Mining Journal

The full monty

BDO, one of Australia's leading audit and mining industry advisory firms, has advocated an overhaul in industry disclosure practices to help investor decision-making.

John Robertson* | 21 Sep 2016 | 20:01 | Opinion

BDO thinks investors would appreciate a full frontal view of equities in which they plan to invest

The Australian Securities and Investments Commission (ASIC) put the cat among the pigeons earlier this year when it released 'Mining and resources – Forward looking statements', a document referred to as IS 214.

The content of the policy document has infuriated industry executives. They are angry despite ASIC's insistence that the document contained nothing new.

According to the regulator, it had simply intended to clarify what companies could say about their future production by summarising existing rules in one place.

Executives and their advisers remain unconvinced. They see fresh constraints on being able to talk about their production intentions, making capital raising even harder.

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IS 214 has been widely read as unrealistically requiring investors to hand over the money before being told what is planned.

Sherif Andrawes, the national leader of the BDO natural resources team, has been one of the practitioners consulted by ASIC about how it can make its policies more palatable to the industry.

Based in Perth, Andrawes oversees a high proportion of capital raising disclosure documents and industry independent expert reports each year.

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Philosophically, ASIC appears to favour more constraints being placed on what companies can say as a means of protecting investors.

Andrawes, on the other hand, believes investors are better off with more information rather than less.

BDO is concerned that "the focus of the debate on IS 214 has been on the ability of companies to talk about the potential value of a project rather than the potential impact on the value of an investor's share".

This important distinction is universally absent from the analytical studies emanating from the industry.

Pilbara Minerals, for example, released details of a feasibility study into development of its Pilgangoora lithium project in Western Australia on September 20. The study places a value of A$709 million (US$538 million) on the project.

Calculating point estimates for project values is standard practice in the industry despite the uncertainties attaching to an inevitably complex array of factors underpinning a valuation.

Cost estimates in the Pilbara Minerals study had an intended accuracy of ±15% but scoping study estimates may fall within ±30-35%.

Even at this early stage, investors are misleadingly guided toward accepting the veracity of a single number that implies far greater valuation certainty that is consistent with reality.

BDO is proposing that "a single point or preferred net present value of a project should not be announced". Reflecting the estimation uncertainty, BDO favours companies only announcing a range of values.

But even that does not take into account that portfolio investors are not being offered a direct interest in a project.

Other classes of investors may have an option to fund the project directly but not the vast bulk of investors buying their shares through a broker on the stock exchange. If attracted, they must buy a security in a listed company.

Companies use net present value calculations as lures for these investors as though any positive project value can justify an equity investment.

A $709 million project valuation sounds an impressively high number but the market value of Pilbara Minerals is already A$627 million. The project value implies a premium of only 13% over what an investor is currently required to pay.

Even then, capitalised expenditures or corporate expenses relating directly to development and incurred prior to construction are not included, unrealistically inflating the assessed value.

Who knows, too, whether the company has adequately provided for working capital, which is constantly underestimated or ignored by companies planning developments.

Pilbara Minerals' summary disclosure makes no reference to this. Nor does it quantify the ongoing maintenance capital needs.

Pilbara Minerals has estimated that its project will produce an annual average EBITDA of $121 million. Again, that sounds an impressive enough outcome for any investor who might have suffered through many years of profitless endeavours and strategic dead ends.

Anything less than a five times EBITDA multiple would leave the market value of the company short of where it is now. A generous six-to-seven times multiple in four or five years once the company is demonstrating it can deliver its targeted profits consistently is, at best, only a 6% annual return. And that assumes no additional equity raising along the way.

BDO proposes that companies such as Pilbara Minerals should recognise explicitly that the value from a project must be shared with those enticed by an alluring feasibility study to buy the company's shares.

BDO is recommending a fixed set of parameters to show the impact of projects on a diluted basis. Companies would have to adopt standard assumptions about debt/equity ratios, discount rates and discounts for equity raising to permit investors to gauge the impact of a project on company values and to compare companies effectively.

The accounting firm suggests laying its proposed changes out in the ASX listing rules or in a rewritten JORC Code.

The BDO suggestions would greatly improve the capacity of investors to judge the quality of the propositions being presented.

Of course, there is nothing to stop companies from taking up the BDO model now as they report study results. They don't because it may not always look pretty.

No longer being able to exaggerate the impact of projects on corporate value is a flimsy argument against change.

That may not deter companies from opposing disclosure changes meant to enhance the reputation and integrity of the Australian market.

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