

## CPS Capital Group Submissions on Exploration Development Incentive scheme (EDI)

Manager: Not-for-Profit and Industry Tax Concessions Unit, Small Business Tax Division - The Treasury

By Email: [ExplorationIncentive@treasury.gov.au](mailto:ExplorationIncentive@treasury.gov.au)

### Summary

CPS Capital (CPS) feel this submission on the EDI as vitally important to the industry however we will try and keep it as short and simple as possible.

Australia and more specifically Western Australia has been the mining engine of Australia. This position is being eroded for many reasons identified below and if something is not done now more capital will be directed to mines in other countries robbing Australians of the tax revenue and jobs.

CPS Capital feel that the Exploration Development Incentive scheme (EDI) as a very positive step towards bringing the 600 or so ASX junior listed mining companies and the many private junior mining companies ("The Junior Explorers" ) back to exploring for economic mines in Australia and not spending that money overseas. If implemented many many as yet undiscovered deposits will be found. The majors (BHP, RIO etc) won't find these because of cuts to their exploration budgets and they don't do much grass roots exploration given their overall expenditure as they are more geared for JV's on projects that juniors have already found.

### About CPS Capital

CPS Capital, established in 2001, is Australia's #1 stock broking firm in the micro capitalisation end of the ASX Market and private equity. CPS is the 8<sup>th</sup> biggest firm by staff numbers in Perth. Other stockbroking firms do more in the \$10 to \$50m market capitalisation range but CPS is the biggest in the \$1m to \$10m market capitalisation range. CPS has primarily been focused in raising money for ASX listed companies to explore overseas. CPS would like to focus more on Australian companies but the for the reasons outlined below it is just too hard in Australia however the EDI would go a long way to incentivising companies to come back to Australia.

### About Tony Cunningham

CPS Managing director Tony Cunningham is a Stock Broker and has been in the industry 19 years and has a Bachelor of Commerce and a Graduate Diploma in Applied Geology. Tony has invested, advised and been a director in numerous junior and microcap ASX listed and private mining companies.

### Statistics

There are 684 companies listed on the ASX under \$10m market capitalisation. See appendix 1. Of these 503 are in mining related industries or exploration. The average cash at bank of these companies is \$1.5m If you take the bottom 400 companies their average cash balance is just \$1.2m and if you look at companies under \$5m market capitalisation there are 300 companies with less than \$600,000 cash. This is not enough to survive for another year. Sirius Resources NL which has had huge success with the Nova Deposit was just such one of these companies prior to

the discovery using new and modern resource sensing techniques. It has now a capitalisation of nearly \$1 billion dollars and the project once developed will bring millions in tax revenue and jobs to the Australian Economy.

It is clear to see that the junior end of the mining investment market is not in a healthy state. The chart below represents the last 12 years of the Small Resources index (XSR) compared with the (XJO) the S&P ASX200. The XSR comprises of 87 junior resources companies with market caps ranging from A\$30m to A\$1.4bn. Oil & Gas companies form the bulk of the Index (32% by weight) followed by Gold (25%), Base metals (20%), Bulks (13%), Uranium and Other. As you can see this is NOT a good representation of the small resources stocks we are trying to encourage to explore but there is NO other index to compare how they have performed. (Read more at appendix II)

So we are left with the XSR as the best chart is to compare the desperate state of junior mining explorers. Below it is overlain by the XJO the S&P ASX 200.



As you can see from the above the Small Junior Explorers have had a very tough time of it of late. For some years now it has become too hard to explore in Australia. The reasons for this are:

1. Green tape
2. Red Tape
3. Lack of finance for projects and exploration
4. The Canadian EDI scheme taking capital from investors that could be going to Australian companies.
5. Cost of drilling per meter in Australia Air Core, Diamond or RC drilling.
6. Belief that all the good Australian projects have already been found
7. Native title
8. Environmental concerns for financiers local and overseas.
9. Fear of negative tax changes as evidence by the exodus after the mining tax was suggested only to be replaced by the equally frightening Minerals Resource Rent Tax. Any Negative changes to taxes create sovereign risk for investors.
10. High Australian tax rate for workers/mining engineers/geologists

All of the above have reduced junior Australian companies' ability to raise capital or just forced them offshore. Many junior Australian companies have placed their Australian mining assets on hold or have completely given up on mining in Australia. If the EDI is introduced it will provide an incentive to raise capital for Australian exploration. It brings back these Australian companies as it will allow investors to deduct the expense of eligible mining exploration against their taxable income. If the mining is only allowed on Australian exploration then the money is spent here in Australia further enhancing the economy. There will be new big discoveries given the new remote sensing techniques and this it will have a multiplier effect as success will bring more foreign capital to Australia looking for similar finds. Establishment of the mines will generate jobs and flow on further into the Australian economy.

The Coalition's election commitment was to provide incentives for Greenfields minerals exploration activity, with a focus on the small exploration sector. Greenfields exploration is the future of the mining industry. Without exploration our existing mines will run out and they will not be replaced.

### **Other Countries**

Saudi Arabia. It is interesting to note that even countries like Saudi Arabia has identified that at some point its huge oil reserves will run out and it is pouring money into other mining and ventures.  
<http://www.nytimes.com/2005/12/13/business/worldbusiness/13saudiecon.html>

Canada. Canada has some amazing statistics and much of it is due to the Canadian flow through scheme. 43% of global mining exploration is by Canadian Companies, 75% of world mining companies are based in Canada and since the introduction of the Canadian flow through scheme Canada's percent of world production is up from 12% to 16%.

<http://www.international.gc.ca/trade-agreements-accords-commerciaux/topics-domaines/other-autre/csr-strat-rse.aspx>

The facts don't lie and Australia must take action or we will be left behind by other countries with better tax regimes, exploration incentives and/or cheap labour. We must do something to offset the ten negative points listed earlier.

The options for targeting junior mineral explorers are simple. The EDI will bring money back to Australian listed junior resource companies.

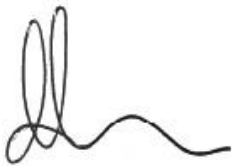
All investors should be able to receive exploration credits and it should not be limited to retail clients of means tested.

Eligible expenditure' should be defined as ONLY expenditure in Australia and be limited to actual drilling regardless if it is for proving up a resource or exploration drilling. It should also include remote sensing, soil sampling, interpretation, metallurgical work, assaying and sampling work. It should not include director salaries and admin expenses as too many companies have been "mining money" i.e. paying themselves a wage with shareholder money and NOT putting the money into exploration. These companies should be reward for taking risks and exploring in Australia.

CPS don't think the word Greenfields should be used. Greenfields means that there has been NO drilling or exploration on that area at any time. Brownfield is when some exploration or drilling has gone on but as yet it has not been proven up to a reserve or resource or any level of prospectively. Both these definitions should be removed in favour of any work that complies with the above paragraph of "eligible exploration".

Currently the option is to cap the cost of the scheme. The numbers are simple. If 600 companies have eligible expenditure of just \$1m p.a. then it will need \$600 million, given that it should be capped at \$500m and not the suggested \$100m. It should be limited to \$3m to \$4m per company however as if not a handful of companies could take up the bulk of the cap.

The exploration credit system should work much as the current dividend imputation system works. For simplicity the share must be held for the full financial year in question. The company would report in its financial accounts its EDI expenditure and that percentage should be passed back to the shareholder. For example if a shareholder has 2% of a company that has for that has spent \$4m in eligible expenditure then the shareholder should receive a credit of



Tony Cunningham

Managing Director

CPS Capital Group Pty Ltd 2 April 2014.

**STOCKBROKING PORTFOLIO MANAGEMENT CORPORATE ADVICE CAPITAL RAISING**

Level 45 108 St Georges Terrace Perth WA 6000 ph: (08) 9223 2222

Appendix I

Attached spreadsheet.

## Appendix II

There is the S&P/ASX 300 Metals and Mining Index (XMM) which is based on the S&P/ASX 300 index and comprises companies that are classified as being in the Metals and Mining industry. These are mining companies in the top 300 companies in Australia. Clearly this index does not represent explorer companies. The other index is the S&P/ASX 200 Resources (XJR) consists of companies from the S&P/ASX 200 index where the company is classified as belonging to the Energy sector or the Metals & Mining industry. Again these are the top 200 resource companies in Australia so again not a good representation.

Appendix III

Not-for-Profit and Industry Tax Concessions Unit, Small Business Tax Division - The Treasury

Langton Crescent

PARKES ACT 2600

Enquiries: Antony Pietsch (Treasury) or Joshua Reakes (Department of Industry)

Phone: 02 6263 3674 (Treasury) or 02 6243 7051 (Department of Industry)