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Zinc fails investment test

Equity market reactions to recent zinc prices rises are at odds with one of the most widely promoted investment propositions in resources sector investing.

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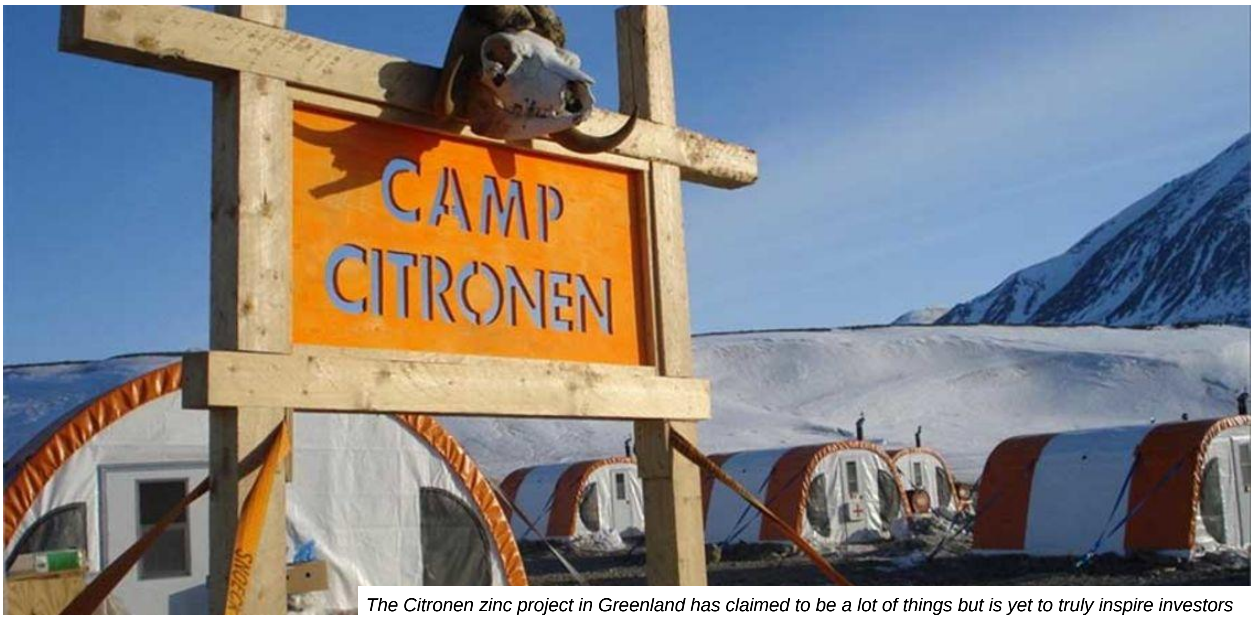

The Citronen zinc project in Greenland has claimed to be a lot of things but is yet to truly inspire investors

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Bullish overviews of metal market conditions - whether analytically sound, deliberately exaggerated or simply wishful thinking - have always gone hand-in-hand with investment pitches from mine developers or explorers.

In their own pitch for investors in April 2016, near the start of the current climb in zinc prices, Ironbark Zinc directors had referred to a downtrend in zinc inventories being "perfectly timed for the development of the Citronen base metal project".

The Citronen zinc project in the northern environs of Greenland, now described variously as a zinc-lead colossus, a giant among peers and, more soberly, one of the world's largest zinc deposits, had been on the horizon for 14 years before Ironbark bought into it in 2007.

An updated feasibility study completed in September 2017 suggests annual zinc output from the site reaching 200,000 tonnes over 14 years at a production cost of US$1,455/t.

The Ironbark share price has added 64% since the beginning of 2016 as the project has moved closer to production and the zinc price has risen 116%.

The Ironbark return is not to be sneezed at but came after a share price slump of as much as 96% since acquiring Citronen, making the company ripe for a strongly leveraged recovery once external market conditions improved. At least that is what one may have thought based on historical experiences of cyclical recoveries.

The $1.3 billion valuation implied by the Citronen feasibility study at current zinc prices is a full $1 billion more than a 2013 valuation when the zinc price was nearly $1,600/t lower.

The huge disparity between movements in the appraised value and the current $32 million market capitalisation of the company suggests investors are placing scant weight on the zinc price in valuing Ironbark's development efforts.

> **“ Zinc miners have not done enough to stoke interest among potential investors encouraged to engage with markets by the advent of new technologies**

Mining sector share prices have been strongly correlated with both commodity prices and broader equity market conditions. The greatest share-price leverage is found when commodity prices are moving in the same direction as equity markets.

With global markets awash in funds supporting a broadening cyclical recovery in growth and a nine-year upswing in equity prices, an investor could have reasonably expected the likes of Ironbark to perform far better than it has against the backdrop of the highest zinc prices since 2007.

Of course, Ironbark is not alone in its muted responsiveness to improved zinc market conditions.

The share price of Metalicity, which has described its Canning Basin zinc find south of Broome in Western Australia as "a world class zinc-lead development project", is now lower than during January 2016, when signs of a recovering zinc price were first emerging.

Alta Zinc, looking to develop properties in Europe, shows a similar price profile to that of Metalicity having also produced a negative return in 2017 as zinc prices continued to rise.

All three companies had highlighted tightening metal market balances as a reason to invest.

The flow of data suggests the fourth consecutive year of declining zinc metal inventories in 2017.

The inventory fall has come despite below historical average growth in metal usage since 2010. The International Lead Zinc Study Group (ILZSG) reported this month that metal consumption in the first 11 months of 2017 was 1.9% higher than in the corresponding period of 2016, consistent with the 1.8% growth trend since 2010.

Slow growth in output, not buoyant demand, has been the principal driver of lower inventories in the past year. The ILZSG data suggest that metal output did not increase in 2017 and has expanded by less than 2% since 2014.

The response of equity investors to these market conditions has contrasted conspicuously with reactions elsewhere to the barest hint of lithium or cobalt exposure.

All but one of the seven best-performing ASX mining sector investments in 2017 had an exposure to the battery metals. Meanwhile, the return from Ironbark Zinc, the best of the three zinc stocks, was beaten by two-thirds of available returns within the universe of nearly 800 ASX-listed resources companies. The other two fared worse.

Ironbark, Metalicity and Alta illustrate how companies often have just one chance to make a first impression. Familiarity can breed indifference if not contempt.

The lengthy equity market exposures of these three zinc miners have meant ample opportunities for shareholders to have been disappointed by their experiences and reluctant to put further capital at risk in backing their future ventures even after the often promised rise in zinc prices was eventuating.

Many, although not all, of the recent crop of lithium and cobalt producers, on the other hand, have benefitted from a chance to make a first impression unhindered by a history of prior disappointments.

Equity investors may also be legitimately wary about the risk of dilution from new share issues. New issues are an especially threatening investment hazard near the bottom of a cycle in which already underfunded companies are attempting project developments costing many times their market capitalisations.

Accompanying narratives may also be making a difference. Publicity about transport electrification has spread well beyond the confines of mining industry investors. No one seriously disputes the growth potential for key metals from advances in energy storage technologies.

Perhaps, in this connection, zinc miners have not done enough to stoke interest among potential investors encouraged to engage with markets by the advent of new technologies.

The reaction to the zinc price rise also hints at possibly justified investor scepticism about the zinc market itself. Production cuts can be reversed. And, however enthusiastically companies may extrapolate historic growth rates in zinc usage to lure investors, the averages have been slowing.

Mediocre growth, currently supportive but uncertain supply conditions, and arcane analyses of market balances are not fertile recruiting arguments among tech-savvy investors searching for themes to match their lifestyle aspirations.

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