

# Investor relations is a two-way street

In the mining equity space sometimes no-one hears you when you scream



**John Robertson**  
Melbourne, Victoria

As well as telling the corporate story, the best investor relations practitioners will be feeding back to directors what the market has to say about a company's value proposition. That way those planning business strategies are given a realistic view of their investment market prospects.

The rationale for most investor-relations professionals is a belief that the market is not working as efficiently as it should and that financial returns can be boosted by an additional effort at persuasion.

Despite its many adherents, the market failure hypothesis is not on especially firm ground. It presupposes that even the most astute analysts and investors will overlook market mispricing, no matter how egregious and contrary to their own interests, unless it is drawn specifically to their attention.

In the case of the mining industry, the investor relations rationale also rests on the crowded nature of the space. The economic and business attributes of the thousands of companies operating around the world end up being very similar. In practice, elbowing out competitors to get access to a limited funding pool becomes part of the investor relations task.

Atrum Coal NL is just one of the companies grappling with these communications and tactical challenges as it attempts to push ahead with an anthracite mining project in British Columbia. On 6 May, the company released the results of its feasibility study for the Groundhog anthracite mine.

The company's announcement headline proclaimed a A\$2.1 billion (US\$1.96 billion) project value. With the company's market value sitting at around A\$250 million (US\$234 million), the intent of the headline was clear. It was designed to cut through the prevalent market noise. Here, it was saying, is a gap between value and price that needs rectifying.

After what was billed as an exclusive conversation with the managing director of the company on the day of the study release, one of Australia's leading investment news sources was enthused enough to describe the study outcome as "simply outstanding" and went on to forecast that "when the company emerges from a trading halt its shares will surge". The article headline even more ebulliently forecast that Atrum shares were "set to rocket".

Over the following week, the share price dropped by 18%. Here was a yawning gap



between what the market thought about the value proposition and how the company and its supporters appeared to view the same evidence. This is not an unusual conundrum for an investor relations adviser trying to fathom how markets think.

In this case, A\$2.1 billion was a huge overstatement of the company's worth. For a start, it would only be a realistic value for the project if tax was never paid. The feasibility study valuation also used an inappropriately low discount rate for an equity market valuation.

On this point, a recent note by Federal Reserve Bank of New York economist J Benson Durham (*Why are equity investors paid to take risk?, May 14*) deals innovatively with the return requirements of equity investors and the link with bond market conditions.

In Atrum's case, a more realistic equity discount rate alone could have stripped A\$800 million-A\$900 million from the headline value. Paying tax would strip out another A\$800 million, according to the company.

Any company's market value implies the application of a discount rate to the future income attributable to equity holders. In Atrum's case, based on the feasibility study projections, this seemed to be around 25%.

As development and financing certainty rises, this discount rate should decline, perhaps to something closer to 15%, and place the share price on a correspondingly upward trajectory. Given its current development stage, however, the market's implied risk assessment of Atrum Coal does not appear unreasonable.

Prior to the release of the study, Atrum

Coal had already received abnormally strong investor support. Among the thousands of resources companies populating the Australian and Canadian markets, Atrum's investment returns since listing in mid-2012 had been among the top five.

Against this background of already extraordinary returns, any feasibility study would have had to show something stunningly novel or unexpected to sustain the momentum or for the share price to "rocket" in response to its release.

The company was probably more at risk of losing shareholders than having them make an additional commitment, at least when viewed against the key investor relations functions.

Investor relations professionals have both an internal and external role in advising a company. The external role has two dimensions: maintenance and cultivation.

The investor relations maintenance role involves looking after the current crop of investors. The most critical aspect of this engagement is to ensure as far as possible the integrity of the investment proposition being promoted. On this score, Atrum appears to have been unusually successful.

Cultivation sets the groundwork for raising capital. It creates awareness of an investment proposition for future shareholders. The cultivation role prepares the way for inevitable shareholder turnover.

The bulk of mining companies put in a huge effort to harvest their initial crop of shareholders. Even in the best of times, however, a pipeline of new shareholders is needed to take account of investor attrition, the evolution of business strategies and the company's evolving capital needs.

Admittedly, making the transition seamlessly to a new shareholder base is an extraordinarily tough assignment under any circumstances. For all the attractions of the Groundhog project, the investor relations effort had not yet replenished the pool of potential shareholders by enough to compensate for those who wanted to take their profits.

The internal investor relations role, on the other hand, involves counselling executives about how their companies can expect to be priced given what they have to offer, the current state of the market and the alternative choices on display for investors.

On this score, the Atrum investor relations efforts seem to have missed a beat. There was, it appears after all, no compelling reason to conclude that the share price would either "rocket" or "surge". ▼