Mining Journal

Big numbers stifle development

Parkway Minerals chief executive Pat McManus has likened the company's extensive potash and phosphate deposits in Western Australia's Dandaragan Trough to the state's Pilbara iron ore resources. But without A$10 million (US$7.5 million), he will be tempted to go elsewhere.

John Robertson* | 18 May 2017 | 5:53 | Opinion

Juniors are regular on their knees in front of investors with projects too big for them to manage (Wellcome Images)

Seven billion people looking for more nutritious food from limited amounts of arable land is the backdrop to the efforts of Parkway to mine fertiliser raw materials.

Formerly known as Potash West until it changed its name in November 2016, Parkway Minerals was listed in 2011 after raising $6 million to fund exploration over more than 2,000km2 of glauconite-bearing tenements north of Perth.

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The company's September 2013 scoping study foreshadowed single superphosphate production of 340,000 tonnes per annum at the Dinner Hill prospect over 20 years after spending $144 million. The resulting valuation was estimated at $218 million.

In September 2015, a revised study put a $378 million value on a significantly larger-scale project. Expected output was raised to 400,000tpa. Capital expenditure rose to $205 million and the mine life extended to 40 years.

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That was only the first stage of a far larger endeavour. Stage two, requiring pre-production capital of over $600 million to produce sulphate of potash and phosphoric acid, has been postponed until after cash from the first stage can assist with funding.

If the company's plans are realised, the stage-one development could produce cash returns equivalent to buying a long-term bond with a yield of 20%.

On paper, at least, the project more than compensates for the risk being incurred. Whether a development decision can occur within a timeframe acceptable to investment markets is another matter.

Parkway is confronting a value trap common among early-stage companies whose mineral endowment greatly overshadows the size of their balance sheets.

> ***"The future of Dandaragan might have to rely on panicky fertiliser producers suddenly realising they have badly mistimed their investment commitments"***

Potential project partners with the necessary financial heft have been canvassed directly and through intermediaries.

At one level, the feedback has been positive. The largest producers of fertilisers recognise the potential of the proposed development. They are likely to participate but only at a later stage, according to McManus.

However strange their reasoning may sound, the industry majors are more likely to join in when capital needs are greater than they are today and investment returns lower.

These larger groups want more risk-friendly investors to complete the earlier stages. They say they do not want the management distraction of an early-stage project but will be ready participants when a construction commitment has been made or is imminent.

Across numerous segments of the mining industry, raw material users appear to be playing a game of commercial chicken.

Despite widely recognised future needs for lithium, tin and rare earth elements, for example, those most in need of the raw materials in the longer term have often appeared reluctant to support sufficient development options to meet anticipated needs.

As a tactic, getting others to take the early risks associated with project selection may be a smart move. Encouraging a long pipeline of incomplete development opportunities without committing to any one helps tilt the negotiating balance in favour of buyers.

The risk for the ultimate users is that they are being too smart for their own good. They could end up without sufficient supplies when needs start to rise more dramatically.

Parkway, needing about $10 million to complete the necessary studies for a decision to proceed with the Dinner Hill project, now faces an invidious choice.

In the absence of a committed development partner, Parkway is in a strategically weakened negotiating position. It may have to concede 50% or more of the Dinner Hill project to attract the needed funds.

The alternative is worse. Rejecting a deal may leave it with no hope of developing the project for the foreseeable future.

For $10 million, an investor would acquire the right to vend its share of a more advanced project, with an anticipated $52 million EBITDA, into a larger company. With this being a possibility within three years, a deal more than adequately compensating for the risks could be structured.

Meanwhile, Parkway shareholders have been displaying growing impatience at the apparent lack of progress. After a 73% drop since the end of 2015, the current Parkway share price has never been lower. The share price action puts the return within the worst 10% of ASX-listed resources companies.

Parkway must rethink its way forward. An investment in German potash assets now looms more importantly in its strategic thinking.

In July 2014, the company had struck a deal to acquire a 55% interest in a potash exploration opportunity in a region within Germany where potash had been mined for nearly a century before depressed prices in the 1990s forced operations to cease.

The German assets had been vended into a Parkway subsidiary with a view to subsequently hiving them off into a separately listed vehicle. That was done in January 2017 with the listing of Davenport Resources in which Parkway has a 26% interest.

Parkway is now counting on the South Harz properties in central Germany leading it into production. Lower capital needs, being located in a region with a history of potash mining, in proximity to major mining activity and within a potash importing region of the world suggest a speedier development than in Australia.

Whether the company can rejuvenate shareholder enthusiasm through a minority equity holding remains to be seen. The historical experience is not encouraging.

Those investors who had been attracted to the Dandaragan potential will be disappointed. They might simply see the German option as a second-rate repetition of an already bad experience.

Parkway is open to a deal. Sadly, without willing professional money, the future of Dandaragan might have to rely on panicky fertiliser producers suddenly realising they have badly mistimed their investment commitments.

A dramatic re-pricing of assets arising from a market imbalance may excite a future generation of investors but offer little solace to those already exposed financially to a stalled development go-ahead.

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