# Mutual Backscratching as a Survival Technique

Miners are so desperate these days that they will grasp at any piece of flotsam drifting by if it helps keep their heads above water. Survival is the name of the game and managements are now starting to realise that the self-same investors on their register that tell them "whatever you do don't dilute us" are also the same investors who cry poor when management comes around seeking funds to keep the lights on.

As a result of these "do as I say, not as I do" core shareholders some companies have experimented with a new(ish) form of mining investment vehicle has appeared in London in recent years. We are not sure if its appearance here is due to a favorable legislative environment for this type of structure or just a case of coincidence. It is definitely one that we were unfamiliar with in North America. Some good quality companies have been attracted to it and it certainly fills a need for companies, but it can also result in an investment writedown that managements may not expect when they embark on the transaction.

Having recently stumbled upon a company confessing its experience I thought it useful to review the phenomenon and give some thoughts on how problems might be avoided.

**How It Works**

Essentially it is a form of mutual backscratching at the financing level. The vehicle for this "financing" is an investment trust which invests in mining companies. So far, so good. However what happens is that the investment trust makes its initial investment and then the mining company subscribes for shares in the trust for an amount less than or equal to

the value of the trust's investment in them. Then the mining company gradually sells the trust's shares into the market in the process exiting the holding and realizing cash for whatever its investment needs might be.

A further twist is that the trusts are sometimes kickstarted by pooling orphan holdings of disparate (or associated) mining investors to create the initial portfolio. This brings the danger that the debut portfolio may consist of unwanted odds and sods or quasi-unmarketable parcels. The trust should in theory not take on board holdings that don't take its fancy or suit the long term strategy but the temptation is always there to bulk up from the get-go by accepting whatever is offered as the shedding of unwanted portfolio holdings by foundation shareholders may ingratiate the trust's management with its key holders.

**Some of the Players**

The first abortive attempt at one of these trusts in recent times was Grafton Resource Investments which came out of the gates post the 2008 slump with a less than sexy collection of bits and pieces and never got beyond the ugly duckling phase. It lingered on mainly invested in unlisted entities, but was eventually delisted and wound up.

After an interregnum of a few years a heavier group of promoters got behind a new vehicle which was called Praetorian. This trust had as founder shareholders, so we heard; groups such as the family office of the Fleming family (remember Robert Fleming, J.P. Morgan Chase Asset Management and BlackRock which seeded it with cash and some of their smaller non-core mining holdings. Praetorian was promptly listed on the London Stock Exchange and one of its first investments was to take a stake in Maya Gold & Silver, a story I have long liked in Morocco. Other major holdings in its portfolio are or were A Cap Resources (ACB.ax), Equatorial Palm Oil plc  (PAL.L), Galileo Resources plc (GLR.L), Polar

Star Mining Corporation and Savannah Resources plc (SAV.L).

More recently another version, going by the name of GRIT (standing for Global Resources Investment Trust – GRIT.L) has been making some minor waves taking stakes in smaller miners on the "I'll scratch your back if you scratch mine" variation on the theme. Amongst those to avail themselves of GRIT's financings are Mineral Mountain Resources (MMV.v), Jaxon Minerals (JAX.v), Tirex (TXX.v), Orovero Resources (OVR.v) and Cornerstone Metals (CCC.v). Some of the management of GRIT, also overlap with Grafton's team.

The story at GRIT has not been a happy one in recent times (as the price chat below shows). Whether this is the fund's fault or not we shall not opine. It can be said however that in these times of ongoing distress in the mining sector it is all too easy for a miner to toss out shares of an investment trust than struggle to raise some shekels by more conventional means.

**A Recent Experience**

While poring over the accounts of Elcora Resources recently, I noted that they too had availed themselves of financing from one of these structures. On March 10, 2014 Elcora issued 4,200,000 common shares of Elcora at $0.19 per common share in exchange for 443,136 ordinary shares of GRIT at £1.00 per share. The Elcora shares were subject to a hold period expiring July 8, 2014.

In the December accounts of Elcora we stumbled on the tidbit that there was a realized loss of $273,210 on sale of marketable securities as a result of Elcora selling part of its shareholding in GRIT. This left it with an unrealized loss of $153,989 on the remnant of the holding. It would appear that Elcora took around a hit of around 70% on the GRIT holding. And yet GRIT at this time are UP on their Elcora

investment…

**Conclusion**

Anything that gets financings out the door with minimum pain or cost for all concerned is a good thing. In fact looking at these structures we cannot help but be reminded of the symbiotic relationship that used to exist between London- (and Edinburgh-) based investment trusts that existed for well over a century until a relative eclipse of this model in the last decades of the 20th century. Interestingly the model has been dusted off and come to the rescue of the mining sector.

If a small amount of money tides over a miner until better days it is not a good thing but as we can see in some cases the miner does well and yet it must take a hit on its stake in the investment trust because some of the other investments of the trust have dragged down its NAV.

The secret here is to do your financial backscratching with one of the better stockpickers in the space. And (just think about it) if they are good stockpickers they may not want to make an investment in your company!