

¹ Red Cloud Mining Capital 1– Teaching Note

Conor Vibert developed this teaching note to guide the use of the multimedia case entitled Red Cloud Mining Capital 1 for instructional purposes. It is not the purpose of this material to serve as an illustration of how to effectively or ineffectively address a managerial situation.

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SUMMARY

Chad Williams, CEO of Red Cloud Mining, a Toronto based consultancy to the mining sector has a challenge to overcome. A client is seeking his company's assistance to raise funds to move forward with a mine property based in Alaska. In normal times, the challenge would not be a difficult one. However, the commodity market is currently in the midst of a downturn and mining stocks are currently not attractive to many traditional investors. Williams needs to figure out a strategy for helping this client raise the needed funds. Advice is being sought as to how to proceed in resolving this real life issue. Students are offered access to a set of transcribed video clips that outline the issue and its cause along with providing context for the issue. In order to arrive at alternative solutions and justify their choice of a solution, students are expected to use sources of information not found in the case.

KEYWORDS

- Raising Capital
- Mining
- Small Business

CASENET VIDEOS

Each video in this multimedia case features a segment of an interview with one of the organization's key decision makers. The videos describe:

1. the *Issue* facing the individual or organization
2. the *Cause* of the issue
3. *Background* information for the individual, organization and industry
4. *Alternatives* for addressing the issue
5. A suggested *Solution* and justification

Transcriptions for each video are also available. Students may not access the *Alternatives* and *Solution* videos or transcripts.

OBJECTIVES FOR TEACHING

There are a number of instructional objectives for this case.

¹ The Author wishes to thank Chad Williams for his support of this project. At Acadia University, thanks are in order for Dave Sheehan.

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- To enhance the decision making skills of students by having them address a real life issue faced by managers of Canadian or international companies.
- To provide students with a brief introduction to the mining industry.
- To offer students an opportunity to analyze a situation using concepts that illustrate how to value a mining property.

POSSIBLE TEACHING STRATEGY

This case is ideal for in-class case analysis or as an assignment. Assuming an 80 minute class, here is an approximate class schedule:

Time (minutes)	Task
5	Introduce case and divide students into groups.
15	Students view <i>Background</i> case videos and make notes.
5	Instructor plays the <i>Issue</i> and <i>Cause</i> clip(s).
25	Students identify alternatives, a solution and rationale.
20	Instructor guides a discussion around alternatives, solution and rationale.
10	Instructor plays the <i>Alternatives</i> and <i>Solution</i> clips.

If the case is used as an assignment, the instructor may want to focus assessment on:

- 1) **Decision-making process.** The instructor would evaluate writing style, appropriateness of information sources, alternatives, solution and rationale. This approach recognizes that the alternatives and solutions offered in the case are not necessarily optimal, and other choices may be equally effective. Students can be rewarded for their selection of decision making approaches, analytical frameworks and cited reference material.
- 2) **Outcomes.** The instructor would evaluate how closely student responses match those offered in the *Alternatives* and *Solution* video clips. Or, the instructor could use the insight of an existing research paper or analytical framework as the basis for judging outcomes.
- 3) **A combination of process and outcome.** The instructor may apportion the grade between process and outcomes.

POSSIBLE QUESTIONS FOR ASSIGNMENTS

Students can be asked to identify a set of alternatives to address the issue outlined in the case, a solution and rationale. Other questions that will help students prepare for their case analysis include:

- What are some of the challenges currently facing the mining industry?
- What are some of the ways that mining projects in remote locations differ from those in non-remote locations?
- What are some of the different metrics used to value a mining company?

CASE ANALYSIS

Issue: The *Issue* and *Cause* video clips outline the problem or challenge of the case.

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- We provide advisory services and raise money for mining companies. One of our mining clients has an 8.5 million ounce mining project in Alaska. It is a very good project. If I look back three or four years we would have easily been able to raise money for them. Today it is very difficult and the reason is because there is a lack of interest in mining, in general and there is a lack of liquidity in the financial system for gold in particular. So they are struggling to raise even \$500,000. This company has a relatively small market capitalization of about \$20 million. They do not have much money right now so time is of the essence. They need the money immediately. They are targeting about \$500,000. They are listed on the Toronto Stock Exchange. Volume is pretty good. Their core asset is located in Alaska so they are not eligible for flow through. If they were exploring in Canada, they would be. They are in the gold business. Gold has not done very well recently. Their sector is very much out of favour. The reality is that they would like to raise a lot more money but they would settle for \$500,000.

Analysis:

To start their analysis of the case, students should view the *Background* video clips. These clips should help students grasp the following points or case facts.

- According to Williams, in this current environment, most small mining companies have lost 90% of their value and are unable to raise funds.
- For fund raising in this industry, the primary regulator is the Ontario Securities Commission
- Red Cloud Mining is a partnership and employs eight individuals.
- Red Cloud mining targets high growth small mining companies as clients.
- They provide four services for clients. They do strategy for them, find money for them, do M&A's and do marketing for them.

Researching information sources other than the content of the cases should enable students to garner the following insights: (Mining Association of Canada)

- In terms of exploration, the average costs of remote projects (more than 50 kilometres from a supply route) are 2.27 times more expensive than non-remote projects
- In terms of exploration, the average costs of very remote projects (more than 500 kilometres from a supply route) are 2.8 times more expensive than non-remote projects
- In terms of production, for a remotely located mine, capital costs are about double for gold mines, 2.5 times higher for base metal mines and 15% to 20% higher for diamond mines
- In terms of production, operating costs for remotely located mines are 30% to 60% higher than non-remotely located mines.
- Remoteness of location is the key variable in the costs of mining projects in Northern and Arctic locations

Effort focused on research coupled with analysis should enable students to present a series of options. These can be compared to the options offered by the interviewee which are also summarized below and found in the Alternatives video clip.

- So the options are as follows. There is the traditional method which is to go see a broker. We could raise money institutionally which means they will do some due diligence on the

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company. They will call their institutional or retail clients and they will see if they can place the shares of my client with their client. Or we could go see a private equity group. Some of them are located in Toronto but there are also some located all over the world. A mining oriented private equity group. They will do due diligence and if they like it they will fund it. Another alternative is through a merger and acquisition. We would merge our client with a cash rich mining company. If the mutual due diligence is satisfactory it will take about six months for these companies to merge. Therefore, the cash rich company will fund the cash poor company. Or we could do crowd funding which is a very new method. Crowdfunding will also entail due diligence and then listing the company on a portal and then seeing if the appetite is there on the internet, globally.

The *Solutions* video clip offers the interviewees' solution to the issue along with a rationale. Highlighted below, this can be compared to the student response and explanation.

- Private equity probably will not work because this company does not have any cash flow. This is an exploration stage company with ounces in the ground. They are not mining anything yet. Private equity usually looks for companies that are more advanced. The traditional broker dealer model really does not work for small capitalization companies. They are focused on larger companies these days because the market is so out of favour. It is unlikely we will get the attention that we want. A merger is also unlikely because it will take months of due diligence on either side. My client needs the money right now. To close a deal it will likely take six months on an M&A. The likely best scenario is to do crowd funding which has its positives and negatives as well. At the end of the day it is probably going to work as it is a small amount of money that is needed. This is a company that is quite attractive on the social media side and we think that is the best way to go.

SUGGESTED COURSES

We suggest that this case would be suitable for a number of courses. These courses include:

- Marketing
- Finance
- Entrepreneurship

ADDITIONAL RESEARCH

The case offers students opportunities to undertake interesting additional research.

Students may want to delve deeper into how managers make decisions. Classic approaches to decision making include works by Cyert and March (1963) and Tversky and Kahnemann (1974).

Students interested in learning more about the industry in general might make use of numerous online information sources some of which are noted below.

- BRW
http://www.brw.com.au/p/entrepreneurs/how_ipo_raise_capital_for_your_business_cmCJgff7786Mn3WdAa0sJP. How to raise capital for your business. Eight alternative way to an IPO

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- High Beam <http://business.highbeam.com/industry-reports/mining/gold-ores> High Beam Business Reports – Gold Ores
- Investopedia, <http://www.investopedia.com/ask/answers/022315/what-value-metrics-are-best-analyzing-companies-metals-and-mining-sector.asp>, Best metrics for valuing mining companies.
- Manning Elliott
<http://www.manningelliott.com/sites/default/files/Mining%20companies%20raising%20capital%20in%20Canada%20Article.pdf> Mining Companies raising capital in Canada
- Mining Association of Canada,
http://mining.ca/sites/default/files/documents/Levelling_the_Playing_Field.pdf, Study of costs in remoted and non-remote mining locations
- Value Line http://www.valueline.com/Stocks/Industry_Report.aspx?id=7249#.VcOjUPn09fA Metals & Mining (Diversified)
- Value Line
http://www.valueline.com/Stocks/Industries/Industry_Analysis_Precious_Metals.aspx#.VcOjAPn09fA Industry Analysis – Precious Metals

REFERENCES

A number of articles, referenced below, offer insight that might help instructors effectively explore this case with students.

- Cyert, R. and J.G. March (1963), *A Behavioral Theory of the Firm*, Second edition, (1992), Oxford: Blackwell
- Efthimios G. Demirakos, Norman C. Strong, and Martin Walker (2004) What Valuation Models Do Analysts Use? *Accounting Horizons*: December 2004, Vol. 18, No. 4, pp. 221-240
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http://mining.ca/sites/default/files/documents/Levelling_the_Playing_Field.pdf
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