

Juniors fare no better under new resource tax

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QUITE naturally, all of the talk about the potential impact of the government's planned new mining tax has so far focused on the big miners. After all, the likes of BHP Billiton and Rio Tinto are where the bulk of the taxation windfall will come from. Story by resource analyst Gavin Wendt.

But the big miners are also in the spotlight for another even more cynical reason. The government in its taxation propaganda has pointed the finger at these two companies as essentially foreign-owned robber barons, nicking Australia's resource wealth. This conveniently ignores the fact that both companies have been essential cogs in the development of Australia's resource industry.



Effectively, without BHP and Rio, Australia would be laggards in terms of world mining, rather than the frontrunners that we currently are.

But let's not forget that there are more than 850 resource companies listed on the Australian Securities Exchange, so the resource tax changes will adversely impact more than just BHP and Rio. And the smaller companies have been just as fervent in their opposition to the new tax as their big brothers.

Let's look at the example of a \$50 million market cap company looking at say a \$100-200 million investment to develop a new gold mine. It's an extraordinary leap of faith for a small company like this to invest in mine development, as the project investment is several times its existing market value.

The risks are particularly high for companies with their first foray into production, where you are talking about a one-mine company that is just making the transition. They are high enough anyway but when you start putting an added tax impost on things, you have to wonder if all the risk is worth it.

These companies are the ones with the most to lose and their job has just become even harder as the bar has now been raised in terms of taxation on their projects, eroding returns and value. And junior companies will hardly take comfort from the government's proposal to reimburse 40% of any losses on failed projects.

Companies don't weigh up developments on the basis of the potential for a bailout in the event of failure. Likewise, investors and financiers don't invest in resource companies on the basis of a safety net. The market therefore wants to support robust projects, yet the government is theoretically encouraging the development of marginal projects.

And while the proposed 30% allowance for claiming of exploration expenses in any one year is commendable, the benefits are likely to be offset by the fact that junior exploration companies are likely to find it much harder to raise exploration dollars in the first place. Then, if they are fortunate enough through exploration success to find something worth evaluating, the threshold for development has been made that much harder because of the 40% tax.

After taking all of this into account, what is my advice for resource investors? Sit tight is my message, as the important thing for investors to bear in mind is that the immediate share price damage has pretty much already been done in terms of the RSPT. This means the bad news has already been largely factored into the valuations of our miners. There is therefore little point in taking money off the table now.

Investors must remember that, at the end of the day, Australia's miners are high-quality companies that will continue to generate strong earnings over the coming years. Profitability will remain strong irrespective of the new tax. The big diversified international miners will have the luxury of reweighting their assessment of project risk in Australia and potentially sending more project development dollars offshore.

If I had to pick a sector that will weather the storm better than most, I believe the coal sector is best placed. The supply-demand balance is going to be favourable for coal producers for a long time, while there is correspondingly a relative dearth of emerging Australian coal aspirants.

Where to find out more

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