Observations on the History of the Blackwater Gold Mine

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Brian Hill's revisiting of the history of the formation of Blackwater Mines, Ltd raises several interesting questions about the ownership, sale and valuation of mining properties.[1] Hill provides the following details about the three transfers of the property that occurred between its location in November 1905 and the formation of Blackwater as the operating company in December 1906, together with an estimate of its value at each stage:

a) From the original group of four prospectors to an individual investor, Kingswell:
Cost: £16 plus 'desultory' development.
Sale: £2,000 Valuation: uncertain but much higher.

b) From Kingswell to a British group (Consolidated Gold Fields of New Zealand, Ltd and Progress Mines of New Zealand, Ltd):
Cost: £2,000 plus 'not inconsiderable' development work.
Sale: £30,000 Valuation: £50,000 to £96,000.

c) From the CGFNZ group to Blackwater:
Cost: £30,000 plus development for total of less than £50,000.
Sale: 200,000 vendor shares at £1 Valuation: £115,000.[2]

The conventional history has focussed on the first two stages, and Hill revises it in the following way. He agrees that the prospectors sold their property for less than it was worth, but points out that they did so quite voluntarily on the basis of their own assessment of the comparative cost and risk of further development. The obvious gap between the valuation of the property following Kingswell's development work and the price he received allows Hill to refute the claim that the mine was overvalued at this stage. Hill then extends this history to consider the hitherto neglected third stage, to which he applies the same logic. The gap between the cost of less than £50,000 and the consideration of £200,000 in vendors' shares is dubbed 'a quick profit of more than £150,000' and the gap between the valuation and the consideration is treated as 'so egregious that it constrained Blackwater Mines Ltd's ability to service its capital with an adequate rate of dividends....' This set of conclusions requires further attention.

Blackwater was formed with a total nominal issued capital of £250,000. £200,000 represented the vendors' shares and shareholders in the CGFNZ group were invited to subscribe the remaining £50,000 in cash. Although the transfer of the property to Blackwater took the same legal form as that of the earlier ones, it was different in two fundamental respects. The vendors took not cash, but shares which meant they were entitled to 80 per cent of the dividend stream over the whole life of the mine. There was, therefore, no quick profit of any amount.

The second difference is that the ultimate beneficiaries of both the vendor and the cash shares were, at least in principle, identical. The shareholders were entitled to two streams of dividends, those paid directly by Blackwater, and those paid by the vendor companies that either transferred the dividends from Blackwater or from profits from their reinvestment in other ventures. Overvaluation of the property would simply reduce the former stream and increase the second, but these distortions should simply cancel each other out. The extent to which this happened, together with the constraints set by overvaluation on dividend policy is best considered against the financial history of both Blackwater and the CGFNZ group.

The group was structured in the following way. CGFNZ owned 61 per cent of the issued capital of Progress, and 50 per cent of Blackwater. Progress held 40 per cent of Blackwater, with the remaining 10 per cent in the hands of the shareholders in both companies in the group.[3] While both CGFNZ and Progress had other properties, none were successful and Blackwater provided their only source of profits. Two sets of streams of dividends can therefore be traced, those declared by Blackwater and those declared by the CGFNZ group.

For the first three years in which Blackwater started paying dividends, 1909 to 1911, the amounts to which CGFNZ and Progress were entitled were mainly transferred to their shareholders. Over the following 19 years, two problems emerged. Blackwater was only able to declare dividends on seven occasions, and none of the amounts received by the group were transferred.

The year 1930 marked a critical point in the history of both the CGFNZ group and of Blackwater: Progress declared bankruptcy and CGFNZ reduced its issued capital by marking down the nominal value of its £ shares to 4 shillings. With the devaluation of the New Zealand pound against sterling, and the revaluation of gold,[4] Blackwater was again in a position to pay dividends, which it did consistently between 1931 and 1944. The reduction in capital also placed CGFNZ in a position to pay dividends and most of the amounts received from Blackwater were transferred. From 1945 the rise in production costs meant consistent losses and in 1951

Blackwater was forced to declare bankruptcy. CGFNZ naturally followed.

The following table summarises the dividend history:

Table 1: *Distribution of Dividends from Blackwater Mines, Ltd, 1906-1951*								
	Blackwater			Blackwater		CGFNZ	Total	
	Average Dividend		total paid	to		to	to	Ind Shldr
	declared	for period		Ind Shldr	CGFNZ	Ind Shldr	Ind Shldr	% Blckwtr
1906-11	11.7%	5.8%	88	8	80	55	63	72%
1912-30	6.1%	2.4%	106	10	96	0	10	9%
1931-44	8.8%	8.2%	287	27	152	141	168	59%
1945-51								
1906-51	8.4%	4.2%	480	45	327	196	241	50%

Source: *Mining Year Book, 1932, 1946.* Absolute figures are rounded to nearest £000

The overall figure of 4.2 per cent needs to be discounted to take into account the uneven time interval over which the dividends were received and Hill calculates an effective annual rate of 2.9 per cent. He then concludes that 'if allowance is made for the opportunity cost of money, Blackwater Mines, Ltd was not a lucrative investment for the shareholders who had subscribed the cash'. The low rate of dividends is then considered the result of the original overcapitalisation of the company.

Two questions arise: did overcapitalisation set constraints on the dividend policy of Blackwater; to what extent were the modest returns on the cash shares compensated by higher returns on the vendor shares? The above table suggests that the answer to the first of these is negative. When Blackwater paid dividends they were quite respectable in nominal terms; the problem was that they were not paid frequently enough. The periods without a consistent dividend stream correspond to ones where profits were being squeezed by increasing unit costs and declining unit income.[5] That should be sufficient to explain the variation observed above.[6]

Addressing the second question requires putting the position of the shareholder in a comparative perspective. There are at least four different ways in which the shareholders in the CGFNZ group could look at the return on the investment in Blackwater: A) on the cash shares in the overvalued company; B) on the cash shares in a fairly valued company; C) on the total cash investment for both the property and the operating capital as received by both individual and the corporate shareholder; D) on same investment received by individual shareholders. Analysis of returns on mining investment best proceeds on the basis of calculations of annualised internal rates of return.[7] The following table computes them both for Blackwater's entire life and for its first 24 years.

Table 2: *Annual Returns to Investments in Blackwater Mines, Ltd*				
	A	B	C	D
	Blackwater Cash Shares		£100,000 investment	
	Actual	Fair	Total	Ind Shldr
1906-30	-1.2%	3.2%	10.1%	2.3%
1906-51	3.5%	6.5%	11.6%	6.4%

Source: see Table 1.

The first observation is that Blackwater was not a particularly profitable mine. Had it been fairly valued, the dividends would have generated a respectable, though hardly lucrative, return on all shares of 6.5 per cent. However, that was a result of the revaluation of gold and the New Zealand pound in the 1930s, since for the first period the return was only 3.2 per cent. The much lower returns, at 3.5 per cent and -1.2 per cent for the cash investment in the actual company reflect the distortion produced by overcapitalisation.

As they received their dividend cheques from Blackwater, the shareholders may well have grumbled about the actual low return. However, had they considered the fate of the total amount of the actual cash they had, directly or indirectly, invested in the company, they would have adopted a very different position. The 11.6 per cent return can properly be considered lucrative, and the fact that it is much higher than the 6.5 per cent return on Blackwater simply reflects the unearned increase in the value of the property as a result of the terms on which it was acquired by the CGFNZ group from Maxwell. That the return of 6.4 per cent actually enjoyed by the individual shareholders was much lower than this was simply a consequence of the failure of the Directors of CGFNZ and Progress to find a profitable use for the funds that they retained.

The financial history of the CGFNZ group reveals several problems of which the overcapitalisation of Blackwater was the least important. Had the shares been fairly valued, the ultimate shareholders would have received 52 per cent rather than 50 per cent of the income produced from their original investment in the property. The loss of the remainder, at least £239,000,[8] raises a series of questions: where was it invested?; why was it unsuccessful?; were such investment decisions made with the full support of the ultimate shareholders?; were they happy with the modest returns on their actual investment because of the illusory prospect of even greater wealth? Are there any sources that would offer some answers?

Endnotes

[1] Brian R. Hill, 'A Reinterpretation of the History of the Acquisition of the Blackwater Gold Mine', *Journal of Australasian Mining History,* vol. 4, September 2006, pp. 156-65.
[2] This valuation is based on the subsequent cash flow of the mine, rather than on an estimate of the value of the mineral contents at the point of transfer. If it does not take into account income derived from subsequent acquisitions, it is probably on the high side. That would strengthen the argument Hill makes.
[3] Without access to the shareholders' lists, this analysis is inevitably tentative. It is based on the *Mining Year Book, 1930.*
[4] A combination of these two factors almost doubled the local price of gold between 1929 and 1935.
[5] The level of profitability dropped sharply. In 1918 each ton crushed generated an income of 38s 8d with working costs of 24s 4d; in 1929, income had declined to 31s 2d and costs had risen to 27s 6d. See, *Times*, 7 July 1919; *Mining Year Book, 1932*.
[6] On those occasions where the level of the nominal issued capital does set constraints on dividend policy, they can be overcome by writing down the nominal value of each share.
[7] Relying on dividends to analyse the financial performance of mining companies is misleading since they conflate return on capital with a return of capital. There are several ways in which IRRs can be computed, and the method adopted here traces the history of the initial investment through to a point at which it could be realised for cash. In 1930 the stock market valued a £ share at 2s 2d; in 1951 it was worthless. Dividends are taken from the *Mining Year Book*, and differ slightly from those presented by Hill. For a fuller discussion and use of IRRs, see S. Herbert Frankel, *Investment and the Return to Equity Capital in the South African Gold Mining Industry, 1887-1965,* Blackwell*,* Oxford, 1967.
[8] This amount should be increased by the value of the vendor shares transferred from Progress to CGFNZ when the company was liquidated. CFGNZ was its largest creditor. It is likely that these shares were sold into the buoyant market in the 1930s.