Asset valuation disputes rarely best settled through legal means

By **Andrew van Zyl** - May 11, 2018

LEGAL disputes over the value of mineral projects and mining companies are difficult to win conclusively, suggesting that a new approach in contracts is required – especially given inherent uncertainty for all parties in mining-related valuations.

While most valuations rely on measures of net present value (NPV) and the value of comparative transactions in the marketplace, these valuations contain high levels of residual uncertainty. In the case of NPVs, price forecasts are unreliable and discount rates rely on assumptions over which academic consensus has not always been reached. In addition, commodity cycles continue to surprise observers and analysts, despite how regularly they recur.

In terms of comparable transactions, true comparability between projects is rare and this factor, in conjunction with the uncertainties described in determining NPV, contributes to a high level of uncertainty over the value of a mining company or project. This can lead to large differences in valuations, which could result in one or other party to a mining agreement feeling disadvantaged or aggrieved. The impact can be exacerbated where the stake being valued is for a stake to be held by a government or community trust and where social license to operate can be affected.

Importantly, this gulf between one valuation result and another for the same project cannot always be resolved by legal means, as the high levels of uncertainty mean it is unlikely that a case of negligence or bias – in determining the value – could be proved. Rather, the difference in value is generally not due to any blatant errors but arguably the result of favourable versus unfavourable assumptions.

In a recent case study in which SRK was involved, two valuators arrived at valuations that differed by more than 30% – even after using identical data regarding the life-of-mine, capital cost, operating cost, plant recovery and

grade of a mineral project. This highlights how many of the lesser known variables – such as beta, the equity risk premium and the risk-free rate – can drive substantial differences in value. What signatories need to bear in mind is that these differences are not readily resolved in a dispute since there is disagreement on some of these, even in academic circles.

These differences in NPV unfortunately can seldom be readily resolved conclusively by referring to recent transactions. Comparable transactions should be similar across a range of characteristics, including geography, geology, grade, size and other technical factors. The pool of comparable transactions would then need to be large enough to facilitate the determination of statistically significant values. Ideally, there would be enough transactions of comparable projects to prove the value of an ounce by classification – that is, in the reserve and resource category, as well as in the measured, indicated and inferred category. However, just removing the 'noise' from the price of any ounce is challenging.

A further complication when attempting to contain the valuation range is that – while the price used when comparing transactions should exclude sentiment and strategic value – most databases reflect the price paid rather than the third-party, arms-length value that the independent valuator is often aiming to determine.

Given that it is very difficult to create a defensible argument for any value, a range is likely to be the most defensible position – and a value needs to be very carefully derived if there is a likelihood that it will need to be defended. We would even advise that the process whereby value will be determined at a future date should be carefully considered with input from experienced valuators and with assumptions generally agreed prior to signature.

Andrew van Zyl is a partner and principal consultant at SRK Consulting (SA).