Guesswork not good enough

Ironbark Zinc has moved closer to realising its decade-long ambition to build a zinc mine in Greenland after getting the go-ahead from the island's government.

John Robertson* | 15 Feb 2017 | 23:57 | Opinion

Investors have gone cold on Ironbark's Arctic Circle zinc development at Citronen, Greenland

The Citronen zinc project sits on the edge of a fjord well within the Arctic Circle on Greenland's northern coast.

Nearly 10 years after acquiring the property in April 2007 and over two decades since Platinova first drilled there in 1993, Ironbark Zinc was granted 30-year exploitation rights in December last year.

Ironbark directors have described Citronen as potentially the world's sixth-largest zinc mine.

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Backed by a Greenland government keen to tap the country's rich mineral endowment, Ironbark Zinc is set to begin construction of the underground mine once it has locked in finance and project management arrangements, most likely with an offshoot of China Nonferrous Metal Mining, with which it has a memorandum of understanding.

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All going well, the Chinese partner will agree to deliver a completed project at a fixed price, help arrange debt finance for up to 70% of the US$485 million needed and exercise an option to take a 20% project stake itself.

Ironbark also has equity links with Nyrstar and Glencore, which have rights to 70% of the available output. Glencore also grabs a US$10 per tonne concentrate marketing fee for the 65% of output being bought by third parties.

In a lukewarm response to the mining approval, the company's market value slipped from A$56.2 million (US$43.4 million) to A$41.4 million. It seems some shareholders were too weary to continue or uncomfortable with the value proposition.

The company's published analysis of the Citronen project is unusually outdated, patchy in its quality, and sometimes prone to over exuberance.

"The Ironbark Zinc investment proposition lacks the rigour one would expect from a project seemingly so far down the track"

Investors have to rely on an April 2013 feasibility study document based on October 2010 cost estimates. The 2013 study applied a 15% cut to the 2010 estimate of project costs to take account of cheaper Chinese project management and labour. No operating cost revisions were made.

Surprisingly, the company referred in a presentation this month to having completed a 'bankable feasibility study' despite having separately advised a few weeks earlier that the 2013 study will have to be updated and tailored to meet Chinese banking requirements.

Through some quirky coincidence, seven-year-old cost estimates might give the same answer as a freshly re-done assessment but, until then, Ironbark Zinc investors confront an unusually large number of uncertainties about the value proposition.

While the Citronen project valuations were quoted in the dot point headlines to the 2013 document, there was no economic evaluation explicitly setting out the assumptions used.

In discussing zinc prices, the 2013 study said "it is important to apply future forecast metal prices to the financial model to more accurately reflect the likely prices at the time of production" and referred to a life of mine zinc price forecast of US$1.37 per pound.

In presentation material published this month, the company attributes the project net present value – still estimated at an unchanged US$354 million after tax – to a zinc price of US$0.835/lb, hinting at the prospect of considerable valuation upside.

The valuation is, in any case, more than usually spurious as the company does not disclose in its public filings the discount rate used in its calculation.

Also missing is any sensitivity analysis. The Chinese yuan has varied by as much as 13% since October 2010. The euro is down 23% against the US dollar. The effect of these changes, if any, becomes anyone's guess.

Luckily, the zinc price has gone up but how much a change in zinc prices, including the possibility of a future decline, might affect valuation has been kept hidden.

Ironbark Zinc chief executive Jonathan Downes has consistently used the outlook for the zinc price as a central feature of his marketing pitch highlighting how mine closures and steady growth in usage will cause a historic compression of available inventories.

The company's apocalyptic claim that "the world is running out of zinc" made as late as this month echoed the earlier remarks.

As last week's 'From the Capital' column highlighted, the most recently available data from the International Lead Zinc Study Group show inventories falling by just 72,000t over the first 11 months of 2016, leaving them higher than at the end of 2014.

The 90% zinc price rise since the end of 2015 has occurred in anticipation of what is turning out to be a rather modest rebalancing of the zinc market.

Meanwhile, Ironbark Zinc needs 10 times more than its market value to get the job done with all the company's funding eggs apparently nestled in the China Nonferrous Metal Mining basket.

Funding risk aside, investors may also need comforting about how well the Chinese company's development credentials, based on projects in Zambia, Mongolia, Kazakhstan and Iran, translate into the peculiar surrounds of Arctic mining.

The 2013 feasibility study implies an investment of US$525 million (in project costs and existing equity) will produce cash flows over a contemplated 14-year mine life equivalent to buying a 14-year bond with a yield of 13%.

Discount rates of 14-16% applied to the 2013 information would value Ironbark Zinc in the range of A0.15-0.25 a share compared to the current share price of A$0.09, a handy but not unusually strong gain over possibly two or three years in a market containing hundreds of stocks now very heavily leveraged to more buoyant markets and easier funding.

Citronen will probably be a mine but the Ironbark Zinc investment proposition lacks the rigour one would expect from a project seemingly so far down the track.

The company needs to put aside its reliance on bullish zinc market sentiment and do more to bolster its investment case by presenting a thorough contemporary analysis of its project with reassurances about its capital sourcing and execution prowess.

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