

FROM THE CAPITAL

MZI sending mixed messages

Market valuation reflects confusion over Keysbrook mineral sands mine life

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MZI Resources has joined a select club: companies that have brought a mine into production in the current cycle. The world's newest mineral sands producer is no shrinking violet as it labels itself "compelling" and a "rare gem" in the resources sector.

Any company that gets a mine up and running in modern times deserves special credit, but finding a company without some excess baggage is improbable.

MZI Resources CEO Trevor Matthews was reported in *Mining Journal* as long ago as October 2012 describing the Keysbrook mineral sands property – which is 70km south of Perth – as "compelling". He attracted some strong believers. Leading up to the *Mining Journal* report, the company's share price had more than tripled and the market value had topped A\$60 million (US\$43 million). At the time, production was due to start by the end of 2013.

As it turned out, the Keysbrook project did not start producing until November 2015. Not surprisingly, by then the share price had retreated more than 70%. The market value is once again nearing A\$60 million, but only after a near 300% rise in the number of shares on issue.

As I recently observed in these pages, the best companies will have adopted a rigorous process to explain why there have been departures from earlier plans and how deviations are rectified. Without that, investors are prone to tune out. The communication links are broken. Value is permanently eroded.

MZI Resources has adopted the more conventional approach of airbrushing away the corporate hiccoughs. A document released on February about a fortnight ago asserted boldly "construction completed and production commenced on budget and ahead of schedule". Vintage 2012 shareholders may differ over this characterisation.

While that record has been playing out, Keysbrook has apparently remained compelling in the minds of directors. First and foremost has been the robust economics. Their other related reasons have been low-risk, high-value titanium dioxide and zircon products, resource base expansion through exploration potential, offtake commitments for more than 85% of its output and a strong board and management.

In the mineral industry, the term robust



MZI's Keysbrook mineral sands mine could run for anywhere between five and 30 years

economics has been hijacked to describe a feasibility study with a positive net present value. If this much-abused term was used properly, a project would be described as having robust economics only where explicit stress testing had been conducted to produce evidence of little change in value outcomes across a broad range of business scenarios.

Companies whose valuations are highly leveraged to changes in exchange rates or commodity prices, for example, and are at risk of very sharp value losses when conditions change cannot reasonably be described as having robust economics.

The ability of a project to operate over multiple economic cycles contributes robustness. Long life adds value directly through its impact on output and sales and, indirectly, through the flexibility it gives investors to recoup market losses or opportunity costs in later cycles.

Despite its achievement and the self-congratulatory tone of its disclosures, MZI poses some difficulties for anyone trying to form a judgement about its investment attractiveness.

Critically, and where many falter, MZI appears to be operating satisfactorily through its early days. It is potentially profitable enough to tempt thoughts of a dividend. On the other hand, the company finds itself in a confusingly schizophrenic state about its long-term operational life.

In some of its disclosure documents, it leaves the impression that it has a potential 30-year life, but this is "subject to land access and further approvals" as, I could say, is my ownership of Buckingham Palace. Potentially stropy farmers whose land rights came with a mineral entitlement prior to 1899 could get

in the way of its ambitions. Without their cooperation, only five years of production is on the cards.

For formal guidance about future production the company has resorted to a tightly formatted footnote – barely noticeable on a big screen presentation. The footnote in its current disclosures says "all material assumptions underpinning the production forecasts in the independent expert's report continue to apply and have not changed" in reference to an October 2014 report. This report values a 5.5-year operational life. Not 30 years.

In this way, the company straddles the chasm between the conservatism preferred by regulators and what is needed to gee-up investors.

The 2014 expert's report placed a A\$21 million mid-point cash flow valuation on the Keysbrook project, which would be equivalent to A12.5c per share on issue today compared with an actual share price of A36c.

The project's economics are greatly improved with a more favourable Australian dollar exchange rate than the US\$0.83:A\$1 assumed in 2014. Extrapolating the current US\$0.705:A\$1 exchange rate for the duration of the planned production, without any other changes, would lift the project value to over A\$45 million or A27c/sh.

Though the company no longer has A\$81.4 million of development spending ahead of it, it was carrying a net debt load of A\$108 million at the end of December. All of that leaves the proposition some way short of compelling. The investment file should be marked "a job well done but not at current prices".

The market is greatly overpricing the formal production guidance being given by the company. Most probably, in pricing the stock, some investors are reacting to the intimated 30-year mine life. Assuming this, the stock is probably too cheap.

So, whether MZI Resources is a compelling investment or not hangs on how confident one can be about the operational life of the mine, a subject on which the company is sending out purposely mixed messages.

A clear commitment to 30 years of production would more than validate the current market price and set the scene for some strong investment returns. Without an unambiguous commitment to a 30-year operating life, on the other hand, the company faces a rolling five-year mine life for the best part of three decades and an ongoing leakage of potential value. ▼

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