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Viewpoint > From-the-capital

No gains from strategy switches

Major strategy changes among junior miners have a poor record of producing a positive investment return and have offered little chance of recapturing historical lost ground.

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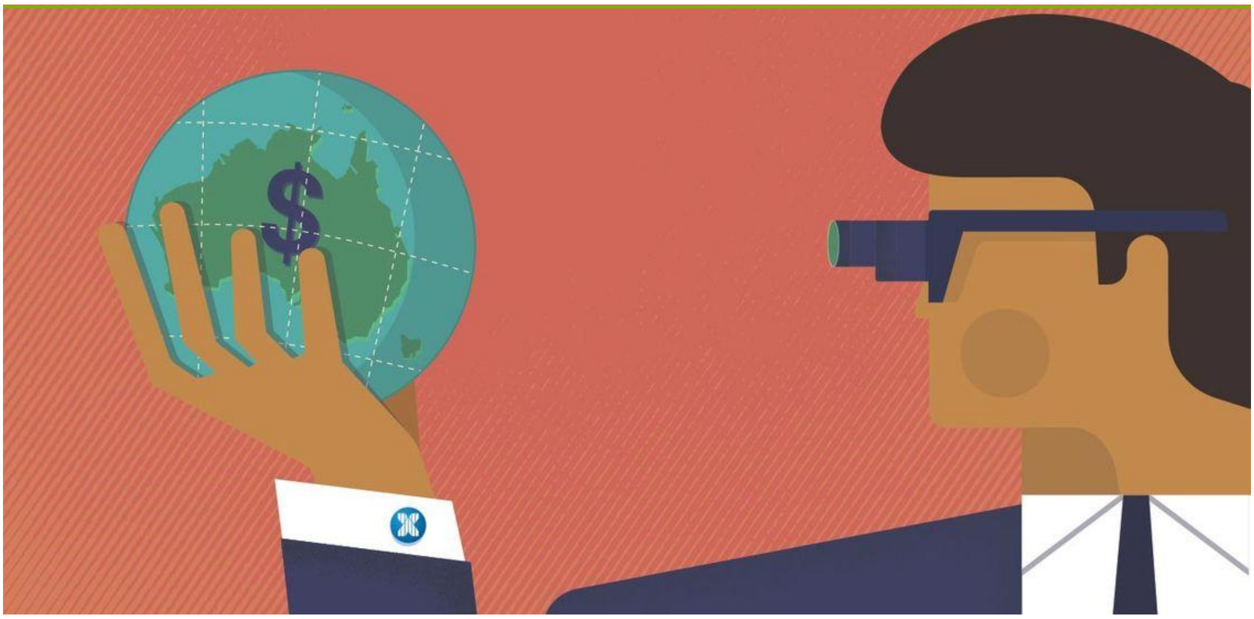

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Mining is a tough business. With so many required steps from exploration to production, each needing to be taken in the right sequence at the right time, the chance of unambiguous success is tiny. The temptation to see easier routes to better investment outcomes is strong.

Two extreme examples of strategic redirection were referred to in last week's From the Capital column.

PepinNini Minerals jumped from a central Australian portfolio of exploration interests to a lithium exploration property in Argentina and then back to central Australia without significant progress in either place.

Mustang Resources, now known as New Energy Minerals, was pursuing graphite in Mozambique before switching to rubies and then returning to graphite mining before giving up on both in favour of something better, albeit still unspecified.

Sometimes, the strategic redirection occurs more through happenstance than planning. Kidman Resources and Pilbara Minerals, two companies now touted as industry successes, went through several strategic redesigns before being bailed out by the lithium frenzy.

More usually, revamped strategic priorities are a perceived escape route from a capital market dead end. They are a regularly used tool when funding alternatives are sparse and disgruntled shareholders are upset at tardy development progress.

Elementos is closer to the norm. For years, its executives had presented the company as a developer of a tin mine in Tasmania, initially through the reprocessing of tailings from prior mining activity. In 2017, production was promised by the third quarter of 2019.

Frustrated over progress in Tasmania, and in a bid to re-enthuse investors, directors bought into tin investments in Malaysia and Spain. The Spanish venture now clearly takes priority.

Prior to June and a rising tin price, the market had appeared to attribute no extra value to what Elementos had claimed was a "transformational transaction" with "significant share value-uplift potential".

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Executives brandish newfound strategic initiatives, however novel or inconsistent with past statements of intent, with a certainty unwarranted by real life experience. Each corporate reincarnation is characterised as a potential catalyst for a share price re-rating.

I have reviewed 45 examples of companies abandoning an earlier investment proposition, all since the beginning of 2018, in favour of a new location or a new commodity, or both. In each case, the strategic switch culminated in a change in corporate identity as a further emphatic statement of altered intent.

The median share price move among the 45 companies over the six months after each company announced a change in strategic direction was zero.

As time goes on, outside influences grow in potential importance as determinants of investment outcomes. One would expect, for example, that the currently higher gold price will have befitted companies pivoting to gold.

Over the 12 months after each announced change in strategic direction, the median return among the 45 companies was a mere 8%. In those instances in which the change occurred less than one year ago, the investment return was based on prices at the end of last week.

Over six months, the highest return of 269% was from Lotus Resources, the former Hylea Metals. At the end of March 2019, the company had $75,248 in the bank. It claimed to remain focused on a cobalt project in New South Wales with platinum, nickel and scandium exploration opportunities.

In June 2019, Hylea announced the acquisition of Paladin's stake in the Kayelekera uranium project in Malawi. Prior to the announcement, the company's share price had shed as much as 95%. The share price gain to date accounts for less than 2% of the earlier losses.

Other large gains among the 45-stock sample of strategically redesigned businesses were made by New World Cobalt (+210%), Galan Lithium (+200%) and Resolution Minerals (+150%). In each instance, the changes involved swapping in and out of battery metal related investments.

Longford Resources, now New World Resources after a spell as New World Cobalt, went to the USA in October 2017 as the cobalt metal price was rising. By April 2019, after the acquisition of several properties containing cobalt mineralisation, the company had thrown in the towel because the cobalt price did not have the expected legs. Although the company still operates in the USA, copper is now the commodity of choice.

The nearly cashless Dempsey Minerals, having abandoned all of its earlier efforts, became Galan Lithium to pursue lithium brine deposits in Argentina.

Resolution moved in the opposite direction. The company formerly known as Northern Cobalt found the search for gold in Alaska more appealing than mining cobalt in the Northern Territory.

Despite the gains, the share prices of all three companies remain as much as 80-90% below their 2017-19 peak levels. The strategy swings did little to reinvigorate investor interest let alone make up for historical losses. Apparently extraordinary returns, where they have existed, depended on large pre-existing share price falls.

The largest six month losses from the 45 stock sample came from Big River Gold (-76%), Global Oil and Gas (-75%) and New Energy Minerals (-72%).

Big River, the former Brazilian iron ore miner called Crusader Resources, sold the Juruena gold project, once pitched as a central part of its refocussed gold strategy. Global Oil and Gas retreated to the carbon economy having dumped the green economy ambitions it had espoused when it was known briefly as Global Vanadium.

Strategic agility and the capacity to respond to changing business conditions, often highlighted by management researchers as signs of a sustainable business, can just as easily be construed as directionless flip flopping.

Making a go of one project adds credibility and licenses new endeavours. Unheralded strategic changes come at a cost.

Unexpected project acquisitions or divestments create uncertainty. They cast doubt on the reasons for an earlier investment commitment. Multiple strategic changes kill management credibility. Rewards for opportunistic switches in direction are rarely sufficient to compensate.

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