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COAL MINE LOAN A WASTE OF MONEY

The sharemarket thinks the Adani project is viable

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Controversy surrounds both Adani's proposed Carmichael coal mine in Queensland and the potential $1bn concessional loan from the federal government to Adani for mine-related rail infrastructure.

Apart from the environmental issues, proponents and opponents of the Carmichael project have made conflicting claims about the project's profitability and the need for a concessional loan. However, the project's profitability can be debated endlessly without resolution. Fortunately, the best arbiter of likely profitability is what the sharemarket thinks. Market reactions to news about the project demonstrate that investors expect the project to create substantial value for Adani shareholders. Consequently, any concessional loan to Adani would be a waste of taxpayer dollars.

A $1bn concessional loan has been under consideration by the Northern Australia Infrastructure Facility (NAIF).

Last May, the then minister for resources, energy and northern Australia, Josh Frydenberg, gave NAIF an Investment Mandate Direction. That direction states a key mandatory criterion to be eligible for NAIF assistance: "The proposed project is unlikely to proceed, or will only proceed at a much later date, or with a limited scope, without financial assistance."

The direction also requires NAIF to "limit the concessions offered to the minimum required for the investment proposal to proceed".

Therefore, the key question that NAIF should address is: will the Carmichael project (without assistance) create shareholder value for Adani?

If the answer is yes, it's in Adani's interests to proceed with the project and do so as quickly as possible, even without government assistance. If so, any rationale for government assistance disappears.

The uncertainties associated with large-scale long-term investments make it is difficult for pundits to predict with confidence the answer to this question.

However, the enormous amount of evidence produced by finance academics demonstrates clearly that the best predictors of uncertain outcomes are markets.

Market reactions to company announcements on investment, acquisition and other events are the best predictors of the impacts that they will actually have.

Why? Those who put their money on the line have the strongest incentives to make correct predictions.

We can tell what the market thinks about our key question by looking at the share price reaction to news that raises the market's perception of the probability that the project will go ahead.

If the market believes that the project would create/destroy shareholder value, the share price would rise/fall on news that raises the go-ahead probability. The full amount of shareholder value that the market expects the project to create could be directly measured if there was an announcement that shifted the go-ahead probability from 0 per cent to 100 per cent.

While there hasn't been an announcement like that, we can learn much from the market's reaction to two announcements that have significantly affected the go-head probability.

On October 15, 2015, then minister for the environment Greg Hunt announced his formal approval of the project on environmental grounds. The headline in India's *Financial Express* newspaper screamed the market's reaction: "Adani Enterprises share price soars over 11 per cent after Australia clears $7bn Carmichael project".

On April 3 last year Queensland Minister for Natural Resources and Mines Anthony Lynham approved three mining leases for the project. The *Financial Express* headline? "Adani Enterprises shares surge over 7 per cent on winning mining lease in Australia".

These two share price jumps combined are worth about $325m to Adani shareholders. They demonstrate that the sharemarket expects the Carmichael project to create substantial value for shareholders — much more value that $325m. For example, if the market perceived that these two announcements raised the go-ahead probability by 20 percentage points, the market must expect the Carmichael project to create over $1.6bn of shareholder value.

Those price jumps occurred before there was any public mention of a $1bn concessional loan. In any case, the shareholder value impact of a five-year concessional loan is about $200m. Therefore, the market clearly expects the project to create shareholder value even without government assistance.

This is irrefutable evidence that there is no case to provide any assistance to Adani. A concessional loan would simply be a waste of taxpayer dollars.

Of course, proponents of a concessional loan claim that the project isn't sufficiently profitable without it, while opponents claim the opposite.

Some opponents and commen-

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tators claim that Adani wouldn't be able to finance the project (even with a concessional loan) and have cited several banks that have said they wouldn't fund it.

But basic finance tells us that large companies will be able to raise funds for a project that investors expect to create shareholder value. We should be wary of ring-arounds to a few banks. The world has thousands of them.

In any case, the answers depend on how you ask the question. If you ask a bank whether it would 100 per cent debt-finance such a major project, the answer will of course be no. It's normal practice for companies to issue more equity to enable them to attract sufficient debt financing for big investments.

If a big investment will create shareholder value, it will get funding.

The sharemarket evidence suggests that the most honest person (at least publicly) in this whole debate was Adani Australia spokesman Ron Watson, when he said in December of the concessional loan: "It's not critical. We have obviously applied for it because it's available .... It doesn't necessarily mean it's make or break for the project." I doubt that his masters at Adani were happy with him.

This case illustrates why governments shouldn't offer industry/regional assistance in the first place. Vested interests on each side will make biased claims and naive and/or politically-conflicted politicians will waste taxpayer money unnecessarily. The government should direct NAIF to cease consideration of a concessional loan for the Carmichael project.

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Share price impact of positive news on Carmichael mine

Date	Event	Share price impact
October 15, 2015	Federal government gives project environmental all-clear	+11%
April 3, 2016	Mining leases	+7%