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# Feasibility study … who cares?

Feasibility studies are not impacting the views of investors about the value of future mining developments.

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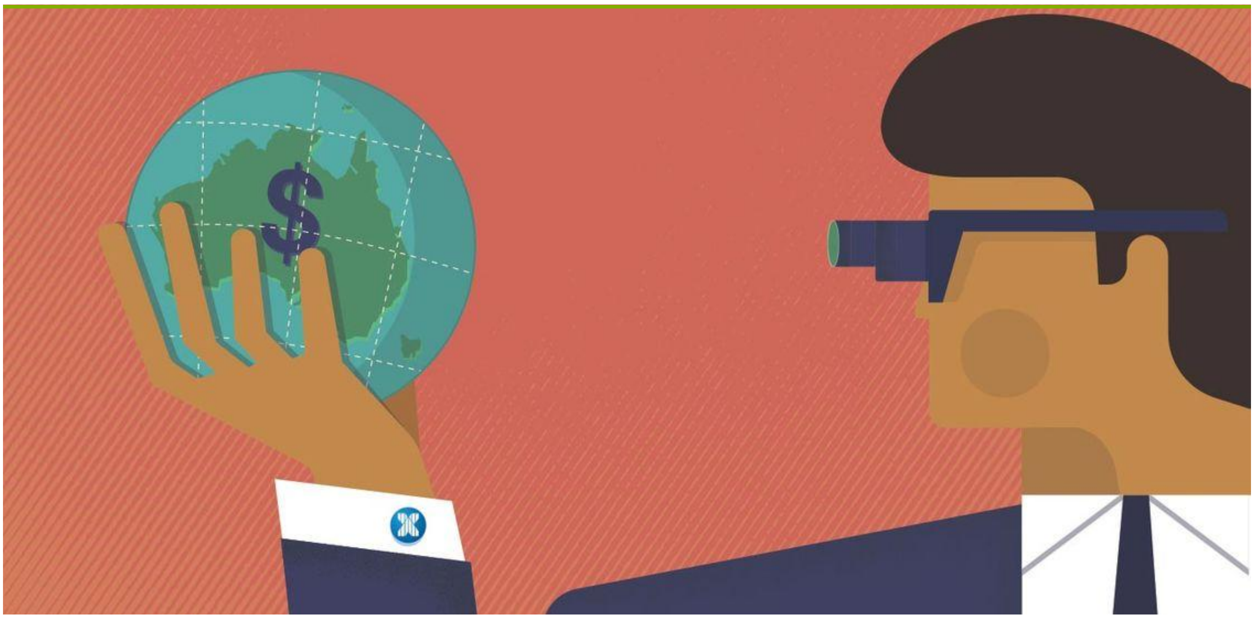

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ASX-listed mining companies have, on my reckoning, completed 53 business case studies ranging in sophistication from scoping studies to bankable feasibility studies, so far in 2019.

The median day-of-release investment return for companies producing these studies has been just 0.8%. Over the subsequent seven days, the median return has been 0.0%. Over the 14 days after the release of these studies, the median return has also been 0.0%.

Investors have barely reacted to publication of the study details despite release of such information often being spoken of as a value-defining event.

Within these results is one noticeable geographic disparity. Of the 53 studies, 28 came from companies with Australian-based projects. The median day-one return in these instances was 1.3%. Over seven days, the return was still 0.0%. Over 14 days, the return dropped to -1.6%.

Twelve of the feasibility studies involved projects located in Africa. The median first-day return for companies publishing these studies was 7.1%. The return over seven days was 3.6%. The median 14-day return was 5.4%.

The sample sizes differ but the statistics suggest a stronger chance of investment surprise among African studies. They appear more likely to contain information which had previously been unknown or too heavily discounted. On reflection, it is not surprising that projects most physically remote from the location of investors are the ones most in need of reappraisal.

General market conditions at the time of a new feasibility study could have an impact on individual company investment returns. A coincidentally weak market may, for example, depress the price response to a published study. To take account of that possibility, I adjusted each of the 53 individual company returns for movements in the ASX small resources share price index.

The median first-day index-adjusted return for companies with Australian projects was 2.4% falling to -1.3% and -2.1% over the subsequent seven and 14 days, respectively. The dispersion in returns widens as the time from the initial announcement lengthens and the median return declines. The standard deviation in returns drifts from 8.9% to 14.4% and 16.9%.

> “ **Investors want to know how much they should pay for a project today given the substantial chance of a company failing to meet development guideposts**

The median return among the African stocks remains higher after adjusting for market effects. It starts at 6.5% before contracting to 3.5% and 3.9% over the subsequent seven and 14 days.

The remaining 13 companies among those reviewed mostly have projects in the Americas and Europe. They show an immediate 1.8% index-adjusted lift before a gain of 0.2% over seven days and a loss of 0.2% over 14 days.

Company executives commonly characterise upcoming feasibility study announcements as future price catalysts. The 2019 experience flies in the face of this conventional wisdom. The news effect is generally tiny and unsustained.

Completion of a scoping or feasibility study should reduce project risk. As risk is reduced, investors should be prepared to pay more for any anticipated future income stream. That link appears to have gone missing.

The short-term performance statistics point to investors taking a view about valuations before formal studies are released. Given a chance to reconsider, investors appear largely satisfied with their previous summation of project worth.

Investors appear to have drawn enough inferences about future production, cost and revenue outcomes from the progressive supply of information, most likely over several years, to permit a judgement that the more formal release of detailed information does little to change.

Experiences with other companies and projects will have helped inform these investment conclusions. Observations about the skill of executives based on their track records and interactions with investors will also have helped form impressions about the likelihood of eventual success and appropriate prices.

The way investors have responded to feasibility studies may have implications for how markets are regulated. Market oversight puts a heavy emphasis on how companies describe their intentions in feasibility study reports lest they mislead. Investors are telling regulators that other sources of information are more influential in dictating their pricing decisions.

Since shares of many aspiring mine developers are trading at prices near historically low levels, feasibility study project values many times greater than the market values of their corporate owners are common. Executives frequently cite these valuation gaps as objective indicators of the extent to which investors can expect future stock price appreciation. Frustratingly for boardroom occupants, investors are not displaying any urgency in trying to narrow the difference.

None of this is to say that feasibility studies do not play crucial roles in the progression of a project from discovery to production. In practice, feasibility study valuations are addressing a different question to the one investors are asking.

Feasibility studies usually address what a project would be worth if the development plan was executed in the manner documented in the study. Project risks usually go unquantified. The assumed costs of funding used to discount cash flows are, unrealistically, those which typically apply to well established companies with strong credit ratings in low-risk jurisdictions.

Investors, on the other hand, want to know how much they should pay for a project today given the substantial chance of a company failing to meet one or more of the development guideposts outlined in the feasibility study.

Failing to raise capital in a timely fashion, missing production targets and delays arising from regulatory or policy decisions are just a handful of a larger number of concerns to which investors must attach a price and which are typically ignored in the official version of what a project is worth.

Since optimistic study authors universally ignore risks which experience shows are more likely to occur than not, they effectively render the feasibility study redundant as a decision-making tool for investors. Unsurprisingly, the reports have little impact on value deliberations in public markets.

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