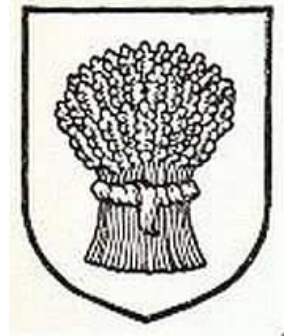


Sunday, September 9, 2018



# HALLGARTEN & COMPANY

Portfolio Strategy

Editor: Christopher Ecclestone  
[ceccestone@hallgartenco.com](mailto:ceccestone@hallgartenco.com)

## Model Mining Portfolio: China's self-defeating "weaponisation" of metals

Performance Review – August 2018

# Model Mining Portfolio

## China's self-defeating "weaponisation" of metals

- + **Base metals prices seem to have bottomed for now**
- + **Gold and silver are in a holding pattern**
- + **Overbid in the Nevsun tussle shows that competitive bidding is back**
- + **The Trump trade measures are starting to have an effect upon thinking on future sources of metals like Rare Earths**
- ✗ **The Chinese have been accused of "weaponising" their stockpile of Copper and dumping product on the metals market to prove a point in the "trade war"**
- ✗ **Tungsten prices taking a beating. Chinese machinations again?**
- ✗ **Lithium stocks remains in the doghouse with falling prices and capital raising crimping project builds and thus disproving the uninformed Wall Street projections of excess capacity**

### Going Ballistic?

It was interesting to see that a London equities analyst put out a Morning Note ascribing the fall in the price of red metal to China and its "weaponisation of Copper". While we have argued for years that China was building a stockpile post-2008 so that it could control and bracket the price of the metal we had never thought of such a nifty and accurate explanation of what the Chinese had done. Indeed we can now take the concept and apply it retrospectively to Rare Earths where undoubtedly the Chinese "weaponised" that group of metals in 2011 and in the process of blowing up the TSX wannabes in the REE space they actually managed to damage themselves by continuing the ongoing giveaway of REEs at sub-economic levels as a means of maintaining that market under its control.

The latest pushing of the button and setting off the "copper bomb" owes more to Dr Strangelove than to a grand strategy to maintain control. What do we have here? Seemingly a fit of pique that the US has imposed tariffs on trade with China. So what does China do? Destroy the mark-to-market value of its own holdings of Copper (not that it marks anything to market if it can get away with it). To what effect? Well, it puts an extended dampener on development and exploration in the Copper space ultimately meaning higher prices down the line for the world's largest consumer of Copper... China. Nice own goal there.

How does this effect the US which does not export Copper to China or import China from Copper? Makes it cheaper for US manufacturers. Once again, nice one guys!

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Lesson in all this? One thing is to weaponise a metal and another thing is to then strap on said weapon and blow oneself up. Not that bright...

### **Portfolio Changes**

There was only one portfolio change during August:

- Closed our Long position in Abitibi Royalties. Sold 11,000 shares in RZZ.v at CAD\$9.95 per share on the 29<sup>th</sup> of August

### **The Portfolio Move**

Things just got worse in the markets during August sending the Model Mining Portfolio down to \$4.543mn from the \$4.856mn at the end of July. Cash was up from \$1.438mn to \$1.517mn due to the Abitibi sale.

In two developments we have seen the pathetic bid for Nevsun of the Lundin/Euro Sun consortium overtaken firstly by a mystery bid and then by a barnstorming offer from Zijin Mining from China that left all other offers in the shade and prompted management to recommend it. Normally we are not a fan of Chinese takeovers but frankly any bid that keeps the Bharti interests out of the picture is welcome. Lundin should be more careful of the company it keeps in the future.

Secondly our wildest hopes for our Short on Bacanora have been more than met with the collapsing stock price zooming past our target price to cover the position. Dare we hope it will go even lower? Who out there wishes to catch a falling dog?

### **Cobalt27 – Curiouser and Curiouser**

On the 30<sup>th</sup> of August the Financial Times ran a story stating that Cobalt27, had reported that 76 tonnes of its Cobalt stash had been stolen from a warehouse in Rotterdam last month. The theft from the Vollers warehouse would be worth around \$4.9m at current cobalt prices. Strangely though Cobalt27 made no announcement of this theft. To put it in perspective the amount stolen is larger than the market caps of a few of the junior Cobalt players in the public markets. Not worthy of a news release? However to the FT, it commented that “All cobalt was fully insured for fair market value at the time of theft”. Vollers did not immediately reply to an email the FT sent them seeking comment on the theft.

“A total of 112 tonnes of cobalt were taken during the theft in early July, from Cobalt 27 and others” according to Metal Bulletin.

Cobalt 27 has (had?) a stockpile of 2,982 tonnes of cobalt in warehouses in Baltimore, Rotterdam and Antwerp, worth \$265m, according to the FT.

This whole matter arouses various questions. The TSX, as we know, is slack but really it should have demanded an explanation of this from the company. The company would definitely have been queried if

it was ASX-listed.

Secondly, the amount stolen was obviously more than one truckload. Arguably a small fleet of trucks would have been needed to move 112 tonnes.

Next, where would this go? It could scarcely be flogged off down a dark alleyway by a guy in a grubby raincoat. Seeing that even the LME Cobalt contract trades in teacup-sized quantities (well, almost) how does one dispose of such a quantity? It's not like 112 tonnes of Cobalt can just be slipped into the regular flow of metals through Rotterdam. This quantity would be similar to what some of the largest users in Europe might consume in a few months if not a year. These are also not the type of companies to buy undocumented lots flogged by dubious characters.

Then there is the issue of Conflict Metals. If we presumed that this fleet of trucks made it across the Russian border then the product was blended with some other material over there before being despatched to China (to end up in Apple products or the wonderful EV battery supply chain) then how does it pass muster as NOT being from a Conflict source? Surely you aren't suggesting that the whole Conflict Metals certification process is only honoured in the breach??!!

The whole affair is very strange and we could not help thinking of that other weird occurrence back in the mists of time when a geologist fell out of a helicopter. That the stored metal was insured is no comfort to us at all if there is more than meets the eye here.

### **Parting Shot**

In recent times we have developed the theory of the phases of mining booms/boomlets. The thoughts have evolved by looking at some of the sub-sectors we have been involved with in the specialty metals space. In all three cases the metals concerned were generally regarded as yawnable before their rise to prominence, indeed in the case of Rare Earths, virtually no-one except chemical engineers had heard of them before their emergence, while the average investor associated graphite with pencils and Lithium with drugs for depressives.

So we have had booms in all these metals since 2008. To discriminate between the different iterations of these booms/boomlets we use to 1.0 and 2.0 terminology. So we had:

- Lithium 1.0 in 2009-10
- Rare Earths 1.0 in 2010-2011
- Graphite 1.0 in 2012-2013
- Lithium 2.0 in 2016-18

The sequencing is worthy of examination. Lithium 1.0 produced maybe 30 players though some say as high as 50. It was cut short by the Rare Earth boom that shifted all the focus to those metals and left

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Lithium gasping for air. Rare Earths was the mother of all booms with so much capital being squandered and destroyed for so little actual eventual production. Somewhere between 200 and 300 wannabes generated only two actual producers, one of which promptly went bankrupt.

Then came the generalized mining slump from 2011 to early 2016 in which the only bright spot was Graphite's boomlet which produced maybe 20-30 players.

Lithium was first to reappear out of the Stygian gloom with a roaring boom that showed little recollection amongst mining investors of the excesses of the REE boom. While the REE boom had been powered by (excuse the pun) green energy, the Lithium 2.0 rode on the back of EVs alone. Indeed it was partly powered by thermal energy with hot air from Elon Musk driving the boom to new heights.

As always Vancouver knows what to do with too much of a good thing and kills the goose that laid the Golden Egg. Every old shell in creation was rallied to the cause and between 150 and 200 Lithium "plays" were invented, not to mention the small hard-core of players from the first go-around that had survived (e.g. Neometals, Orocobre, Galaxy, Nemaska). Too many players with too little of consequence resulted in indigestion. To this was added the amateurish and laughable contributions of Wall Street (e.g. Lithium is the new petroleum) and another analyst detailed off to "initiate the sector" who knew nothing better than to make apocalyptic prognostications on demand out to 2025. Those ramblings put the skids under what was already a delicately overblown situation and, hey presto, it blew up.

Operating on the theory that nothing exceeds like excess, Vancouver managed to run another horse in the EV Stakes and thus was the Cobalt boom born. Not a metal that was totally unknown, having enjoyed a day in the sun pre-2008, it also spawned a swarm of wannabes that flowered and wilted rather rapidly as the souring Lithium picture took the shine off the lesser species in the Cobalt ecosystem. Notably one stock managed to glean as much capital raised as all the others put together producing a strong sense of *déjà vu* back to the times of Rare Earths 1.0 and the ascendancy of the ill-fated Molycorp.

We feel that there is life in the old dogs yet. Lithium 2.1 should fire up shortly with most of the wannabes being unable to garner traction in the next go-around. Graphite does not have much of a prospect of a boom so fortunately for the players in that space there will be no influx of carpetbagging promoters. Cobalt should also have a 1.1 moment but it does not help that the largest play has become a butt of jokes rather than a subject of admiration.

Then there is the Rare Earths space. The 2.0 moment is awaited here and we believe it will happen. Exact timing is unknown but it's interesting that Northern Minerals and Rainbow Rain Earths are being added to the ranks of producers during 2018 and a hardy band of (small) survivors from the first go-around are husbanding their projects in the hope that the sun will shine on them again. It shall, but we doubt that a frenzy will ensue.

There endeth the lesson....

**Mining Model Portfolio as at: 3-Sep-18**

Security	Initiated	Currency	Price Avg.	Current	Portfolio Weighting	Increase in Value	Target	
<b>Long Equities</b>								
<b>Various Large/Mid-Cap</b>	Teck Resources (TECK.B)	5/29/2009	CAD	22.46	29.41	10.10%	30.90%	\$38.00
	NevSun (NSU)	3/23/2012	CAD	3.45	4.94	6.50%	43.20%	\$5.00
	Sherritt International (S.to)	7/11/2013	CAD	1.78	0.83	3.30%	-53.40%	\$2.50
	Metals X (MLX.ax)	29/5/2014	AUD	0.98	0.52	1.80%	-46.80%	\$1.00
<b>Trading House</b>	Noble Group (CGP.SG)	15/11/2017	SGD	0.20	0.13	2.30%	-34.70%	\$0.30
<b>Uranium</b>	Uranium Participation Corp (U.to)	10/20/2010	CAD	7.01	4.73	3.10%	-32.50%	\$6.00
	GoviEx (GXU.v)	6/29/2015	CAD	0.08	0.21	6.70%	155.50%	\$0.50
<b>Zinc/Lead Plays</b>	Zinc ETF (Zinc.L)	1/15/2010	USD	7.04	7.22	2.50%	2.60%	\$11.00
	Canadian Zinc (CZN.to)	12/9/2011	CAD	0.82	0.12	0.40%	-85.40%	\$0.70
	Ascendant Resources (ASND.v)	10/31/2016	CAD	0.49	1.00	7.50%	104.50%	\$1.70
	Telson Mining (TSN.V)	3/19/2018	CAD	0.79	0.44	3.90%	-44.30%	\$2.00
	Southern Silver Exploration (SSV.v)	8/25/2016	CAD	0.19	0.49	3.20%	155.30%	\$0.94
<b>Gold Producers</b>	Para Resources (PBR.v)	2/17/2017	CAD	0.23	0.18	2.40%	-21.70%	\$0.58
	Westgold (WGX.ax)	12/6/2016	AUD	2.01	1.36	3.20%	-32.30%	\$2.40
<b>Copper Producer</b>	Coro Mining (COP.to)	2/23/2015	CAD	0.03	0.08	2.10%	166.70%	\$0.30
	RNC Minerals (RNX.to)	11/17/2016	CAD	0.33	0.10	0.80%	-69.70%	\$0.60
<b>Coking Coal</b>	Colonial Coal (CAD.v)	6/4/2018	CAD	0.35	0.28	3.00%	-20.00%	\$1.10
<b>Beryllium</b>	IBC Advanced Alloys (IB.v)	4/29/2016	CAD	0.30	0.32	0.80%	6.70%	\$1.40
<b>Driller</b>	Cabo Drilling (CBE.v)	9/28/2016	CAD	0.03	0.01	0.50%	-60.00%	\$0.08
<b>Tungsten Producer</b>	Almonty Industries (All.v)	7/31/2015	CAD	0.36	0.81	10.70%	123.50%	\$1.00
<b>Copper Explorer</b>	Asiamet Resources (ARS.v)	4/28/2016	CAD	0.05	0.10	3.90%	96.40%	\$0.12
	Panoro Minerals (PML.v)	1/22/2018	CAD	0.25	0.37	2.90%	46.00%	\$0.65
	Western Copper & Gold (WRN.to)	4/25/2017	CAD	1.57	0.87	2.30%	-44.60%	\$2.74
<b>Lithium</b>	Neometals (NMT.ax)	7/31/2014	AUD	0.04	0.29	3.60%	683.80%	\$0.45
	Lithium Power Intl (LPI.ax)	10/25/2017	AUD	0.44	0.31	2.30%	-29.50%	\$1.38
<b>Scandium Explorer</b>	Scandium International (SCY.to)	8/23/2016	CAD	0.14	0.19	3.00%	35.70%	\$1.00
<b>Gold Explorer</b>	Banyan Gold (BYN.v)	11/14/2017	CAD	0.07	0.06	2.10%	-14.30%	\$0.25
<b>Graphite Developer</b>	Talga Resources (TLG.ax)	8/25/2016	AUD	0.27	0.56	3.50%	111.30%	\$0.90
<b>REE Explorer</b>	Northern Minerals (NTU.ax)	6/9/2011	AUD	0.23	0.09	1.50%	-61.60%	\$0.28
	NET CASH					\$ 1,517,859		
<b>Short Equities</b>					<b>Weighting</b>			
	Bacanora (BCN.L)	12/4/2015	GBP	0.825	0.463	24.70%	43.90%	£0.60
	Lithium Americas (LAC.to)	10/25/2017	CAD	10.1	6.20	46.10%	38.60%	\$5.00
	Galane Gold (GG.v)	4/28/2016	CAD	0.06	0.05	29.20%	16.70%	\$0.03

Current Cash Position	1,517,859
Current Liability on Shorts Not Covered	143,821
<b>Net Cash</b>	<b>1,661,680</b>
Current Value of Bonds	0
Current Value of Long Equities	2,881,402
<b>TOTAL VALUE OF PORTFOLIO</b>	<b>4,543,082</b>

## Important disclosures

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