

WORKING WITH VALMIN. A PRACTITIONER'S VIEW

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ABSTRACT

As a consultant preparing public and private valuation and assessment reports since 1990, the writer has worked under the former NCSC guidelines and since 1995 under the original and modified (1998 edition) VALMIN Code. This paper highlights some of the more difficult and contentious practical issues resulting from that experience. The extent of site visits is an area of debate. Aspects of confidentiality can be difficult to resolve. Balancing the time available to prepare a report for Corporations Law purposes with the degree of due diligence required under VALMIN can be stressful, particularly when combined with arguably token adherence to the Code by the client.

This paper concludes that the VALMIN Code is a generally effective and pragmatic operating discipline. Recommended areas for future attention include the balance between the detail of reports and their readability and greater recognition that mineral asset values can vary significantly with both the market and the purpose of valuation. The reconciliation of Technical Value and Fair Market Value cannot always be addressed by application of an arbitrary premium or discount.

While in the writer's belief, the VALMIN Code is enforceable while at the same time pragmatic, its detail means that there will always be scope for "nit picking". It is hoped that in administering its enforcement, there will always be an emphasis on flexibility when good faith and care within the scope of the brief are obvious.

INTRODUCTION

The VALMIN Code and working drafts of it have guided practitioners in the preparation of assessment and valuation reports on mineral assets since 1995. Previously, practitioners were guided mainly by Release 49 of the former NCSC. Many of the principles included in Release 49 have been incorporated in the VALMIN Code.

The objective of this paper is to highlight for discussion and possible future attention some examples of circumstances in which compliance or strict compliance can be difficult.

In this paper, the references to clauses of the Code uses the Code convention of prefacing the clause number with the letters **D** (Definitions), **C** (Code rules), or **G** (Guidelines). Examples referred to are real but not identified.

SITE VISITS

C38 states that where inspection of a Material Asset is likely to reveal information or data which is Material to a Report, it should be inspected. Material is defined (D22) as an observation or information of sufficient importance that its conclusion or omission could affect the value or conclusion which is subject of the Report. In reference to valuation, a range of 5% to 10% of total value is provided as a guide to Materiality.

It is not uncommon that the client, in an effort to keep down costs, might discourage a site visit. Alternatively, through the pressure of deadlines, the practitioner might be tempted to go without a visit. At other times difficulties of access or the lack of key site staff might inhibit a visit.

Rarely is there a good reason not to visit a mining operation or major development. Visits to exploration sites can be more difficult to argue because there is little to see. This may not be a problem when the assessment is of a mix of mining operations and/or major developments with some outside exploration but, for assessment of an exploration portfolio (e.g. as the basis for a prospectus report), some of the individual assets are going to have a proportionate value above the Materiality threshold. In one recent situation there were three exploration assets of broadly equivalent value, each of them in different parts of Australia, but no site visit was made either by the Independent Geologist or by the, separate, Valuer. Both reports attracted peer criticism, particularly the latter.

It is hard to think of a case in which a site visit did not add appreciably to the understanding of potential of a prospect and hence to a better valuation. Often that is because the site visit is conducted by the geologist more recently familiar with the relevant work than those who might brief the practitioner in a head office.

THE LENGTH OF THE REPORT

The Corporations Law, both existing and in the drafts of the Corporate Law Economic Reform Program Act ("CLERP"), emphasises that a report needs to include all information reasonably required and expected by shareholders and investors to make an informed assessment, whether that is to help those parties make a decision about a takeover offer or an investment decision through a prospectus offer.

The VALMIN Code in its definition of Material/Materiality and in C33 echoes that requirement. The necessity to write a 100-page report to achieve this objective is debatable. However other provisions of the Code make it difficult to avoid producing something which is very detailed and, under the pressures of time, often excessively technical. Very few readers would have the time, let alone the interest, to read such lengthy reports completely. Yet if the investor doesn't read it completely, he may not be adequately informed.

C8 states that an objective of the Code is to address only Material matters. C7 says that Materiality is an overriding consideration. C6, however, says that those preparing a report must aim for a maximum rather than minimum disclosure. Other rules and guidelines persuade the writer to include more than less.

Various guidelines suggest the desirability of a technical glossary (G111), a full listing of tenements (G118), a comprehensive and detailed analysis of resource and reserve database issues, estimation methods and parameters (G122), detailed descriptions of mining and treatment

methods and a review of all the contributing issues and estimates (G136 and G137), a sufficiently detailed review of capital costs to allow assessment as to their achievability (G138) with all the supporting data or capital and operating cost estimates (G140) etc. A report containing a detailed review and analysis of all of these issues, together with enough words to address the need for transparency of valuation methodology as well as all the necessary qualifying statements that flow from the VALMIN Code, can be a document of many tens of pages, and sometimes more than a hundred pages. The situation is worsened if the Expert or Specialist feels it necessary to append any sub-consultant reports. Arguably the potential investor (or the party considering a takeover offer) needs only to be confident that all of the relevant issues have been reviewed by a competent person and be able to read in clear, not too technical language within not too many pages, the important conclusions of the Expert's review highlighting the material risk factors and, if appropriate, a summary of his valuation.

It is possible that the Code has this objective in mind, at least to some extent, but the number of lengthy Specialist reports suggests that practitioners are not game to take that chance. Time pressures can be a contributing factor given that there is often inadequate time to carry out a good editing of one's own due diligence reporting, let alone that of sub-consultants. Moreover in a hostile takeover or the like, the antagonists are very keen to attack each other's Expert reports. The writer thinks that this is an area which deserves more attention from the VALMIN Committee. Issues of time availability and meaningful materiality need to be discussed with bodies such as ASIC.

TIME AVAILABILITY

From the time of a dispatch of a Part A Statement to shareholders, directors of the target company have a period of 14 days to respond with their Part B. Not uncommonly, the process of selecting financial advisors and then an Expert before consideration of a Technical Specialist means that the latter may be left with a week or two to carry out proper due diligence on a portfolio of assets that can include several mines and vast acreages of exploration tenements. With the best will in the world, the value of the due diligence and the conclusions important to the investor or shareholder must suffer.

C8 says that the process must be as objective and rigorous as the data or as the information available allows. In practice there are circumstances when the process is so constrained by the time available that it may be difficult to meet this requirement. C59 contemplates a situation in which it may be impracticable to obtain sufficient reliable information but the implied action under those circumstances – i.e. no opinion or report or one which is heavily qualified – is not a happy situation for anybody.

The time problem can be partly addressed by better planning by the client but there may be a chain of two or three clients before the Specialist gets involved. Education of clients about the VALMIN Code with some influential help from bodies such as ASIC and the ASX will help. A different approach is for a change to the timing requirements of the Corporations Law. As noted above, the writer feels that this is an area which should be discussed with ASIC by the VALMIN Committee.

ATTITUDE OF CLIENT TO THE VALMIN CODE AND THE “OBLIGATIONS OF THE COMMISSIONING ENTITY”

The written brief from the client, particularly if it is a corporate advisor, often states that the appointed Specialist shall comply with the VALMIN Code. Yet the same client often lacks enthusiasm when asked to represent in writing that to the best of its knowledge, complete accurate and true disclosure of all relevant material information has been made (C27). If, in the opinion of the Specialist, this provision of C27 cannot be met, his options are to refuse to provide a report or to heavily qualify it and its conclusions. In either case it makes for an unhappy client.

A particular consideration which, in the writer's experience, has only arisen once since the finalisation of the VALMIN Code is a brief from the target's advisor to value the offerors' mineral assets when, because the bid is hostile, no access can be made available to relevant information other than that in the public domain. In that particular case, a heavily qualified report was provided.

Often a Specialist's brief is restricted in that he may be asked to provide valuation inputs but not to carry the valuation through to considerations of taxation, projections of metal prices, consideration of debt finance or selection of discount rates. As the writer understands it, the Code places the onus on the Expert to ensure that all of these matters and any other matters outside of the Specialist's brief are properly addressed. However it is feasible that the Specialist may have to put his name to a valuation in which certain parameters, for example metal prices, are, in his opinion, unrealistic.

Guideline G117 says that the practitioner should not rely uncritically on the information provided by the Commissioning Entity or any other third party and that he should undertake all verification procedures he considers reasonable. This is highly desirable but may be inhibited by a client's usual desire to see the best case presented. For instance, a client's rosy view of exploration potential may be given more credence than appropriate simply because we are dealing with matters of opinion.

TECHNICAL VALUE AND FAIR MARKET VALUE

The Code is not prescriptive as to valuation methodology. C8 notes that there are a number of methods of valuation from which to select and that the selection may affect the outcome. Further, G150 notes that the selection of the appropriate valuation method depends on several things including the purpose of the valuation and relevant market conditions.

The definitions of Technical Value and Fair Market Value can lead to an inference that there is a one step adjustment between the two, be that a premium or a discount. In practice the process can be somewhat more complex as some of the methods used to generate the primary value (normally the Technical Value) can in themselves involve market factors. An example is the use of Yardstick Values in considering the value of a resource for which a feasibility study does not yet exist. Moreover at any one time the “trade market” (i.e. mineral industry participants typically dealing in all or a large part of a project) is likely to have a different view of value than is the share market which deals in portfolio interests and implicitly very small parts of a particular project. The

balance of and between Technical Value and Fair Market Value can also be different when the valuation is for a receiver and manager or is in relation to matters such as insurance or taxation. Normally implicit in a Fair Market Value is an assumption that there is competition amongst buyers and a demand for the asset being assessed. For a company under receivership and management this is often not the case. The price that might be offered for an asset, if any, can be far below a figure that might be assessed by normal approaches to Technical Value and any attempt to find the right discount in such a situation is not much more than a thumbtack. The writer believes it is correct that the Code is not prescriptive as to valuation methodology and in highlighting this issue is suggesting only that the position is better recognised through the text of the Code and hence by prospective clients.

CONFIDENTIAL INFORMATION AND CONFIDENTIALITY AGREEMENTS

Increasingly, confidentiality agreements require practitioners, at the conclusion of an assignment, to return or destroy all information provided to them including sometimes their own workings. However, particularly in hostile takeover cases, all of the information and records used by a practitioner may be discovered. If there is any action against him or involving him, the best defence is to be able to show the information upon which he relied. VALMIN could address this problem by adding to the Obligations of the Commissioning Entity recognition of the practitioner's right to maintain its records for a certain minimum time.

C29 provides that a Commissioning Entity may instruct the practitioner to withhold information from his report on the basis that it is confidential even though it may have been material to the conclusions of the assessment of valuation. While experience indicates that this provision is usually only applied in genuine situations, there does appear to be some scope for abuse. An example is a valuation which is heavily dependent on a "confidential" marketing assessment.

CONCLUSIONS

In the writer's opinion the VALMIN Code represents an improvement on earlier guidelines because it is more comprehensive and has been drafted by people involved in the mineral industry. It is pragmatic in the sense that it is usually possible to achieve substantial compliance with its rules and guidelines. However this often requires a proviso that compliance is restricted to "the extent of the brief".

Proper compliance with the Code requires the practitioner to undertake comprehensive due diligence and consider most aspects of a mineral asset relevant to a good evaluation of it. However, partly because there is often a lack of appreciation by clients and relevant authorities of the time and work involved, the effectiveness and quality of that evaluation can vary. Perceived compliance with the Code can result in an excessively detailed report which undermines its value.

These last two observations suggest that two worthwhile objectives for the VALMIN Committee are education of the market in the interests of a quality product and recognition of a degree of self-regulation by competent practitioners enabling a more "user friendly" product.