Follow us on twitter @miningonline

Opinion

FROM THE CAPITAL

You’ve got to be in it to win it

Only meaningful exploration can uncover meaningful deposits

Australia’s explorers are more than paying their way by generating A$1.95 in value for every $1 spent, according to Minex Consulting managing director Richard Schodde. That’s good news, but Schodde’s analysis may offer little comfort to the growing number of companies he shows are battling to raise $1 in the first place.

The second annual International Mining and Resources Conference this week in Melbourne brought together miners, investors, and an impressive array of industry service providers with local and international governments. The Victorian state government-supported event looks set to become an industry fixture.

The balanced emphasis in the conference on innovation, technology, community partnership and investment streams no doubt helped temper what might have been an overwhelmingly dismal tone at a purely investment gathering.

Four points stood out in Schodde’s wide ranging and statistically detailed scene setting presentation on the historical performance of mineral explorers in Australia.

First, the number of mineral discoveries has fallen. Schodde has tracked industry discovery rates from as far back as 1840. On his reckoning, there were 732 discoveries between 1975 and 2014, with the number varying closely with the industry cycle. They peaked in 2008 at nearly 50, fell sharply in 2009 and returned to near record levels again in 2010 before starting a downward trend. Over a longer period, the rate of mineral discovery in Australia has been running at 15-25 a year.

At one level, this rate of success sounds impressive enough, but it also highlights an important source of investor disenchantment. The number of ASX-listed resources companies has expanded dramatically through the recent cycle from around 600 to nearly 1,000.

The Schodde statistics imply a discovery rate, adjusted for the number of listed companies, shrinking dramatically. With only around 20 discoveries likely this year, well over 900 companies will have had nothing with which to satisfy their investors. Even if the impossible happens and every company eventually does find something of note, some investors will have a wait of 25 years or more, based on these statistics.

Photo: Blastcube

Investors must accept disappointments if they’re going to fund the next generation of discoveries

The second point worth highlighting is gleaned from the Minex numbers throwing a light on where exploration value is being created. The largest companies accounted for 25% of industry exploration expenditure between 2005 and 2013. Based on Schodde’s valuation metrics, this group of companies contributed 30% of the value of discoveries.

The industry juniors, on the other hand, accounted for an estimated 50% of the industry’s spending. They delivered nearly three quarters of the discoveries, but only 45% of the value.

The mid-sized companies have been the most productive with just 8% of industry spending generating 10% of the discoveries and 12% of the value.

The role of the mid-tier companies is particularly significant because this most productive part of the industry has been driven to near extinction over the past 15 years. The industry has become dominated by a few global giants and a huge tail of juniors with little in between.

Companies like MIM Holdings, Western Mining, Pasminco and North, among others, have disappeared. These companies directly or in combination with others underpinned much of Australia’s exploration effort when they were at their most active. More broadly, companies like Asarco, Falconbridge, Inco, Noranda, Phelps Dodge and Amax, to name just a few, had Australian subsidiaries running meaningful exploration programmes.

The budgets of these local and international groups went beyond the current quarter, or even the current year. Their financial positions allowed them a long-term commitment to exploration with the luxury of time to learn as they went.

The third striking feature of the Schodde analysis is what it says about discovery prospects. He has quantified the depth of mineral discoveries in Australia since 1900. Companies have been going deeper, but the vast majority of discoveries remain near the surface. The average depth of gold deposits found in Australia since 2005, for example, is 64m. The weighted average is just 84m.

Mapping the geographic distribution of discoveries highlights their incidence in areas of low cover. In general, says Schodde, “we are exploring in the shallow areas of shallow cover”. Disproportionate numbers of discoveries are also along strike of historic workings.

There are vast areas of Australia with a depth of coverage in excess of 100 metres where no discoveries have been made because of poor surface signs of mineralisation.

Since drilling is expensive, this aspect of the industry’s conduct is unlikely to change in the foreseeable future but, as Schodde says, there is ample scope for discoveries by future generations of explorers.

Funding is the fourth feature of the Schodde analysis worth highlighting. He has quantified the declining financial standing of Australia’s junior mining cohort, over half of which have access to less than $1 million in cash. Separately, analysis from accounting firm BDO shows only 43% of Australia’s listed resources companies having sufficient cash reserves to sustain operating expenditures for two quarters.

Both BDO and Schodde show a growing percentage of companies, now as high as 11%, having spent nothing on exploration for six months or more.

However miserable Australia’s explorers might be feeling, Schodde’s calculations suggest their Canadian counterparts are in worse financial shape, though the Australians are unlikely to derive much solace from that.

With a permanent contraction in the number of mid-tier companies able to support exploration and with so many companies chasing reluctant investors, falling drilling activity is unsurprising. The resulting decline in the rate of discovery will reinforce already prevalent perceptions among investors of an industry insufficiently successful to warrant closer attention.

Exploration has been able to create value historically, but risk-averse drilling for shallow brownfield targets reduces the chance of high-quality mineral properties being on the investment menu. ▼

John Robertson is a director of EIM Capital Managers, an Australia-based funds-management group. He has worked as a policy economist, business strategist and investment-market professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia