FROM THE CAPITAL

Northern Minerals seeks development help

Giving with one hand, and taking with the other

John Robertson*

Northern Minerals is on the cusp of having its Browns Range prospect sitting near the border between Western Australia and the Northern Territory become the first significant producer of dysprosium outside China.

After a round of his regular shareholder briefings, Northern Minerals chief executive George Bauk was off to Canberra recently to brief politicians on both sides about what it will take to realise the project's potential.

Government decisions could be critical to the value proposition. As always, there are approvals and permits to get. The final environmental go-ahead from the Western Australian state government will allow funding talks to commence in New York in November. But his efforts to get politicians on-side go beyond the standard industry approvals.

The Browns Range project is expected to cost a relatively modest A$314 million (US$276 million) but a large chunk of the pre-production capital for the project will go on infrastructure in one of the most remote parts of Western Australia. For Browns Range to work, more than A$90 million for roads, an airstrip, water and power supplies will be needed.

Bauk is hoping to get a helping hand from the federal and state governments for the infrastructure. He is trying to convince them of the benefit for small communities otherwise isolated and lacking an adequate economic base to support indigenous employment and improved living standards.

He is very careful in talking about his government relations efforts to emphasise how willing politicians have been to listen. In contrast with many in the industry who have expressed strong preferences for building mines overseas, Bauk is complimentary about the speed with which regulators have dealt with him and is strongly committed to mining in Australia.

If it has to, Northern Minerals will stump up the full amount in the end but anything the government can contribute will make it that much easier to convince financiers to get involved and precipitate much needed regional development.

When Bauk goes to North America, he will be taking data that say Browns Range could be generating annual after tax cash flows of A$173 million for the A$314 million spent on its development. His analysis says the investment will be repaid within three years.

Browns Range in central Australia could become the first significant producer of dysprosium outside China

According to the business plan, outlined in a June 2014 pre-feasibility study, the mine will produce 279,000kg of dysprosium oxide on average over the 10 years starting in late 2016. Dysprosium will account for 62% of the total rare earth project revenue.

Bauk is more than a little sensitive about describing the project as having a life of only 10 years. He is adamant that the resource size is limited only by funding for drilling and that, once cash flows allow, the company will demonstrate an indefinite production capability.

Northern Minerals has found, like others before it, that a published feasibility study changes the nature of the discussion with investors. Suddenly, bold vision and grand plans are overtaken by dour numbers dictated by rules requiring the most conservative assumptions. Where surprise drives investment performance, a feasibility study can be a wet blanket on share price outcomes.

To bolster his case that there is something better, Bauk points to six mineral resources remaining open at depth, 10 high priority targets for follow up drilling and 170 conceptual targets across Browns Range. The company has other prospects in northern Australia displaying similarly easy to process xenotime mineralisation.

Northern Minerals has been treated better than most companies by investors after the release of a feasibility analysis. The Northern Minerals investment return has been among the top 20% available to investors in the Australian resources sector since June.

Northern Minerals now faces the challenge of rewarding the loyalty of an existing shareholder base while offering the new investors critical to any eventual development enough incentive for their support. Companies with very low market values needing hundreds of millions or even billions of dollars to get the job done may leave little or nothing for existing portfolio investors swamped by the impact of new money or having to face an abandoned project. There are many of these.

There are fewer examples at the other end of the spectrum where a stock like Sirius Resources has a market value that already prices in development and, in doing so, limits future returns.

Needing just under two-and-a-half times its market value for development capital offers Northern Minerals shareholders a balanced investment proposition. A realistic capital target suggests a competitive investment return for everyday shareholders.

There is some value padding in the Northern Minerals numbers. Use of an US$0.80 Australian dollar exchange rate detracts from the quality of the valuation analysis. The average exchange rate since 1980 has been US$0.80 but, reflecting diverse economic circumstances, the range around the average has been a massive US$0.68 and the average absolute deviation has been US$0.13. A definite view about exchange rate direction in a valuation warrants appropriate confidence limits rather than a single point valuation to take account of exchange rate variability.

Ironically, the exchange rate embedded in the valuation may also be the strongest argument for not investing. The assumed US$0.80 exchange rate implies no cyclical upturn in commodity markets this side of 2030. Any investor would be circumspect about putting money into the sector if that were going to be the case. And non-Australian investors would be especially wary.

Use of a relatively low exchange rate assumption makes it harder to accept that a project has the robust economics companies like to claim. Being robust should mean the presence of a value proposition even when the exchange rate is high.

Thirteen cents would be worth around A$150 million on the A$446 million appraised value of the project. The point valuation in the Northern Minerals study is probably toward the upper end of the range of feasible alternatives given the exchange rate assumption and its potential range. ▼

*John Robertson is a director of EIM Capital Managers, an Australian-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