

## <sup>1</sup> Red Cloud Mining Capital 2– Teaching Note

Conor Vibert developed this teaching note to guide the use of the multimedia case entitled Red Cloud Mining Capital 2 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 place a value on a mine property that it owns 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 not that attractive to many traditional investors. He needs to think through how he can place a value on the property. 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

- Valuation
- 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.

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

## Red Cloud Mining Capital 2

- 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 mine.

### 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 different ways of valuing a project?

### CASE ANALYSIS

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

## Red Cloud Mining Capital 2

- My name is Chad Williams and I am the CEO of Red Cloud Mining Capital. The issue at hand is valuing a non-producing mining company. They have got a property in Alaska. They control 100% of it. We know through drilling that the property contains 8.5 million ounces of gold. So the issue is how do we value that? How do we ascribe a market value? So this company has 8.5 million ounces in the ground. They have very little cash. Let us assume zero cash. They have no debt. The prospect of producing gold is far out in the future. They need permits. So we are least five years away from generating one dollar of revenue. There are comparable companies in the area. Some have different characteristics. Some are not gold. The gold price is currently about \$1100 per ounce. The Canadian dollar is at 85 cents to the U.S. dollar. Interest rates are extremely low. Let us assume the interest rate is zero for the sake of valuing this company.

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

With this information in hand students can be challenged to identify an analytic framework that will help them organize their thoughts.

- In this instance, instructor can discuss generic means of valuing an asset include Net Present Value, Discounted Cash Flow, Internal Rate of Return and other methods. What should become apparent is that in this case, the level of uncertainty is such that traditional model will not prove accurate. An analyst will need to use a comparative approach based on market information.

## Red Cloud Mining Capital 2

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 we could look at the net asset value of the company which is a discounted cash flow adjusted for balance sheet items. We could do a dividend type model. We could look at comparable assets. We could value the project on a per ounce basis ascribing some type of margin relative to the gold price.

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.

- The method that we would use is to evaluate on a per ounce in the ground. We would compare it to other similar projects in the area and also around the world at that stage. It is an imperfect solution. The best way would be to do an NAV. But there is no clarity on when it will be in production. We do not know what the capital costs will be. We do not know what the commodity price, the gold price will be in five year when this mine is actually in production. We do not even know what margin is going to be. It is very difficult to evaluate it on any operating metrics so we will just give it a per ounce in the ground value.

### SUGGESTED COURSES

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

- Finance
- Accounting
- 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.

- Basinvest [http://www.basinvest.ch/upload/pdf/Valuation\\_of\\_Metals\\_and\\_Mining\\_Companies.pdf](http://www.basinvest.ch/upload/pdf/Valuation_of_Metals_and_Mining_Companies.pdf)  
Valuation of Metals and Mining Companies
- 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.
- Value Line [http://www.valueline.com/Stocks/Industry\\_Report.aspx?id=7249#.VcOjUPn09fA](http://www.valueline.com/Stocks/Industry_Report.aspx?id=7249#.VcOjUPn09fA)  
Metals & Mining (Diversified)

## Red Cloud Mining Capital 2

- Value Line  
[http://www.valueline.com/Stocks/Industries/Industry\\_Analysis\\_Precious\\_Metals.aspx#.VcOjAPn09fA](http://www.valueline.com/Stocks/Industries/Industry_Analysis_Precious_Metals.aspx#.VcOjAPn09fA) Industry Analysis – Precious Metals
- Yahoo Finance <http://finance.yahoo.com/news/overview-valuation-metrics-mining-companies-210014949.html>, Overview of Valuation Metrics for Mining Companies

### 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
- Levelling the playing field. Supporting Mineral Exploration and Mining in Remote and Northern Canada. The Mining Association of Canada, April 2015  
[http://mining.ca/sites/default/files/documents/Levelling\\_the\\_Playing\\_Field.pdf](http://mining.ca/sites/default/files/documents/Levelling_the_Playing_Field.pdf)
- Tversky, A.; Kahneman, D. (1974), "[Judgment under uncertainty: Heuristics and biases](#)". *Science* 185 (4157): 1124–1131.