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Lithium investors miss bumper trade

Dakota Minerals (ASX: DKO) traded out of its Lynas Find lithium prospect in the Pilbara into a strategically superior lithium opportunity in Europe with a multi-million dollar profit but lost 80% of its market value along the way. How's that fair?

John Robertson* | 16 Mar 2017 | 3:49 | Opinion

Value is in a constant state of flux and, as the experience of Dakota Minerals illustrates, very much in the eye of the beholder.

In December 2015, Dakota Minerals agreed to acquire a package of six tenements adjacent to the Pilgangoora lithium-tantalum deposit of Pilbara Minerals in Western Australia.

Pilgangoora was being billed at the time as the world's second largest spodumene deposit. In the midst of frenzied market reactions to anything to do with lithium, investors were already paying nearly A$250 million for Pilbara Minerals and destined to pay twice as much within five months.

By early May 2016, when Dakota Minerals disclosed its first drill results from its recently acquired properties, Pilbara Minerals was being valued at A$807/tonne of Li_2O contained in its 80.2 million tonne resource.

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Dakota had not yet estimated a resource itself. Based on the estimate published subsequently in October, its A$84 million market capitalisation in May would have been equivalent to A$1,054/tonne of Li2O, a premium of more than 30% over the value attributed to the more advanced Pilbara Minerals at the same time.

Three days before the company had reported results of its phase one drilling at Lynas Find, it had completed a capital raising at what turned out to be a 30% discount to its rising share price.

The impulse to sell profitably near the bottom of the cycle, repeated across the market, remains a heavy constraint on sector upside

Pilbara Minerals itself was in the midst of its own heavily discounted share issue also giving investors the prospect of immediate profits.

With anxious sellers confronting a dwindling number of less enthusiastic buyers, investors in the Dakota offer were under water within 72 hours of the issue being completed. Within seven days of disclosing its drill results, the Dakota share price had plummeted 53% and, by mid-August, was 75% lower.

The Pilbara Minerals share price, having peaked just a few hours ahead of the Dakota price, had fallen by as much as 47%.

A few weeks later, Dakota supplemented its Pilbara lithium position with historically worked mineral deposits in Portugal also prospective for the popular battery metal.

And, in October immediately after the release of its maiden Lynas Find resource estimate, the company announced a deal to sell the WA property to Pilbara Minerals. The Lynas Find sale had an A$8 million price tag of which $3 million was a payment, with an option to use Pilbara Minerals scrip, delayed until after tenement transfers had been finally approved.

The transaction price was less than one-tenth of the price once paid by investors for the company and implied a valuation of just $100/tonne of Li2O.

A buyer and seller with full understanding of the assets on offer mutually agreed that the WA property was never as well-positioned as had been touted and always overpriced by the public market.

Pricing aside, Dakota directors had shown unusual strategic clarity. They had chosen to cut ties with Australia and reposition their activities within the European customs union close to where a high proportion of the world's electric car batteries would be installed.

The geographic switch did not excite investors, prompting chief executive David Frances to question their understanding, according to a November 15, 2016 *Mining Journal* report. Frances' sentiments smacked of ingratitude toward investors who had backed the company with A$20 million in the prior five years. He also implied he could buck broader market trends.

The current Pilbara Minerals resource is now being priced at $300/tonne of Li2O, 63% below what investors were paying in May 2016.

In assessing the merits of the market treatment of Dakota Minerals, the lingering effects of history on current sector pricing are also worth remembering.

Companies that might have once traded at two dollars and now trade at two cents, for example, can produce a 100% return near the bottom of a cycle by trading at four cents.

After years of negative returns, some still badly scarred investors are inclined to ignore absolute values, despite historic price disparities, to place more emphasis on returns.

The impulse to sell profitably near the bottom of the cycle, repeated across the market, remains a heavy constraint on sector upside. The median share price gain since mid-2016 across the roughly 850 ASX-listed resources stocks is zero.

Dakota Minerals itself has helped to put a dent in the market valuation of its own assets. Using the same benchmark as it applied in its sale of Lynas Find would value its Portuguese assets at just A$10.3 million. That and its $16.9 million currently estimated cash holdings give the company a value close to its market capitalisation of A$22 million.

In sizing up how much to pay for Dakota Minerals, local investors would also be aware of the unfortunately mixed results from Australian companies venturing to Europe to tap historical mining assets, teased by apparently speedy routes to production and profitability.

One of the more frustrating examples in recent years has been the thwarted attempts by Highfield Resources to complete development of its potash properties in Spain. Highfield looked set for an impressive debut on the international mining stage until the unanticipated impact of an inconclusive Spanish election in 2015 derailed its plans.

Until then, the budding potash miner had been as adamant about the ease with which it could proceed as Dakota is today.

Investors are assimilating an array of risks and opportunities in judging the value that should be applied to the Dakota Minerals assets. Some considerations are specific to the company. Others reflect broader macro forces. Market price dynamics cannot be ignored.

How these forces fuse into a price will vary, sometimes dramatically, but one thing is clear. Today's market judgements about the Dakota Minerals value are analytically more robust than they were at the start of May 2016, giving investors a correspondingly firmer footing.

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