Mining Journal

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Legend Mining returns to slow

Legend Mining boss Mark Wilson has foreshadowed a sixfold rise in the market value of the Fraser Range nickel explorer.

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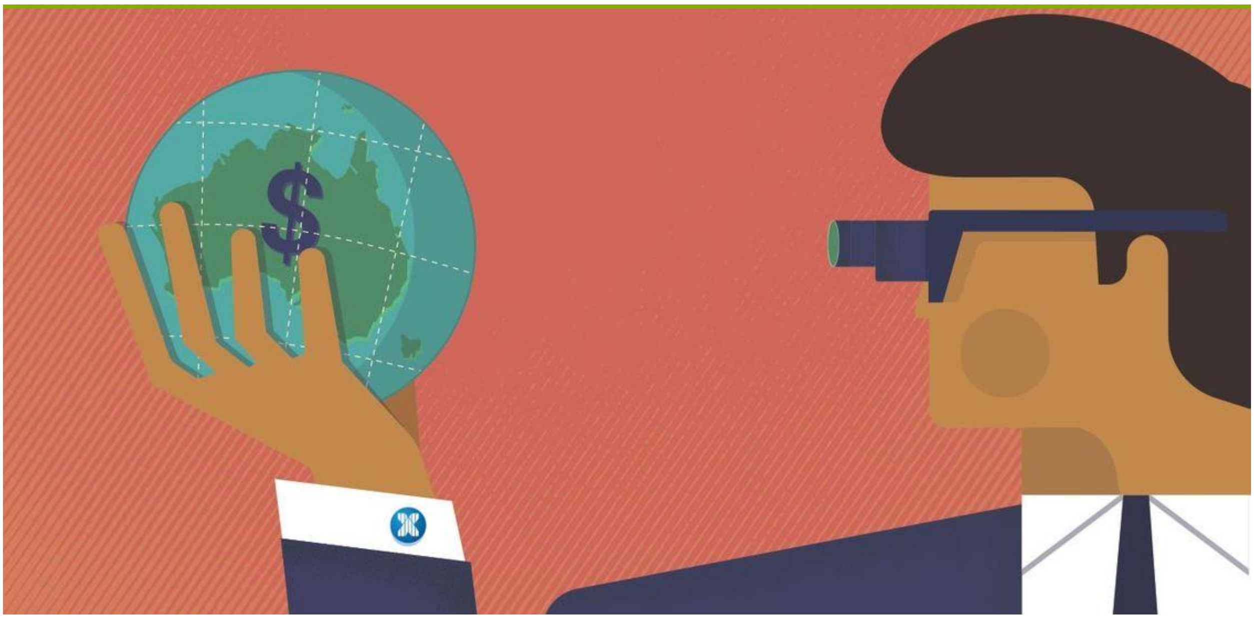

27 August 2020

Wilson is not shy in putting forward an investment case for Legend. Back in March 2017, he described the company as being "the only investible opportunity" in the Fraser Range region of Western Australia.

Wilson's approximately 3,000 square kilometres of landholdings sit midway between the Nova and Tropicana mines, two of the most outstanding mineral discoveries in Western Australia since 2000.

The temptation to draw a parallel with the stockmarket performance of Sirius Resources following its discovery of the Nova orebody in July 2012 has been too strong to resist. Speaking to investors in mid-July, Wilson cited a Sirius market capitalisation leap from just A$10 million to A$2 billion within three years of the Nova discovery as a guide to what Legend investors could expect. Wilson directed listening investors to Legend if they wanted "a crack at nickel".

The $2 billion price tag latched onto by Wilson was an exaggeration. The Sirius market value touched A$1.57 billion for a minute or so but averaged just A$1.29 billion after the Sirius takeover by Independence Group was announced, according to Morningstar daily closing price data.

There is much to like about the Legend positioning. For a start, it does have a clear focus. Of course, that is easier after exploration success and a 300%-plus share price rise. But, beyond the market performance, the company's personnel and principal shareholders have a strong historical commitment to the region.

Legend has the majority of the ground covering a central gravity high in the belt. The company is financially equipped to take advantage of its location having finished June 2020 with A$26.6 million in the bank after completing a $20 million capital raising.

Investors have shown a willingness to support credible exploration. A $60 million market capitalisation at the start of 2019 had already risen to $100 million by mid-October before the company confirmed the discovery of nickel-copper mineralisation at its Mawson deposit on 13 December. Then, the market value immediately doubled.

“ **A prospective annual equity return of 14-20% for a company at such an early stage in its development cycle means Legend is not cheap**

The market value more than doubled again in early April this year, to a peak of $512 million, after the company reported five significant nickel-copper intersections from a diamond drill hole.

Wilson has tried to raise expectations of similarly dramatic gains as those in December and April from future drilling results.

Large market gains usually arise from one of four principal sources: a correction to temporary mispricing, changed expectations about strategic positioning, the effects of macro conditions or, over longer periods, a lowered risk profile as mine development progresses.

Legend's December and April announcements both forced a recalibration of expectations.

Companies will often refer to news flow as though any announcement can force a change in market values. In practice, market values are only impacted to the extent new information is at odds with what had been known previously.

Following his July presentation, Wilson released new assay results from infill drilling which extended the footprint of the Mawson mineralisation. Later in July, the company announced another possible extension of mineralisation after geophysical analysis. This month, the company reported having intersected 25m of nickel-copper sulphides across two intervals. None of the announcements have had any discernible impact on the company's market value.

A mispricing is far less common than company executives claim. Most often, an apparent undervaluation can be sheeted home to the uninspiring track records of the personnel in charge rather than an entire market deliberately or inadvertently overlooking a fundamentally important aspect of valuation. Legend is not in this category.

Legend is now in transition. Big value changes due to expectation effects have become less likely. The next source of capital market appreciation will come from growing confidence about the ultimate development value.

Share market upside will reflect a long-term decline in the rate at which investors elect to discount future cash flows and the reduction in the duration of the waiting period before cash flows arise. This pricing process commences, notwithstanding the angst of regulators, irrespective of any feasibility studies or JORC compliant resource statements being published.

Let's assume that Legend does directly replicate the Sirius experience and has a Nova-quality mine operating by 2027 capable of producing annual earnings before interest and tax of around A$340 million at the current nickel price. Let's also say that the market will be prepared to pay A$1,700 million at that time. The 350% rise in market capitalisation would imply an annualised uplift in equity value of 24%.

Sirius itself raised A$368 million after the Nova discovery. Giving Legend the same capital raising task would imply a near doubling in the number of shares currently on issue and a cut in the implied annual share price uplift to as low as 14%.

A prospective annual equity return of 14-20% for a company at such an early stage in its development cycle means Legend is not cheap.

Current prices are already crediting a Nova-like development to Legend.

In the absence of some further significant change in expectations about the magnitude of the Legend development potential, the likelihood of a step-change in market value through exploration has fallen. Value will now be driven by the effluxion of time and possibly changing perceptions of development risk reflected in future return requirements.

The evolution in value sources is one reason for the corresponding evolution in the profile of investors which is typically needed as this transition is completed.

Companies may sometimes refer to this period of less dramatic investment returns as representing an absence of news. Certainly, the changed return profile correlates with reduced news flow but there are sound reasons for investment returns being lowered permanently.

Wilson might have to reconcile himself to the best returns now being in the past no matter how successful he might be in replicating the Nova experience. There is no shame in that.

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