Opinion

FROM THE CAPITAL

Excelsior boosts investment case

Bold plans can often be lacking a little detail

John Robertson

Excelsior Gold is one of a growing number of Australian miners looking to creep into production with modest capital budgets as they use early sales to help fund larger capital commitments and later production increases. Investors relying on this finely tuned strategy have little room for error.

Excelsior Gold has accumulated more than 130 sq km of granted mining leases and exploration licences in the eastern goldfields of Western Australia. The Excelsior tenements start approximately 10km north of the Paddington mine and mill operated by the Zijin Mining-controlled Norton Gold Fields. Twenty-two defined resource areas extending over more than 20km currently contain a 1.38Moz gold inventory.

Two major resources – Excelsior and Zoroastrian – are just 300m apart and near the Bardoc mine formerly run by Aberfoyle. The two contain 456,000oz and 581,000oz, respectively, in a mix of potentially open-pit and underground resources.

Advances in the understanding of the regional geology since the days of Aberfoyle's involvement in the area had emboldened the company to contemplate a 1Mt/y processing plant to treat Zoroastrian and satellite ore reserves for annual production of 60,800oz. A 2014 study put the capital cost of this plan at an impractical A$93 million.

Excelsior had the advantage of the nearby Paddington mill and, in June 2014, the company outlined a significantly less capital intensive route. The company agreed to contribute up to $12.5 million toward refurbishment of the mill. In exchange, Excelsior received a minimum mill allocation from Norton of 2.5Mt and an option over an additional 2.5Mt.

In February 2015, Excelsior announced a second agreement with the Paddington owners under which it could deliver 400,000t of ore during the second half of 2015 by tapping pits south of Zoroastrian.

The agreements offered Excelsior a chance to bypass construction and plant commissioning risks while it went about expanding its resource base, improving its understanding of the local geology and, hopefully, positioning for a full-scale development when markets were more receptive.

Investors were reassured by these arrangements. The company's share price increased 30% through February while the sector index changed little.

The first phase of the development strategy offered investors an especially attractive return on the capital subscribed. But the capital needs could not be averted permanently. This became evident as the company disclosed more detail about its plans.

While the first stages were financially attractive, the company estimated that the later move to underground mining around 2019-20 would require an additional $69 million. This course, the company said in July, had a net present value of just $37 million using a A$1,500/oz gold price and an 8% discount rate. With the company's market value of $41 million at the time, the plan lacked strong appeal.

On September 4, Excelsior released a revised plan with a better bottom line. Production was hiked by approximately 10,000oz and the duration of mining cut by nine months to 7.3 years. Capex was nudged slightly higher, but the underground development costs were cut by about $18 million.

The new discounted cash flow value estimate was an improved $51 million. With a market value now sitting at $31 million, investors were offered a stronger proposition.

The Excelsior Gold experience highlights the important role being played by skilled and experienced geologists and mine planners in reassuring directors and investors alike about development prospects. Their informational content can form a critical input into an investment decision.

In the Excelsior Gold case, the difference in valuation between the September variant and the July alternative would be the difference between a good investment and a dud. Consultants' fine tuning can leave very little room for implementation error.

Financial optimisation exercises such as this also highlight the important role of the 2012 JORC code in presenting relevant information in a form useful for potential investors.

Unfortunately, Excelsior Gold has joined an undistinguished group of companies flubbing some important JORC 2012 responsibilities.

The JORC code requires, for a mining reserve estimate to be compliant with the code, a commentary from a competent person about the underpinning economic analysis. The commentary must refer to the sources of the economic inputs being used, the confidence attached to them and the sensitivity of valuations to changes in the assumptions.

The requirements were obviously designed to improve investor decision making. The information required would allow investors to assess for themselves the impact on investment decisions if their own assumptions were substituted for those of the competent person picked by the company.

Discussion of the economic criteria is toward the end of the JORC code pro-forma. The competent person may be unusually fatigued by this point, insufficiently skilled to cover the additional disciplines, or simply neglectful. Whatever the cause of their too frequent disregard for this aspect of the code, the quality of the responses is often disappointingly lower than the responses about the geology and mining plans.

So, for example, why did the competent person acting for Excelsior Gold use a discount rate of 8%? The answer was simple: "Provided by Excelsior". Using this ploy, the company and the designated competent person can both neatly duck responsibility for the resulting analysis.

How sensitive is the valuation to changes in the discount rate (or any other economic input), according to the Excelsior Gold competent person? Answer: blank. Ironically, a company whose development prospects rely overwhelmingly on how sensitive its valuation will be to a range of economic inputs has ignored this aspect of the code's requirement entirely.

Excelsior Gold is redefining the regional geological footprint over its extensive tenements. Its location advantages confer a unique safety net that might underpin a long-term development opportunity but, right now, an investment decision rests on the validity of some very precise operating and economic assumptions. That means an assiduous adherence to the disclosure rules would be helpful.

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