

Opinion

FROM THE CAPITAL

Beating funding pressures

Juniors facing funding shortages will need to get more and more inventive to survive

John Robertson

As hundreds of listed exploration companies face the prospect of not having enough capital to keep the doors open for more than a few months, investors are being forced to choose between supporting their exploration potential or fleeing from the financial risk. Botswana Metals illustrates an investment dilemma that could precipitate tougher deals and new ways of funding.

In December 2014, Botswana Metals reported the completion of a 6,130m drill programme at its Maibele North prospect, where some nickel sulphide intersections exceeded 20m in thickness. Since then its joint venture with state-owned BCL Limited has appointed an independent consultant to calculate a maiden resource by the end of next month. A scoping study is to follow shortly after.

From an investor standpoint, the company seems to have many of the attributes of the ideal exploration company. Importantly, results signalling the development potential will be evident well within a timeframe acceptable to investment markets.

A planned resource definition programme in 2012 was put on hold after delays in receiving exploration licence extensions. Over this critical period, the number of shares on issue started to blow out from 108 million to the current 569 million, with two capital raisings in 2013 and 2014 only managing to reap slightly over one million dollars. The value proposition was harmed irreparably during this time.

Now, a dicey financial position offsets the exploration attractiveness. At the end of December, Botswana Metals had cash holdings of only A\$482,000 while spending was running at a rate of A\$300,000 a quarter.

Hundreds of exploration companies are facing similar predicaments and hoping desperately for a change in cyclical conditions to bail them out. At a presentation in Melbourne this week, the managing director of Western Australian nickel explorer Rox Resources was asked how he would summarise his investment proposition. His plaintive reply was that he hoped we were at the bottom of the cycle.

Companies will have to contend with another problem, whether or not a cyclical uplift is near. Investors of any size now have more effective ways to gain exposure to a cyclical change than in the past. An array of relatively inexpensive, sophisticated tools are making direct equity exposures redundant.



Explorers in a rut... trench sampling at Maibele North

Exposure to appropriate foreign exchange, commodity or exchange-traded equity funds might be just as effective in producing targeted investment returns while, at the same time, removing much of the specific company equity risk. Funds, with or without leverage, are proliferating and easily accessed.

The trough of the current cycle is already well past the duration of cycles in earlier times. While a change in direction will happen, as usual, when everyone is most pessimistic, the complex set of global influences prolonging the present trough may require companies to survive longer or react differently to how they have done in the past.

Selling off a slice of exploration assets is one common way to go. Botswana Metals signed a farm-in agreement with BCL in January 2014. BCL agreed to spend US\$4 million on the licensed areas to earn a 40% interest and to fund projects to the completion of a bankable feasibility study to earn 70%.

BCL is not only backed by the government, but has nearby smelting facilities. The arrangements between the two companies offer investors some assurance that progress will be made. But greater development certainty comes with a diminished share of the project.

In this instance, BCL has taken advantage of the risk appetite of Australian and other smaller investors to fund the riskiest part of the development cycle. As that appetite diminishes – ironically as development prospects appear to improve – leaving Botswana Metals with fewer funding options, BCL is positioned to make an offer Botswana Metals cannot refuse.

Selling the entire project to its partner would give Botswana Metals the financial breathing space to fund other activity in adjacent areas but, in effectively starting again, investors will be confronted with a potential repetition of

the earlier experience. All companies bringing in larger, better financed partners are at risk of this sequence of events.

Tough deals are likely to become more common. Fund managers should be in a position to extract better terms, too. Revenue shares and royalty arrangements that guarantee returns for investors if projects are developed should feature more prominently in deals. That is one way to raise the chance of development value flowing to the providers of capital.

Complex structures such as these with an enhanced cash return would make the sector more attractive to institutional investors. The need for these arrangements to operate in conjunction with pooled funds will detract from the sector's appeal to small direct investors. Private portfolio investors could face underperforming ordinary share prices while returns are siphoned off into other financial securities held by the bigger players.

The conventional route of discounted share offers, spiced up occasionally with attaching options, will continue. But this, too, is likely to prove ore difficult as investors become more sensitive to the prospect of frequent small fund raisings at ever lower share prices.

In the absence of an imminent cyclical rescue, the number of companies is set to fall dramatically over the coming year. As pressures mount, some companies will face the choice of whether to exit the mining industry entirely. Biotech and information technology have been alternatives in the past. Investors will then be confronted with a fresh choice, namely, whether to support a vended-in asset from another industry as a last ditch effort to recoup something after years of disappointment.

The fate of Botswana Metals is far rosier than this extreme eventuality, but all the signs for investors are pointing to some tough dealing for the even the best positioned of companies. ▼

*John Robertson is a director of EIM Capital Managers, an Australia-based funds-management group. He has worked as a policy economist, business strategist and investment-market professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia