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Viewpoint > From-the-capital

Long risk lists stretch credibility

Searching a prospectus for a considered appraisal of investment risks is rarely worth the effort as the largest risk is usually ignored.

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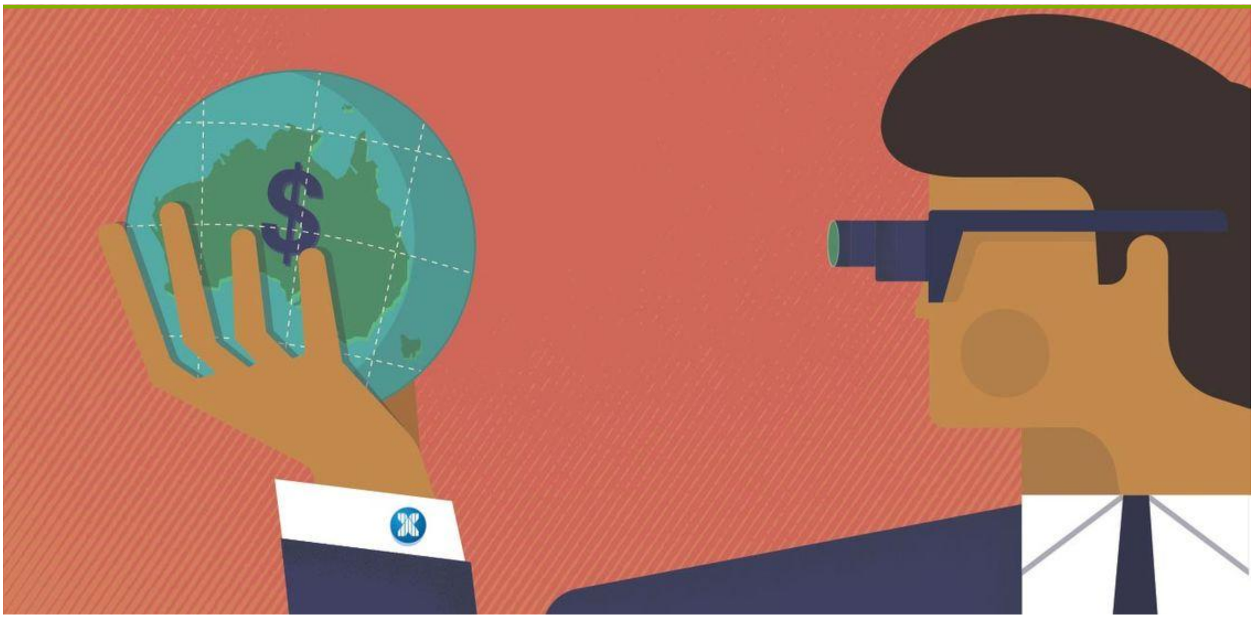

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Day-to-day, mining entrepreneurs are likely to express great confidence about their commercial exploits. Asked to put pen to paper for a prospectus, on the other hand, and they conjure an avalanche of what could go wrong.

In a prospectus released on March 21 to support a A$26 million (US$18 million) capital raising, Blackham Resources directors referred to 75 risks supposedly relevant to an investment decision. The probability of occurrence and potential impact of the risks dictated their inclusion, according to the legal document.

Blackham investors have suffered heavy losses as promised funding, operational goals and development plans have failed to materialise. The investment risks peculiar to the company are considerable but only seven of 27 sections in its nine-page chapter on risk contained information that could not be cut and pasted into any other gold company's prospectus.

Perversely, sitting atop the list of prospectus risks was the company's intention to issue 1.72 billion new shares via an entitlement offer. The fully-underwritten share blowout designed to avert financial oblivion says something about what went wrong but characterising an overt goal, with a 100% likelihood of achievement, as a risk borders on the bizarre.

Legal nervousness apparently now extends to warning that, contrary to experience, something could go according to plan.

The next most significant risk faced by Blackham Resources investors, according to the company's directors, is the possibility of significantly misstated mineral resources.

The company raised doubts about its own resource and reserve estimates by describing them as "inherently prone to variability", as though comparable to interest rates, exchange rates or other market prices.

> **Credibility risk is much neglected in assessing future investment returns**

Blackham's choice of language is alien to anything in the unmentioned JORC Code, which is designed to guide investment assessments for all listed companies. Directors did not say how their self-defined view of resource estimate uncertainty fits with the JORC Code definitions of resource riskiness.

If a certain capital raising is actually the biggest risk confronting the company and its resource estimates are inherently unreliable, any investor should be advised to spurn a Blackham investment. Alternatively, it could just be a sign of lawyers helping directors to build a moat around their incumbency. Who knows? The quality of disclosure is simply not helpful enough to decide.

Kalium Lakes sits at the opposite end of the risk spectrum to Blackham Resources for the reasons discussed in my 'From the Capital' column on April 11. And, yet, a December 2016 prospectus to support its ASX listing pointed out 110 general and specific investment risks, on my count.

The Kalium prospectus also addressed the uncertainties associated with resource estimates but did so within the framework of a company complying with the requirements of the JORC Code. It warned that new information could lead to a change in estimated resource size and that varied estimates are likely to affect mining plans.

Kalium went on to identify matters specific to the company's pioneering attempts to establish a brine processing operation, as one would expect.

For all their differences, Blackham and Kalium were joined at the hip on one aspect of the risk assessment of their businesses. Neither acknowledged the most significant investment risk, namely, the competence of the management.

Asked what they regard as the most important criteria in assessing mining investments, investors overwhelmingly cite the track record of the people.

Being smart enough to find a deposit is not the same as being able to complete a development or achieve targeted operational outcomes. Nor is a board with impressive sounding biographies sufficient. Even a non-executive director with outstanding prior development experience could be fulfilling his board duties but have no role in guiding today's staff on setting up a new mill or monitoring brine evaporation ponds.

The Kalium disclosure document attributes the bulk of its technical risks to geology or inadequacies on the part of contractors. In the 12th category of risks cited, Kalium directors recognise the project might suffer from a lack of suitably trained operators. Even this reference to skills begs the question of whether senior management is adequately equipped to address poor or unsuitable training of junior personnel.

Anything going wrong is someone else's fault but directors and senior managers are due all the kudos for what goes right. That is the premise underlying the usual risk statement. Implicit in the approach is a fanciful view that managerial skill is evenly spread with sufficient depth across all companies.

Kalium recruited an independent expert to opine on its market launch in 2016. The selected consultant, highly regarded in the industry, made judgements about the commercial viability of the company's Beyondie potash project without a single observation about managerial skills or the ability of those in charge of the company to successfully complete the tasks investors were being asked to fund. A conspiracy of silence about competence permeates service providers, too.

Credibility risk, an extension of management competence, is also much neglected in assessing future investment returns. Kalium management has a track record of moving speedily to meet its development milestones. Those running Blackham have failed repeatedly to do so. A massive 260 percentage-point spread in investment returns over the past nine quarters is a measure of the credibility differential and ongoing investment risk.

As an aid to decision making, directors should be asked to explicitly attribute likelihoods to highlighted risks. This is what Blackham directors claim to have done but simply not disclosed, so it must be possible.

For simplicity, bands comprising low, medium and high-risk factors might suffice to avoid overly testing the abilities of boards. If directors were doing their jobs, such risk assessments should have already been completed, consistent with "Principle 7 - Recognise and manage risk" in Corporate Governance Principles and Recommendations published by the ASX Corporate Governance Council.

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