MINUTES OF THE SAMVAL SUB-COMMITTEE MEETING

TO DISCUSS PARKED ISSUES, HELD ON 24 AUGUST 2017 AT 14:00

MIDSHAFT BOARDROOM, MINING PRECINCT, CARLOW ROAD

Present:	**H Bornmann (Chairperson)**	
	A Clay	
	R Croll	
	A Macdonald	
Apologies:		
In Attendance:	**C Jardine**	**SAIMM**

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1. WELCOME

It was noted that the Chairperson of the SAMVAL Working Group was Kelly Redman and it was suggested that Hannes Bornmann be Chairperson of the Sub-Committee dealing with parked issues.

2. KEY PARKED ISSUES

Mr Clay gave a summary of the key parked issues. At the request of Ms Redman, Mr Clay reported that he had put together a document on the parked issues, i.e. concerns raised over the years regarding the activity of the Committee, but he reiterated that he was not prepared to write a position paper on this. The parked issues included:

The first parked issue was brought up in the SAMREC Committee regarding whether or not one could report inclusive or exclusive resources. Globally, this was an issue that no-one seemed keen to tackle. Dr Rupprecht brought this up in the SAMREC meeting and it was currently being discussed within SAMREC. Mr Clay believed the Committee should also take note of what was going on, as this affected valuation issues.

The second issue was base prices, i.e. discount rates, commodity rates and exchange rates, and what to do about discussing a more formalised reporting process. He was still involved in the Oil & Gas Committee and, for reporting within Oil & Gas, the SAMOG Code had adopted what was in NI 51.101, which stated: "you will report according to a base price, forecasts and you will do this in nominal and constant money cash flows".

The third issue was independents, which he believed had been dealt with.

Mr Clay seemed to remember there being four specific issues.

Mr Croll added that there was also the issue of whether there should be a qualification attached to being a Competent Valuator. Mr Dirk van Niekerk had gone on about where the SAMVAL Group should be housed. Mr Clay advised that this was being dealt with through the SSC and Kelly Redman, through discussions with SACNASP, ECSA, PLATO, etc. Consideration was being given to formalised training and an attempt was being made to scoop Competent Valuators under SACNASP because of the Council for the Built Environment associations.

One of the other issues had been discipline and it was agreed that this was not for SAMVAL. It was felt that, on this particular issue, that the SAMVAL focus should be to recommend following valuation principles and that should be sufficient.

Issues came up at the workshop that still needed to be dealt with. In essence, it was about being transparent in terms of what was being done and providing adequate sensitivities so that people could assess for themselves how the uncertainties in the inputs impacted onto the final value.

Going back to the very first working group for SAMVAL, Mr Macfarlane had drawn up an Excel spreadsheet list of 30/40 items. The top four items were taken out to focus on and various others were parked. It was believed that the original list should be resurrected by the overall SAMVAL Group at some time.

For the sake of completing the exercise, Mr Lomberg had taken the initiative to finish the SAMREC Code and the SAMVAL Code was also finished in conjunction with Kelly Redman and Alastair Macfarlane. Another reminder was that the IMVAL Committee was still working away and had issued its draft. This was almost exactly the same as the SAMVAL Code and there was nothing in there that rocked the boat. It set a template for people to use the historical costs, the comparative valuation, market comparison and cash flow as the base, and that was where it was left.

From and Oil & Gas point of view, Mr Clay believed there was a problem in that the latest edition of the PRMS (the guidebook) was overhauled and the draft was out. Comments were currently being sent in but that standard, which all QRE's adhered to, had a section on "evaluation" rather than "valuation".

The other thing that they had not done, albeit they had the regulatory standard of NI 51.1.1 and SAMOG, which insisted that "when doing public reporting, the following had to be done". The PRMS had avoided all of that. Ms Redman was against allowing people to do what they liked, which was not the original intention of any of the Codes; it was trying to get standardisation and comparable worldwide. It was felt that SAMVAL would move away from this if it did not become more prescriptive.

The rationale was that SAMVAL needed to put in a sufficient amount of information so that peers could replicate what had been done. If SAMVAL specified very clearly what the input parameters and assumptions, etc. were – without going into a "cookie-cutter" approach – there would be sufficient information for the materiality and transparency to come into play.

Mr Croll believed that the whole underlying purpose of developing the Codes internationally was so that an investor or potential investor was provided with sufficient information to rely on and to allow him/her to make an informed decision as to whether to invest or not. That was the overarching principle and determined how prescriptive the Codes needed to be. Mr Bornmann suggested that this should be contained within the definitions of the Code; Mr Clay did not agree and gave an example within the oil & gas industry of the grey tonnage curve (probabilistic). He also mentioned the deterministic points on a graph, which relied more on judgement. He believed it was a judgement issue, even though one was using a probabilistic approach to calculate the numbers. Some discussion followed on whether or not this was a SAMVAL issue, as the two Codes went together. Mr Bornmann believed that the Competent Valuator relied on the Competent Person doing the resource valuation determination. To write into the SAMVAL Code, "thou shalt use a balanced resource curve" would be out of step if SAMREC did not do the tonnage curve. It was for this reason that Mr Croll believed the two Committee groups should be interlinked, so that the impact of what was discussed in this meeting had projected implications of what happened to SAMREC. The fundamental issue was the level of prescription, which was a key issue, bearing in mind that what the Codes alluded to was the fact that two or three people could come up with different answers; and the fundamental answer was the independent view.

The only requirement where it was specified that an MPV was to be stated was in the aim guidelines; it was not stated anywhere else. SEC had always been very strong on the trailing average but were currently they were trying to eliminate this.

A report was prepared in the late 90s on the challenges facing the SEC and that particular issue had been around for more than 15 years. The inconsistencies were that the unconventionals were using conventional mining drilling patterns but were using oil & gas testing facilities to come up with resources. The point was that the oil & gas industry was allowed to report their figures on a one-year trailing average and mining was three.

Mr Bornmann believed that the Competent Valuator did not always apply his/her mind. To do this, the Competent Valuator had to look at both the history and the market sentiment. If this was done mechanistically, it would lag in a bull market and, in a bear market, this would overshoot. Mr Clay believed that forecasts were not all right. In accounting, the fair value standard was very specific. It asked that the term "observable inputs" be used on at least one case, i.e. a standard set of numbers would be used and, once that had been done, the base could be set. If the company had a different weighted average for a discount rate, this could be plugged on the diagram. Mr Bornmann suggested that one should then be prescriptive when doing the sensitivity analysis. Mr Croll believed that, by and large, the Competent Valuator was not competent to comment or make a judgement call on economic indicators. He quoted an example of a feasibility study taken on a gold project. 19 forecasts were obtained from various big companies and the figures ranged from $750 to $1 450. The spot was $1 100, so the views were very diverse. Mr Bornmann suggested that the question was whether SAMVAL should be prescriptive and, if so, how prescriptive should it be. If the SAMVAL document was prescriptive, it could open itself to clients who might say: "the Code said that and I lost a lot of money because you did not apply your mind". Conversely, there was also a major risk in not being prescriptive. In essence, a feasibility was put out and the analysts took this input and applied their own prices, forecasts, etc. to that. He queried how many cases had gone to Court, based on valuations outlined on the SAMVAL Code as it currently stood. The answer was none, although various accounting companies had gone to Court.

Mr Clay argued that the one case, which should be the base case, is stopped of all those kinds of things. Mr Macdonald agreed that there was logic in that, but the problem was that, depending on which spot showed, it may well not meet the requirements of the client and the client may well go to somebody else. The valuation was only right based on a specific set of assumptions at a specific point in time. SAMVAL should be asking what levels of confidence are known about all of the inputs into a valuation model. When it came to opex and capex, there was a high level of confidence because there was a lot of history to assist in building the case. When it came to the ore body, there was an incredible amount of competent people to assess this and come up with mineral resources and reserves. What was being attempted was to try to forecast a commodity price or set of economic assumptions and use those to drive an evaluation.

Mr Clay believed that those were exactly the same principles as were used in the accounting world. He had argued for many years for running parallel with the accounting practices. In such a case, if that asset went onto the balance sheet as it should, the auditor had to follow the principles of IS 13, to use spot at that point in time. If the value of the asset was higher or lower than the base cost, an impairment would have to be calculated. He believed that the people most likely to use the numbers generated would, in fact, be the accountants. Mr Bornmann countered that that was not a problem for the Competent Valuator. He also asked why the market was using forecast prices if they could not be used by the Competent Valuators. Mr Clay reiterated that before putting in all the forecasts, he was opting for one case must be the base or spot case at a given point in time. Some discussion followed on the Monte Carlo simulation.

When looking at commodity prices, the question was asked as to how to develop a tool that would help in becoming more effective at reading and interpreting figures. Mr Bornmann suggested a linear programme model using futures and creating the forecast model based on the …. programme. In essence, even putting the most sophisticated statistical tools to use;

the only certainty would be that it would be wrong. He recommended using the spot price as a base case and using a forecast price from the banks as the two scenarios to determine the value of the project and state the reasons for using one or the other, or a combination if you use two MPV price methods. MPV was always the most sensitive to price and discount.

Discount rates also had to be considered. In a market where there was extremely low inflation in the US, your …. would be lower than in an environment where the inflation rate was higher. Mr Clay believed that mineral assets should not be treated any differently to any other asset. There was some disagreement. He continued that the bottom line was that assets were assets, whether they were wasting away or accruing, and the principle of reporting should be similar. He argued that the fair values standard and the impairment standard in accounting gave a good handhold to lock in with what accounting wanted. His recommendation was that the observable input description that was used in IS 13 should be adopted.

Mr Clay suggested that the committee discuss Mr Macdonald's concerns around real and nominal. Mr Macdonald commented that it was a pity that Mr Clay had not attended the recent workshop. It was pointed out that the cost of the workshop (R6 000) made it prohibitive for pensioners to attend and it was suggested that this be taken up with SAIMM.

Action:

Mr Macdonald advised that in a real terms model, the base cost assumptions were put down and they remained constant, these could at least be tracked. The minute inflation factors were applied to the key parameters, e.g. electricity, labour, diesel, etc. it turned into a crystal-gazing exercise and there were increased uncertainties added to the model. If one talks about a feasibility study and then add an increase in rates, it was no longer feasible, because it decreased the certainty and confidence in the parameters. Besides that, in the discount rate one would assume a certain inflation rate linked to the discount. Depending on the model, if one started applying those known inflation rates, e.g. power, water, etc. and constructed the model in a certain way, it was possible to factor those in. By moving towards an inflate/deflate model, it was also possible to get things "more right". The more assumptions made, the more the chances were that the model would be wrong. This had come out in the discussions at the valuations workshop.

The gist of it was about disclosing exactly what you had done, i.e. what the assumptions were, what the parameters were that were applied, etc. Then there would be sufficient information for people to interpret and, if they were concerned about sensitivities, these could be looked up on the sensitivities table, etc. It was not about being prescriptive about which price forecast to use, but rather about being transparent. Mr Bornmann cautioned that if this was not done and the MPV was taken at face value and the investor bought the property which it turned out wrong, there was only one person to blame. The onus was on the investor to check the assumptions. The vast majority of potential investors did not have the skills and ability to do those checks and balances. The numbers that came out of the valuation were based on a specific set of assumptions at a specific point of time, which was what many people lost sight of.

Ms Redman had asked the Committee to pursue this and come up with something. Mr Clay's view was that nothing needed to be changed; it just required an addendum or Table 2 in the SAMVAL Code.

Mr Bormann advised that it had been emphasized many times that the SAMREC Code was a guide and should not be prescriptive. Mr Clay believed the Code was prescriptive in that it used "if not, why not". Some discussion followed.

Mr Clay's recommendation was that the Competent Valuator should go through the modifying factors and, notwithstanding all the modifying factors, which should be in the SAMREC reports, disclose a base case was disclosed where the value was calculated for the business at spot exchange rate, spot metal price and the discount rates prescribed at 5%, 10% and 15%. Some discussion followed on the definition of going concerns and spot rates.

For the base case, it was suggested to go with a spot or fixed price at which to report, but this should talk to the modifying factors and should be consistent. The modifying factors in the SAMREC Code defined the production plan. A lengthy discussion followed.

Mr Clay advised that the concern was the impact between insisting that when running the cash flow models one base case is based on spot. After that, attention had to be given on what else had to be done. Mr. Bornmann suggested using the inverse of that, i.e. using a consensus price as had been done all along and using immediate price; going forward collect the wisdom and, as far as the sensitivity analysis, the spot price would also be used. The statement should be that, in the sensitivity table, there needed to be provision made for reporting the MPV at the spot price/exchange rate.

Mr Bornmann added that the outstanding issues on Mr Macfarlane's list should be reviewed as a separate item and a collective decision made on what to turf and what to add. Mr Macdonald advised that some of these issues had been on the parked list for some time.

Action: All Members

In summary, it was agreed that the sensitivity table would be provided to provide the selected discount rates at spot.

(Spoke to whiteboard and many people talking at once – at around 1:15).

Mr Clay agreed to send all members a link to the latest PMRS Code. He asked that everyone read the section on "Evaluation" as he believed SAMVAL could make use of a similar graph to the one used in that section.

Action: Andy Clay

Mr Croll believed the important thing was that this was not about a base case. He wanted to ensure that a move was made away from the philosophy of a base case, because that was what sat in the minds of the working group. Mr Clay added that if the sub-committee came up with the wording of an addendum to the Code, the SAMREC Committee would have to be made aware of the fact that SAMVAL was concerned about the modifying factors with respect to the disclosure of the cut-off and the ….. are adequately disclosed. This information was required in order to reference it in the SAMVAL Code.

Mr Croll added that words to the effect of: "all other assumptions, e.g. modifying factors remain the same" should be included. Valuations fail when this is not stated. Mr Clay agreed that this paragraph should be drafted and included.

Mr Clay suggested that the wording needed to be agreed and proposed as an addendum to the SAMVAL Code. This would be less complicated to do than actually changing the Code itself. It was agreed that this would be run past …… Mr Croll suggested that this be written up with some examples and circulated to members, with a request to ……. to comment as early as possible. Mr Clay suggested that each person should draft a two-pager and Mr Macdonald agreed to prepare the first draft.

Action: Andy Macdonald

Mr Clay raised a concern that Dr Rupprecht and the SAMREC Committee going off to discuss the issue of reporting resource was something that SAMVAL should think about.

Some discussion followed on the reporting of resources and reserves.

3. DATE OF NEXT MEETING

The date of the next meeting would be advised in due course.

The Chairperson thanked all for their participation.

SUMMARY OF KEY ACTION ITEMS

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Discuss high costs of attending recent valuation conference with SAIMM.

All Members
Review Mr Macfarlane's list of outstanding issues and advise Mr Bornmann of any suggestions.

Andy Clay
Send all members link to PMRS Code. Members are asked to read section on "Evaluation"

Andy Macdonald
Prepare draft addendum to SAMVAL Code.

Kelly Redman
Follow up with John Cato of ECSA re MAV registration issue and suitable categories within ECSA