

Insight: From the capital

Super funding opportunities for Australian miners

A vast pool of superannuation funds will be looking for investment returns. Will the mining sector be a focus?



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Australia's junior miners should be extraordinarily well positioned to fund their activities over the next 5-10 years, but they might need a dramatic investor relations makeover to get their fair share of Australia's booming superannuation assets.

In 1992, the Australian government introduced a compulsory superannuation system under which employers were required to set aside a fixed proportion of wages and salaries for employee pensions.

Under the current law, the superannuation guarantee levy is being raised from 9% to 12% between 2013 and 2022, although there is some difference of opinion between the two major Australian political parties about whether this transition should be left as it is or lengthened.

According to the Australian Bureau of Statistics, total wages and salary payments in 2013 amounted to A\$674 billion (US\$634 billion). The statutory levy rate implies at least an additional A\$62 billion will go to superannuation during 2014. These guarantee arrangements have fuelled a rapid build-up in the pool of superannuation assets in Australia. Since 1988, they have grown at an average annual rate of 13% to A\$1.702 trillion at the end of 2013.

If we assume that wages and salaries grow by, say, 4% a year over the next five years, the levy arrangement would imply A\$13 billion more going into superannuation annually by the end of 2018 than in 2013, by which time the pool of funds would have grown by a further A\$350 billion.

At the end of December, 29% of the pool of superannuation assets was invested in Australian equities, a total of A\$48.7 billion. Based on the 4% a year income projection, the additional funds available for investment in Australian equities at the end of 2018 would be A\$105 billion, if the current allocation was to stand.

If those additional funds were to be allocated across the market in line with current market weightings, the overwhelming bulk of that potential flow would be directed toward the largest companies, but there are some 900 listed entities in Australia that account for 10-12% of the value of the Australian market and are engaged in mining

and oil and gas exploration or production.

If the sector juniors were to capture a share of the superannuation pool based on their current market position, an additional A\$11-12 billion in funding would be available over the next five years and A\$25-26 billion over the coming 10 years.

What a pity, then, that Australia's smaller and aspiring miners are likely to miss out on these funding opportunities.

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Management of the pool of superannuation money is dominated by a small and diminishing number of large superannuation funds whose attitude toward this end of the market is reminiscent of the way lepers were treated in biblical times. They give five reasons for staying well clear of this part of the market.

Index benchmarks loom large in their thinking. With performance being measured against benchmarks dominated by large cap companies, investment objectives can be met without thinking much about a stock outside the S&P/ASX 200.

Governance practices are often cited unfavourably. The risk of companies behaving badly either by siphoning off a disproportionate part of the capital base to sustain individual lifestyles or failing to keep markets properly informed is a common gripe.

From a practical perspective, market liquidity is a problem. Shares can be bought easily enough. Companies will readily issue more to accommodate a large investor but institutional investors want to be able to sell. Thin markets make selling costly.

Market volatility is too high. The standard

deviation in returns across the stocks in the sector is typically in excess of 30%. The standard deviation of the S&P/ASX 200 is typically around 15%. This alone might not be a stumbling block if the mining returns compensated for the risks. But they have not done so.

Another practical problem for the junior miners is that fund managers have to choose. With nearly one thousand stocks in the universe of possibilities, this requires a commitment to analysis. Other sectors of the market are easier and less costly with analysts typically allowed to traverse a wide range of industries to support their salaries.

Against these odds, Australia's mining community has gone elsewhere for funding. That might have appeared a logical reaction but it now puts the miners at a considerable disadvantage. It means a growing number of companies looking in the opposite direction to where the funds are actually accumulating, even as they wonder why capital raising seems to be getting harder.

Re-establishing a claim on this superannuation asset pool will be a herculean achievement. Reforms in the way the sector does business will be preconditions to more successfully exploiting the opportunity.

Governance commitments need to improve. While everyone is notionally obliged to adhere to ASX-listing rules, these are policed lightly. There are, consequently, many examples of companies breaching their spirit if not the letter of the law without regulatory repercussion.

EIM Capital Managers is seeking to work with companies to produce an 'integrity charter' that commits an identifiable few to a high standard of market behaviour through a code of conduct as one way to help reposition the image of the industry.

Structuring returns from successful project development so that shareholders are compensated adequately for the cost of capital is a necessity. The reinvestment model adopted by the sector almost inevitably results in returns to shareholders well below competitive investments, since cash flows are typically recycled into new rounds of exploration and searches for new projects.

The sector needs to develop structures in which project cash flows come back to early stage equity investors as quickly as possible. If this is done well, additional funding for new projects should flow far more readily. ▼