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HALLGARTEN & COMPANY

Portfolio Strategy

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Model Mining Portfolio:

Conflicting Views

Performance Review – November 2016

Model Mining Portfolio

Conflicting Views

- + Inflation fears and loose monetary policies are ultimately good for gold
- + Zinc soared through the $1.30 mark before pulling back
- + Copper made a strong showing during the month
- + Glencore confirmed its return to financial health with a dividend announcement after substantially reducing its debt burden
- + Commodity currencies have largely remained stable against the US, thus maintaining their current healthy margins for miners
- + Palladium challenged recent highs despite an outflow of metal from ETFs, which was an intriguing development
- × Interest rates look likely to rise affecting those players that use credit to finance holdings/stockpiles
- × Gold tanked badly and has been unable to regain its mojo
- × Precious metal financings continue apace which is starving other (healthier and more prospective) parts of the mining space of financing
- × Moves by oil producers to cut supplies appear serious which potentially means higher input costs for miners

Implications for Conflict Minerals of the Demise of Dodd-Frank

The surprise ascendancy of Donald Trump has brought with it a slew of pronouncements made in the preceding months of campaigning that (maybe) give a sign of the shape of things to come. One of the pieces of legislation singled out for change or repeal was the Dodd-Frank Act of 2010. Besides some stultifying rules that made proprietary trading difficult in some commodities, the Act was of less import to the mining community than Sarbanes- Oxley for example, except in one respect, and that was on the question of conflict minerals.

The four most commonly mined conflict minerals (known as 3TGs, from their initials) are cassiterite (for tin), wolframite (for tungsten), coltan (for tantalum), and gold ore, which are extracted from the eastern Congo, and passed through a variety of intermediaries before being purchased by, amongst others, multinational electronics companies.

Everything but the Kitchen Sink

The Dodd Frank Wall Street Reform and Consumer Protection Act was born out of the 2008 financial crisis and the excesses that preceded it and conflict minerals had nothing to do with the financial debacle but in the time-honoured tradition of the US cobbling together omnibus bills that include everything but the kitchen sink and serve as a mass transport for the pet projects of any legislator who has enough pull (or blocking) power to get their hobby horse grafted on.

In the final wash, Dodd-Frank, was passed by the US Congress in July 2010, and included a provision – section 1502 – aimed at stopping the national army and rebel groups in the DRC from illegally using profits from the minerals trade to fund their fight. Section 1502 is a disclosure requirement that calls on companies to determine whether their products contain conflict minerals – by carrying out supply chain due diligence – and to report this to the SEC.

The mutterings from the incoming Administration indicate that all or parts of the Dodd-Frank structure may be repealed and send to the Great Paper Shredder of history. The intriguing thing is whether the conflict minerals aspects will "end up on the cutting room floor".

The Paradoxes

Zeroing in on just the DRC is to take a mere snapshot in time of one global hotspot. Indeed (though unlikely) in five years from now the DRC may be a haven of peace, and crisis may have moved off somewhere else. Conflicts come and conflicts go and the minerals involved in them change. We have read that Niobium was considered for inclusion in the original minerals list. Bizarrely this is a metal that largely comes from Brazil and Canada and which we have never heard of a DRC connection. More paradoxical is that the DRC is renowned for its copper/cobalt deposits and thus the metals are mined together and yet the US congress members somehow felt it was important to track the cobalt but not the copper. This smacks of ignorance at best (how can you have conflict cobalt and non-conflict copper from the same open-pit) and hypocrisy at worst (going for cobalt because its sexy.. and because China is the principal buyer of Congolese cobalt). And to what extent is this mere expedience, as adding copper to the list would create an administrative nightmare. Were they then really interested in conflict minerals or making a token gesture?

Beyond the DRC there are numerous conflicts around the world and minerals appearing out of those conflict areas. We could target two areas that are obvious and egregious but which Dodd-Frank does nothing to remediate.

Firstly we have the not so clandestine oil sourced out of the ISIS controlled parts of Iraq and Syria. It was very well known which country this was exiting the war zone through. Moreover it was very strongly suspected that the son of the president of this country was the chief intermediator with streams of tankers lined up at the border of his father's domain. The US essentially turned a blind eye to this and let the brutal regime fund itself through this trade. We might also mention North Korean tankers loading up with oil from ISIS-dominated areas of Libya.

Secondly, we have the metal closest to our hearts, Antimony. We have written in the past that potentially 14,000 tonnes per annum (or a bit under 10% of annual global production) comes out of rebel areas in the far north of Burma, where a bloody war of attrition between tribes, warlords and the army of the central government has been waged. In recent years China has played a shell game with Antimony and production statistics while taking an increasing flow of this "Conflict Antimony" and passing it off as its own to create the illusion that it still dominates production. Originally this was just artisanal mining and some clandestine smuggling. Last month however we heard that a number of the shuttered highly polluting Chinese roasters had been dismantled and moved across the border into Burma adding environmental air pollution to the degradation caused by the Antimony *garimpeiros*. Truly a nightmare overlaid with a civil war and Chinese meddling. If this isn't a case for a conflict minerals designation then we do not know what is!

There is quite clearly a galloping double standard at work here. Moreover the Dodd-Frank designation of the DRC and its narrow group of metals is overly focused and totally non-dynamic.

Some Solutions

A mechanism is obviously lacking for adding (or subtracting metals). In theory though all metals should be on the list and it is the conflict zones that should change. Thus if Yemen produces zinc from a conflict zone then "Yemenese Zinc" should be regarded as a conflict mineral until this is deemed to no longer be a conflict zone. The mistake of the current structure is targeting the metal rather than the conflict!

With the degree of cluelessness in Washington as to what minerals come from where (e.g. not knowing the copper/cobalt mineralogical combination in the DRC) the task of decreeing what and where would probably better reside with an international commission rather than some State Department factotum. Essentially, the task of verifying the audit trail on a specific input to an electronic device is passed to a corporation/manufacturer and this is far from ideal and places a big time and skills burden upon smaller component makers.

Biting the Bullet

It is said that a camel is a horse designed by a committee. Dodd-Frank is somewhat similar having been born out of the addled collective mind of the US Congress. Therefore it is no surprise that conflict minerals should have been thrown into the witches brew at the last minute. It's all well and good that this grievous problem should have been brought to attention but it was very much a case of too little too late and too narrowly focused, both geographically and in terms of the minerals that are deemed to be of a conflict nature.

Dodd-Frank was the type of legislation you get when you really need the reinstatement of Glass-Steagall but don't want to offend your friends on Wall Street. Hillary Clinton has paid the price of pandering to this crowd (and it was her husband who dismantled Glass-Steagall through some subtle legerdemain) and now we have Trump attacking Dodd-Frank and yet he is not necessarily a friend of Wall Street either. He has railed against big banks (and three at least are in breach of the 10% limit on share of national deposits) so getting rid of Dodd-Frank and reconstituting Glass-Steagall might bring the collateral "benefit" of the demise of the half-cooked semi-ossified Conflict Minerals provisions. This should either be properly constituted, or not constituted at all.

The Portfolio Move

The Model Mining Portfolio was valued on the 5th of December at $4.144mn, up from $4.06mn. Cash holdings declined to $976,000 from $1.12mn due to two purchases.

It should be noted that Metals X has demerged its gold mining activities under the name Westgold (WGX.ax). The new stock entered into both the Russell Global Index and the Russell Developed Index as from the 29th of November 2016. The distribution was one Westgold share for every two Metals X shares held. This grated more than a little upon some US shareholders where the company has done promotion and yet when it comes time to do such a split, it did not get a SEC registration so holders there received a cash payment only (thus triggering capital gains tax liabilities). Really unhelpful.

Additionally the stock will have only a static holding price until the 6th of December. We are using AUD$2.01 as our number for calculation of the Model Portfolio value as a result. We have a $2.40 target price for Westgold. Metals X (which is now a tin and copper producer, with nickel prospects) has a target price of $1.

We would also note that our Short in Bacanora saw its "deal" with Tesla unravel thus justifying our negative stance on this stock.

Portfolio Changes

There were only two portfolio changes during the month. The transactions we undertook were:

- Added a Long position in Komet Resources. Bought 200,000 shares in KMT.v at CAD 47cts per share on November 26th
- Reinstated a Long position in Royal Nickel. Bought 300,000 shares in RNX.to at CAD 33cts per share on November 17th.

The rationales are discussed below.

Komet Resources – a Stealth Mover

In line with the increased flow of companies heading to London those turning up include obviously those seeking financing after the long drought and also companies that have no needs or wants on the money front but which want to increase turnover or to effect a reshaping of their shareholder base.

One such company that we encountered during November was Komet Resources, a Quebec-based gold mining company with a focus on exploration and production at its projects in Burkina Faso. Their goal in coming to London was to diversify the shareholder base particularly towards the more Africa-friendly London crown and then pursue a main-board listing on the London exchange.

Komet, several years ago, acquired a mothballed (yet recently producing) property (the Guiro Mine) and has overhauled the rather shambolic former mining and processing method with the result that it is now seeing a rather steep escalation in net revenues and gold output. It plans to use revenues from this small-scale mining operation to assist with advancing exploration efforts. Around 90% of the property is unexplored and has veins visible at surface; therefore, providing potential for other operations.

Most recently it announced that a Consep Acacia CS250 Intensive Leach Reactor (ILR), which will process concentrates with enhanced efficiency, had been manufactured faster than expected and would be transported to site, by ship and via ground transportation, over November and December 2016. During this period, civil works have been ongoing in order to be ready for installation when the reactor and other equipment arrives. The third Knelson concentrator was also heading to the project site.

A third-party firm with metallurgical expertise is currently working on validating the final process that will include three concentrators, two ball mills and the reactor. Commissioning is planned for 1Q17 and could be accelerated in the early weeks of January if all deliveries are on schedule. The installation is planned to minimize disruption to the current plant operations and minimize the possibilities of production delay with the new equipment.

During 2017, it expects to hit the 150tpd production level with ore grading around 8g/t at which point the company will by producing 12,700opa with an estimated profit (with gold at CAD$1,600) of CAD$11.5mn. Microminers were quite the theme in 2015 and 2016 and so they should be. However this mircominers has a key difference in having Robert Wares, the founder of Osisko as both its largest shareholder and Chairman. Meanwhile the rest of the management team remind us of SEMAFO and thus we are tempted to style this as SEMAFO-Jr.

We have added a Long position to the Model Mining Portfolio at 42cts with a 12-month target price of $1.28.

RNC Redux

We had instituted a Long position in Royal Nickel, a Nickel developer in 2012 when its Dumont property in Ontario (and its team of ex-INCO heavies) struck us as having the potential to be the next big thing in Nickel in Canada. It seems likely that it still holds that title but fatigue with Nickel led us to drop the position in April 2016 at essentially the same price (in CAD) that we had entered it.

Since then company has merged with the producing VMS Ventures (a stock that we had known well a few years ago) and which, overnight, turned RNC into a producer (the Reed copper mine, owned with HudBay and the Beta Hunt, gold-nickel mine) with a diversified portfolio of metals. Reconnecting with the stock recently, we have seen fit to re-establish a position at a price which is 40% lower than where we exited a non-producing story. Such are the foibles of the Canadian market. We now favour this company's strategy again and shall elaborate further in the future. In the meantime we have added a Long position at 33cts with a twelve-month target price of 60cts.

Parting Shot

What a difference a year makes. At the time of last year's LME Week, investors were laying out the corpse of Glencore and there was much ululating on all sides. Then by the time London's Mines & Money had come around things had scarcely got better, Glencore had risen from the slab in the morgue and made a dash for the door but prices of metals and stocks still remained in deeply negative territory.

The mood has definitely taken a turn for the better since the start of this year and it has been apparent in the "zing" in the air at the 2016 versions of the same two events. LME Week is more traders of metals than portfolio investors or listed miners but the mood was cautiously euphoric. The LME Week people also have less interest in precious metals and thus could shrug off the swoon in gold and silver and focus more on the ebullient Zinc and Copper moves as well as stunning moves in less commonly mentioned metals like Manganese, Chrome and Tin.

Despite the gold swoon, Mines & Money was also up significantly on the previous year. This time around the analyst from Hallgarten in attendance could slip out of his false beard, kaftan and Yasser Arafat headscarf and walk around in the guise of a mere investment banker. The mood was significantly stronger and buzzier. Gold and silver companies were not exactly in abundance, but then again neither were Lithium or graphite stocks. It was indeed quite a broad spectrum with iron ore distinctly lacking. It should be remembered that conference attendance by miners is closely linked to their abilities to restock their coffers in recent months and, truth be told, only the gold miners have truly been able to tap into rich veins on Bay Street and its lookalikes. Many of the metals that have risen ferociously, to the delight of the LME crowd, have not seen any sort of market surge or financing flow of much note. Therefore their chasers have not had the wherewithal to get out marketing their virtues.

In a post-conference conversation with one of the event organisers he candidly made the observation that "the numbers in the conference rooms were slightly thinner than in 2015. This was partly due to more people were on the floor doing business". That sounds like a good trend to us. Business after all is what it's all about.

Mining Model Portfolio as at: 5-Dec-16

	Security	Initiated	Currency	Price Avg.	Price Current	Portfolio Weighting	Increase in Value	Target
	Long Equities							
Various Large/Mid-Cap	Capstone Mining (CS.to)	5/29/2009	CAD	2.32	1.02	1.20%	-56.00%	$2.00
	NevSun (NSU)	3/23/2012	CAD	3.45	4.2	5.20%	21.70%	$5.00
	Sherritt International (S.to)	7/11/2013	CAD	1.78	1.35	5.00%	-24.20%	$2.50
	Palladium ETF (PALL)	10/16/2014	USD	72.08	71.22	4.70%	-1.20%	$74.00
	Metals X (MLX.ax)	29/5/2014	AUD	0.98	0.58	1.90%	-40.70%	$1.00
Uranium	Uranium Participation Corp (U.to)	10/20/2010	CAD	7.01	3.66	2.30%	-47.80%	$6.00
	Western Uranium (WUC.cx)	7/5/2016	CAD	2.25	1.27	1.90%	-43.60%	$4.80
	GoviEx (GXU.cx)	6/29/2015	CAD	0.08	0.17	5.00%	106.90%	$0.50
Zinc/Lead Plays	Zinc ETF (Zinc.L)	1/15/2010	USD	7.04	7.95	2.60%	12.90%	£9.00
	Canadian Zinc (CZN.to)	12/9/2011	CAD	0.82	0.26	0.80%	-68.30%	$0.70
	Morumbi Resources (MOC.v)	10/31/2016	CAD	0.22	0.095	2.30%	-56.80%	$0.34
	Nyrstar (NYR:BR)	9/28/2009	Euros	65.1	16.48	11.90%	-74.70%	€ 11.00
	Southern Silver Exploration (SSV.v)	8/25/2016	CAD	0.34	0.485	3.00%	42.60%	$0.94
Gold Producers	NewGold (NGD.to)	5/31/2013	CAD	7.05	4.8	3.50%	-31.90%	$8.00
	Patagonia Gold (PGD.L)	10/2/2013	GBP	3.6	2.25	1.90%	-37.50%	£4.00
	Komet Resources (KMT.v)	11/25/2016	CAD	0.47	0.43	2.10%	-8.50%	$1.28
	Westgold (WGX.ax)	12/6/2016	AUD	2.01	2.01	4.40%	0.00%	$2.40
	Eldorado Gold (EGO)	6/21/2012	USD	9.12	3.85	3.80%	-57.80%	$7.00
	Teranga Gold (TGZ.to)	6/21/2012	CAD	1.57	0.84	2.50%	-46.50%	$1.50
Copper Producer	Coro Mining (COP.to)	2/23/2015	CAD	0.03	0.14	3.40%	366.70%	$0.30
	Royal Nickel (RNX.to)	11/17/2016	CAD	0.33	0.28	2.10%	-15.20%	$0.60
Processor	IBC Advanced Alloys (IB.v)	4/29/2016	CAD	0.3	0.49	1.20%	63.30%	$1.40
Driller	Cabo Drilling (CBE.v)	9/28/2016	CAD	0.025	0.02	1.00%	-20.00%	$0.08
Gold Explorers	Everton Resources (EVR.v)	4/17/2012	CAD	0.08	0.05	1.20%	-33.30%	$0.10
Tungsten Producer	Almonty Industries (AII.v)	7/31/2015	CAD	0.36	0.28	3.40%	-22.70%	$1.00
Copper Explorer	Asiamet Resources (ARS.v)	4/28/2016	CAD	0.05	0.05	1.80%	0.00%	$0.24
Nickel Explorer	Sama Resources (SME.V)	23/2/2015	CAD	0.16	0.1	2.00%	-37.50%	$0.30
Lithium	Neometals (NMT.ax)	7/31/2014	AUD	0.04	0.34	4.10%	818.90%	$0.60
	Galaxy Mining (GXY.ax)	6/28/2016	AUD	0.35	0.44	2.30%	27.30%	$0.70
Scandium Explorer	Scandium International (SCY.to)	8/23/2016	CAD	0.14	0.25	3.70%	78.60%	$1.00
Graphite Producer	Elcora Resources (ERA.v)	29/5/2014	CAD	0.2	0.34	4.20%	70.00%	$0.64
Graphite Developer	Talga Resources (TLG.ax)	8/25/2016	AUD	0.27	0.27	3.30%	1.90%	$0.42
REE Explorer	Northern Minerals (NTU.ax)	6/9/2011	AUD	0.73	0.12	0.40%	-83.60%	$0.28
	NET CASH					**976,740**		
	Short Equities							
						Weighting		
Shorts	Bacanora (BCN.v)	12/4/2015	CAD	1.53	1.22	48.70%	20.30%	$0.80
	Galane Gold (GG.v)	4/28/2016	CAD	0.06	0.07	51.30%	-16.70%	$0.03

Current Cash Position	**976,740**
Current Liability on Shorts Not Covered	**112,932**
Net Cash	**1,089,672**
Current Value of Bonds	**0**
Current Value of Long Equities	**3,054,580**
TOTAL VALUE OF PORTFOLIO	**4,144,253**

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