before releasing the company's quarterly cash flow report for the September quarter.

Despite the understandable excitement, someone in the boardroom should have twigged that the forecast had been rendered redundant even before it was entered on the public record.

Replicated across the market, such a neglectful approach would nullify the usefulness of the requirement to publish quarterly estimates of upcoming expenditures.

Investors would have been better off having their attention drawn to the likely variability in the forecasts, even if no accurate forecast had been framed. They might have been better off, too, with no information rather than relying on the misinformation with which they were presented.

This is not to say that companies should be placed in strategic straightjackets unable to respond to business opportunities or costs as they arise.

The rules requiring continuous disclosure confer enough flexibility to react to changed circumstances provided companies inform the market as soon as they become aware of material deviations from prior guidance about the company's financial or operational outcomes.

It took Hardey until the end of January to acknowledge the spending overrun and a further month to explain why it had occurred.

Continuous disclosure is not the same as continual disclosure, periodic disclosure, occasional disclosure or disclosure when the inclination strikes.

Disclosure of financial information receives an especially low priority among many smaller miners as boards dominated by directors holding price sensitive options keep a lookout for opportunities to create positive news.

In November 2017, New Century Resources put a value of A$1.3 billion on the company's plans to resurrect production at the Century zinc mine. Underpinning the valuation was a zinc price of US$1.25/lb and an 8% discount rate.

In its most recent presentations, the company makes sure that favourable zinc price variations - potentially boosting the valuation by 30% - are highlighted. Other new pieces of information impacting the project value were ignored.

The company signed off on an agreement to borrow US$45 million for three years at an effective cost of 11.3% a year on October 11, 2017. In November, it topped up its existing equity base with an additional A$53 million to go toward completion of the Century project.

These already locked-in funding arrangements imply a 60:40 equity-debt mix. We know, as a result, that an assumed 8% discount rate exaggerates the valuations being touted to lure investors.

Companies habitually use outdated valuations in this way. The justification for what might have once been an acceptable working assumption - even if not very realistic - is shattered when clearly contrary agreements have been struck.

A simple note acknowledging as much would be straightforward enough and, the evidence suggests, would have happened if the variation was favourable.

Internal governance arrangements will affect how closely companies adhere to rigorous disclosure practices.

Several years ago, I surveyed company boards asking directors whether they routinely had placed before them a list of all the forward-looking statements that had been made on behalf of the company and that remained on the public record.

As it happened, none of the companies I questioned had adopted such a discipline, which made it improbable that directors could properly fulfil their disclosure responsibilities.

There was no doubt directors were being made aware of good news. They also had access to presentations and other releases so were broadly, but not always, aware of what forward guidance investors were receiving.

Board agendas were not structured to ensure directors formally reviewed and endorsed outstanding guidance. Without that, it is easy enough for company officers to forget that a continuous disclosure regime is intended to be timely and symmetric. It is not only designed for good news.

A simple rule of thumb works well: If something is important enough to mention in the first place - like a cash flow forecast or a project valuation - it is important enough to acknowledge as soon as it no longer applies.

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