

## IS GOOD MANAGEMENT QUANTIFIABLE?

For some time now I have often wondered whether it is possible to quantitatively assess good management when studying mining companies. Management is often dismissed as one of those qualitative factors. Difficult to assess numerically, coming down to following people's progress in the industry and their success and failure in project execution. This is very true to a point and you no doubt want to invest your money in companies where the management team has a demonstrable track record in whatever it is they are attempting to achieve. For instance, if you are speculating on a grass roots exploration company, your odds of success improve if the geological team has experienced previous success in uncovering economic deposits. If the company is developing a mine, you like to see a management team experienced at "profitably" bringing projects into production. The question is:

**Can good management be assessed quantitatively making it easier for investors to identify those companies which give them the best chance of growing shareholder wealth via profitable development?**

I believe that it can. Let me explain. When you break it all down, the tools management has at its disposal to build shareholder wealth include:

1. **Their portfolio of projects;**
2. **Shareholder funds (equity);**
3. **Debt;**
4. **Internal cash flow (existing operational projects); and**
5. **Experience.**

All these factors are combined to varying degrees in an endeavor to grow shareholder wealth. If the company has a track record of successfully achieving this, access to 2 and 3 is generally unrestricted. This is important because factors 2 and 3 are very often the life blood of growing a company. One thing that has struck me during the present financial turmoil is that we very quickly discovered which companies had something genuine to offer and which ones were mere pretenders. The companies with something to offer continued to be able to raise money on reasonable terms without bastardizing their share capital. Other companies heavily diluted shareholder wealth without blinking an eyelid.

When you explore across the landscape of companies and highlight the few which have genuinely grown shareholder wealth successfully over time, they all tend to share four unique features:

1. **Comparably fewer shares issued.**
2. **The directors and management own a material interest.**
3. **Sound balance sheets (no excessive debt).**
4. **A diverse mix of projects.**

In summary, these companies have generally been able to "**achieve more with less**". The projects they have been involved in have been of a quality that has allowed them to borrow capital and what's more, pay it off quickly, thus cleansing their balance sheets for future financings as opportunities arise. By keeping equity raisings to a minimum, they maximize shareholder returns. The other feature, which probably isn't a great surprise, is the high proportion of director/management holdings as a percentage of outstanding shares. That

is, at least 10% of the total. This is good in that it means the directors' interests are kept more in line with their shareholders. For instance, these companies are more likely to pay dividends and responsibly manage the share capital of the company. Another step is to look at the health of the balance sheet. More often than not, these companies have little debt and large cash balances depending on the life cycle stage of their respective projects. Ideally, they will also have a good mix of projects from exploration right through to mature production.

Australian mining companies, on average, tend to have many more shares outstanding than their North American counterparts. This can be mainly attributed to numerous capital raisings at lower par values, generally around \$0.20 a share. As a result, it is possible to see ASX companies with over 1 billion shares outstanding and lower share prices (less than \$1). This, in my opinion, definitely detracts from the appeal of Australian junior mining companies to international fund managers. It gives the impression that Australian companies are generally less responsible with shareholder funds. With any market, there are exceptions. We do have some fantastically run junior gold mining companies in this country. The better candidates can be easily shortlisted (with access to the proper tools) according to the number of shares outstanding and how advanced the companies are in their development cycle. I personally use a cut off of about 250-300 million shares. Many of the better companies have considerably less shares outstanding.

When undertaking this analysis, investors do need to be wary of share consolidations. I know of Australian gold mining companies that have dual listed on the Toronto Stock Exchange (TSX) and have consolidated their share capitals in order to boost share prices and satisfy listing requirements. These consolidations have been undertaken at 1 for 5 or even higher ratios. This can muddy the waters somewhat when targeting companies with small share bases. One way of alleviating this concern is to study past annual reports over a 3-5 year period, ensuring no consolidations have taken place.

By investing in these companies, there is every chance that you are investing in a company which has sound management and is well run. A quick review of the company's achievements or what the individual directors have accomplished in their careers will provide further confirmation. With fewer shares outstanding, better quality projects and a higher caliber of management, you are bound to get more bang for your investment dollar.

For a database of gold related companies and the ability to custom filter by the number of shares outstanding visit [www.goldnerds.com.au](http://www.goldnerds.com.au). The product is now offered in both Australian and North American versions. Running searches by the number of shares outstanding and studying how advanced a company's projects are, the state of their balance sheets etc is just one of many investment techniques our clients use in chasing quality investment opportunities.

Troy Schwensen

Research Analyst  
[www.globalspeculator.com.au](http://www.globalspeculator.com.au)

Editor of GN North America  
[www.goldnerds.com.au](http://www.goldnerds.com.au)

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