The Funky Metrics of Mining

That mining is a self-declared alternative universe has become apparent to investors in recent years. I have long sustained that most mining mavens were a tad deficient in knowledge of the main metrics that investors use to measure investment options and make their asset allocation decisions. As the gloom has settled over the mining space it has been sad to see the crowd bemoaning the fact that the investment world cannot see the intrinsic merits of investing in this or that of their favorite mining stories. “How can they be so blind?”, the cry goes up. Sorry to burst their bubble but there is much more to the investment universe than mere mining stories and miners must compete for investment dollars.

But mining is special, don’t you know? Yeah, yeah… having analysed REITs and insurance stocks and shipping stocks and airline passenger miles and room-occupancy rates over the decades, I am sorry to inform the mining crowd that they are not the only sector outside that has “special quirks” that an analyst or investor has to get their brain around. But the one metric that is universal is return.. both relative and absolute. If a sector or company doesn’t have either then it’s looking pretty grim.

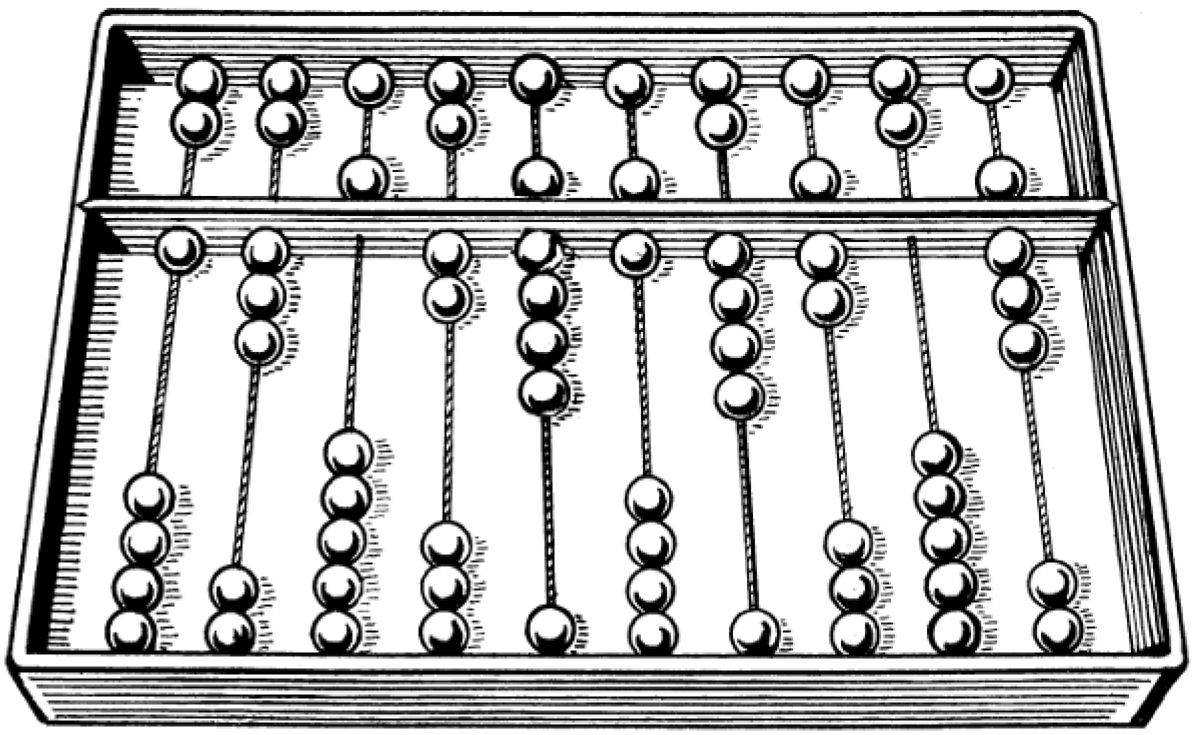
Big Fish and Their Motivations

Why does this matter? Well, because there is virtually no liquidity left in the mining equities markets and investors keep hoping that the “rising” price of gold with trigger a rush of investors into the space. In their minds gold speaks for itself as an attraction. All you need to know is gold! Isn’t that all one needs to make an investment decision? This brings us to the “Soros/Paulson” factor. For those with a memory stretching back to the 1970s there was a flurry of stories back then about still “uncivilized” tribes in places like Papua New Guinea who had taken to building landing strips in the jungle because they believed that the gods would see these gaps in the trees and land there bringing goods for the benefit of the tribe. This form of worship was known as cargo cultism. We cannot help be reminded of this when looking at the response of the mining community to news, earlier in the decade, that Soros and Paulson had finally seen the light and decided to pile into gold. For a start Soros had not run the funds which bear his name for over a decade and they had become largely incubators for new managers while Paulson has since been proven to be a one-trick pony based upon his short mortgages call in 2006-2008. Strange saviors indeed… In some circles these investors were seen as **rubes**. What better proof that they did not know what they were doing than their heavy overweight positions in Novagold with which they trumpeted their faith in the gold space?

And yet these two investors march to a universal beat. They may have made a bad decision but they have since unwound it, because the hedge fund market, unlike the mining market, has certain universal truths and one of these is that an underperforming hedge fund cannot last. If gold is a dud and they stick to it, then they will become a dud in turn. At the time mining investors were bemoaning the fact that these parties were exciting stage left, but, frankly, who wouldn't with gold looking decidedly like a short?

Funny (or Funky?) Mathematics

That brings up to the metrics. And we have a little anecdote to relate. We were interviewed a few years back for The Gold Report and the pearls of wisdom were duly published and the gospel went forth into the land. We got some praise and no challenges, except for one curious email from one of the best known pundits in the mining space. First he quoted part of our comments: "The Canadian model is that the majors pay a measly dividend and keep the money, making serial overpriced bids for juniors. A yield of 0.50% is derisory. It's just to get the company on to the list of dividend payers. If a company is making $0.40/share and paying out $0.05/share, that's pathetic–that's not even worth the effort". Then he noted "A 5c dividend on 40c earnings is a 12.5% yield". He wanted us to confirm that we had been misquoted. Oops…. Sorry to tell you, one does not work out the dividend yield by dividing the earnings per share by the dividend…. One gets the dividend yield by dividing the price by the dividend… What he was talking about was the dividend payout rate..



What does this tell us? Unfortunately his half-sentence reveals an enormous amount about the level of financial analysis in the mining community. Because if you think the yield is calculated that way then such a share looks way better than investing in a government bond or an industrial company yielding 5%. Investors in the gold mining space never talk of P/E ratios, EPS or dividend yield. Sorry, to tell you but if mainstream stocks are from Earth and mining stocks want to be from Mars then very few earthlings are going to be bothered investing in stocks from outer-space, literally or metaphorically.

Conclusion

Only when company managements and analysts in the mining space start paying lip-service (at least) to the metrics that the Great Unwashed of the investment world use then, and only then, will they start to attract money from investors who use those metrics. Here’s a test. Try telling an investor who usually focuses on hotel room occupancy rates about the attraction of “ounces in the ground”… the easiest way to do it is to tell him that it’s like a really big hotel in which all of the beds are empty… see how fast he wants to invest in such a hotel…