Ecclestone on the Zombie Apocalypse in Vancouver

There was much talk last year of the Zombie Apocalypse in Vancouver with the armies of the Walking Dead roughly matching half the total of listed TSX-V entities. Well, time has moved on and the pavements of West Pender Street are still thronged with those bearing the glassy-eyed stare of promoters stuck in a nether-zone between life and death. Yet, despite this there are a few well-documented mega-zombies that have joined the ranks of the truly dead as the remorselessly unswerving markets continue on the path to nowhere. Most recently Allied Nevada, the one-time multi-billion market cap gold miner joined the ranks of the fallen.

The Demise of Allied Nevada

This event reminds us of the old philosophical issue of “If a tree falls in a forest and no one is around to hear it, does it make a sound?” The event seemed to make very few waves despite the size of the victim.

To put the chart below in context the current price is around USD 11 cents, that is quite a fall from over $45 in its heyday.

The travails of the company clearly go back a long way because the paling of the company’s stock price and market cap began back in late 2012. However those who want to focus on the more immediate causes of its demise would highlight that Allied Nevada had apparently positioned itself badly on the wrong side of a currency swap. Apparently the swap converts Canadian dollars from a CAD$400 million bond, underwritten by Scotiabank and GMP Securities, into U.S. dollars. This precipitated a need to restructure its whopping pile of $543 million in borrowings.

The plunge in the Canadian dollar against the US dollar over the last year compounded the problem, once again showing the folly of corporate treasurers being MBA holders rather than practiced streetfighters in the realities of the mining world. So in recent months Allied Nevada had to draw down on its $75 million short-term loan as its liability on the swap balllooned as the Canadian dollar depreciated.

The troubles with its out-of-the-money currency swap exacerbated the company's cash-flow issues as it sought to build out its Hycroft gold and silver mine in Nevada.

As the swaps liability bloomed the company had to post the equivalent of 22% of its mark-to-market liability on the swap to two banks that served as counterparties. This gradually consumed all the cash it had available. The requirement came into force in December 2013 when two banks pulled out as lenders of its revolving loan. When they left, the security they held as lenders couldn't be used as collateral anymore for any swap liability the company incurred.

With the swap being public knowledge the shorters moved in for the kill with the result that, according to Bloomberg, Allied Nevada was the most-shorted publicly traded stock among gold miners. This situation was not helped by the eternal travails of the gold price and constant disappointments with regard to the Hycroft mine's output.

A Trend?

I could not help noting that three of the victims of corporate fatalities in recent times were all with their major operation in the US. First was the aforementioned Allied Nevada but secondly there was Mercator Minerals and the third that comes to mind was Veris Gold (the old Yukon-Nevada). We suspect that US insolvency rules are more unforgiving than those in Canada and that companies operating in the US, when they get too near to the edge, rush for “protection from creditors” under Chapter 11 rather than soldier on with unsustainable debt burdens.

The problem at Veris Gold goes back to a dalliance with a financing with Deutsche Bank back in 2011 which had the goal of moving the company forward while not diluting the controlling block of the major Swiss shareholders. Here we have an example of unnecessary debt bringing about a corporate demise. Despite management that the word “omnishambles” was invented for, the prime asset of the Jerritt Canyon mine and mill remains almost unique and a key playing piece in Nevada power games being one of only three approved refractory roasters in the state. The gormlessness of the crew in the executive suite meant that the company spent a long time unprofitably tolling ore for Newmont, making itself poorer and more dependent in the process. The cashflow squeeze forced it to seek protection from creditors last year.

Again debt played its part at Mercator Minerals, with the heavy burden pushing the company to seek a merger with a Russian group. However the failure of this announced merger with InterGeo had an ultimately fatal effect tipping it into bankruptcy. It is not clear to us what happens next but the Mineral Park property is a long term producer and should be of interest to someone wanting to secure one of the few producing copper mines in the US. The company also owns two properties in Mexico, including the Creston molybdenum project, which I had covered several times back in its guise as the main asset of Creston Moly. It is not clear to us who has a first charge over the assets now that it is in legal limbo.

Conclusion

Canadian miners are accused of many faults but largely the one they eschew is piling on too much debt (unlike their ASX brethren who never see a loan offer they can refuse). And the Canadians have shown themselves to be smart in that respect because the 2008 crash, for instance, took down a bigger swathe of Australian small- and mid-size miners with heavy debt burdens than it did in Canada.

The three companies we have mentioned here that have fallen into an early grave all have in common being US-oriented and being debt-burdened, truly a fatal combination that leaves little option than to seek protection from creditors when the times get tough, even though they have cashflow and promising assets or production stories.

The debt acts like financial quicksand and even the sturdiest-looking zombie succumbs to its suction and goes under.