

Opinion

FROM THE CAPITAL

Kasbah puts currency balls in the air

Africa tin project developer postpones mine funding on weak commodity price

John Robertson

Kasbah Resources has turned a tin mine investment into a risky exchange rate speculation.

The company has decided to delay financing its Achmmach tin project in Morocco to take advantage of more favourable tin prices later in the year.

A March 2015 feasibility study valuing the Achmmach project at US\$171 million was based on a \$21,511/t tin price. The \$17,400 price at the time of the study's release already implied a cut in value to \$65 million. Since then the price has fallen a further \$2,200/t which, if sustained, would render the project valueless.

This is an especially dangerous phase in the development life cycle for equity investors. Whatever their views about long-term value, investment outcomes will depend on how near-term market conditions affect the willingness to invest of professional mine financiers.

In making a judgement on this point, investors must rely almost entirely on guidance from companies. In practice, the investment dangers are amplified because companies rarely proffer realistic views about funding prospects. Expressions of optimism can persist until an announcement is made that funding is unavailable.

Investors had been told by Kasbah Resources that the lower tin price "is not considered relevant to a project scheduled to commence production in late 2016 when tin prices are forecast to rebound strongly". Despite subsequent adverse movements in the tin price, as recently as April 30 the company was saying that positive responses were being received from financiers as it held out the prospect of a positive near-term decision about funding after the end of May.

Sizing up Kasbah Resources as an investment now requires more than one leap of faith. Without knowing the funding terms on offer, and rejected as too expensive by directors, investors are unable to judge objectively the merits of the course being followed by the company. They have no idea what changes in terms must occur for a deal to proceed. Investors are also being asked to take at face value the assertion of imminently rising tin prices.

Kasbah has quoted from supportive analysts to bolster its case that tin prices are unusually depressed and set to rise. Worryingly,



there is no mention in any of the commentary presented by the company of the impact on tin prices of changes in the US dollar exchange rate.

Twenty years have passed since a rise in the US dollar of a similar size to the one beginning in 2011 and magnified over the past 18 months by diverging national monetary policies. Unsurprisingly, since directional changes in the currency have occurred so infrequently, many analysts have failed to build into their modelling the consequences of this change.

The 37% fall in tin prices since April 2014 has coincided with a 17% rise in the US dollar (measured as the change in the trade weighted index published by the US Federal Reserve). The 54% fall from the peak tin price in April 2011 has coincided with a 30% rise in the currency from its lowest value in the same month.

Instances of cyclically weak tin prices in February 2002, August 1994 and May 1986 coincided with US dollar strength. There is no example in the past 40 years of the tin price rising against the trend in the currency.

Cherry picking a few quotes from analysts who may have also conveniently fudged their reading of economic history is at odds with the attention to detail evidently required in assessing every other aspect of a project's feasibility.

Tighter physical market balances will be a

necessary but not a sufficient condition for higher prices later in 2015. Most likely the currency will also have to fall. This, in turn, will most likely require European and Japanese economic growth to accelerate strongly enough to offset the effect on capital flows of Federal Reserve moves to normalise US interest rates. As it happens, this scenario is consistent with the policy aims of the world's major central banks and not implausible.

The question underpinning an investment decision about Kasbah is whether such a currency adjustment is more likely to happen quickly in 2015 or is delayed until some time in 2016 or even 2017. Kasbah thinks it knows the answer. The central banks think the world is too complex for economists to be dogmatic about the timing.

Investors who bought into Kasbah Resources because they thought the company was going to build a mine ready to produce in 2016 are faced with a fundamentally different investment proposition. Now, they are being asked to rely on the company's macroeconomic forecasting credentials. They are being asked to take a bet on the size and timing of a US dollar exchange rate adjustment.

Even a confidently held view about the imminent weakness of the US dollar may not justify an investment in the company. At the time of writing, an investor expecting a 20% drop in the US dollar by December 2015 could buy an at-the-money put option over a US dollar currency index for \$2,310. If right, the investor would stand to gain \$16,690 or 623%, ignoring transaction costs for the sake of the illustration.

To get the same return from Kasbah Resources, the share price would have to rise from A\$0.03/share to A\$0.22/share by the end of the year. Adding layers of equity market, funding and development risk suggests an investor should actually want something even higher from Kasbah Resources to compensate.

Ordinary investors have growing numbers of tools, such as increasingly direct access to currency trading products, to specifically target their investment goals and to set performance benchmarks against which to judge the value of equity investments.

Investors purely interested in the best market returns have more effective ways to speculate on currency movements, if that is what they want to do, than indirectly through equity investments. ▼