



HALLGARTEN & COMPANY

Corporate Action Note

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Fortune Minerals (TSX: FT)
Strategy: NEUTRAL

Key Metrics			
Price (CAD)	\$	0.035	
12-Month Target Price (CAD)	\$	0.08	
Upside to Target		129%	
High-low (12 mth)		\$0.02 - \$0.37	
Market Cap (CAD mn)	\$	7.6	
Shares Outstanding (millions)		216.2	
Fully diluted		274.6	
	2014	2015e	2016e
Consensus EPS		n/a	n/a
Hallgarten EPS (est.)		(\$0.08)	(\$0.002)
Actual EPS	(\$0.06)		
P/E	n/a	n/a	n/a

Fortune Minerals

Fortune Favours the Focussed

- + The company is finally rid of its digression into silver mining
- + Restructuring deal has eliminated most of the debt taken on for the ill-fated Revenue Silver mine
- + Focus has now switched back to the much more promising NICO project which should become a leading source for Cobalt and Bismuth
- + The very large Chinese-owned mining contractor Procon is a strategic partner with Fortune
- + As one of the largest potential sources of Cobalt and Bismuth in North America, we regard it as strategically important and governments may also come to that conclusion
- ✗ The elimination of the Revenue mine came at a high price in asset write-offs, concessions in warrants and distraction from the “main game” at NICO
- ✗ Capex at NICO is high at CAD\$589mn and will need a partner in the project or a major offtaker

Transitioning Between Mines

For a while there Fortune Minerals was a strange beast, part producing silver mine and part-cobalt project with one mine in the US and an advanced project in Canada. The hand of fate has intervened and outside forces have acted to rationalize Fortune's portfolio leaving it concentrated on its Canadian asset, the NICO Cobalt-Bismuth-Copper project in the North West Territories. It also has a proposal to build a refinery for NICO's output in Saskatchewan.

In this research note we shall look at the recent traumas that the company has gone through as part of an ill-fated diversification that was supposed to provide a stop-gap revenue source and instead ended up as a major embarrassment and a mighty distraction from the business at hand in moving the NICO project forward.

NICO

In the NICO deposit Fortune stands out as having one of the unique multi-metal deposits that, in prismatic fashion, can be whatever the beholder wishes them to be. The project is located in the Northwest Territories and was discovered by Fortune Minerals in 1996. NICO, as currently planned is a vertically-integrated project that will include mining and concentrating ores at the mine in the Northwest Territories, and then transportation of the metal concentrate to the proposed Saskatchewan Metals Processing Plant for further processing to value-added metal and chemical products. With scarcely any cobalt production in North America, the NICO project will add massively to the production of cobalt chemicals needed to manufacture rechargeable batteries used in electric vehicles, stationary power storage applications, and portable electronics such as smart phones, tablets and laptops. NICO

represents a rather unique metal assemblage, including more than 10% of global bismuth reserves along with copper and gold as by-product credits thereby reducing exposure to cobalt and bismuth price volatility.

Funding Revenue

The focus of this research note though is on the fate of Fortune's optimistically-named Revenue Mine, a silver operation in southwest Colorado. The backstory to this is that Fortune announced in May 2014, the US mine that it was acquiring the Revenue mine, a producing silver mine in the US. The acquisition of this asset was made with the financial support of the Fortune's strategic partner, Procon Resources. At the time Procon exercised its pre-emptive right to purchase up to 7,717,871 shares of Fortune at a price of 40 cents per share for net proceeds of up to CAD\$3.087mn to help finance part of the acquisition. Fortune purchased a 12% participating interest in the mine by paying the vendors US\$2mn and by issuing 32 million shares in Fortune's capital stock. Fortune was later able to move to a 100% interest in the mine by paying the vendors an additional US\$14 million in mid-2014 and by issuing a promissory note to pay up to US\$36.8 million in deferred quarterly installments over 3.5 to 5.75 years determined by revenue targets commencing in August 2015. Fortune also assumed obligations to make two deferred payments totaling US\$ 4.5mn and pay a 2% net smelter return royalty, which was capped at US\$9mn to the former owners of the Revenue Silver Mine.

To complete financing of this purchase (essentially replacing the promissory note), in October 2014, Fortune entered into a Senior Secured Metal Prepay Agreement with LRC-FRSM LLC (Lascaux) which resulted in Fortune receiving total financing of US\$35 million. The first tranche of US\$25 million was received on October 1 2014 and the second tranche of US \$10 million was received on October 16, 2014. It used the funding from the first tranche to repay the US \$4 million General Corporate Facility on October 1, 2014, fund the Revenue Silver Mine acquisition, including amounts owing to the previous owner of the mine, make capital investments to improve the mine operations, and provide working capital to the newly acquired mine.

The Metal Prepay Facility principal was supposed to be repaid from a fixed schedule of metal shipments from the Revenue Mine to Lascaux, plus interest of 9.25% over a five year term. Additional terms include a concentrate payment of \$7.50 per metric ton of each shipment made and an offtake payment equal to \$0.30 for each ounce of silver and \$10 for each ounce of gold, excluding repayment units.

Under the Metal Prepay Facility, the US subsidiary, Fortune Revenue Silver Mines Inc. was required to maintain net working capital and cash in an aggregate of not less than US\$2 million during the term of the facility.

The Metal Prepay Facility was secured by the assets of the Revenue Mine and a corporate guarantee. In late December 2014, Fortune amended the Metal Prepay Facility, which resulted in the company receiving a further US\$7 million. This additional funding was to be repaid with 430,000 Ag-equivalent ounces, within a one-year period, accruing interest at 15%, to be paid in accrued ounces. The debt was to be repaid using a silver equivalent price of US\$16.50 or if lower, the silver market price at the time of the delivery. In addition Lascaux was entitled to a net smelter revenue royalty to be paid to Lascaux commencing January 2016. The NSR percentage ranged from 2% to 4% until the original facility has been repaid and 1% to 2% thereafter for the life of the mine.

Also included in the agreement was a copper payment equal to 25% of any shipment of copper during the repayment period of the Metal Prepay Facility.

Unfortunately this transaction (and its aftermath) shows the perils of *Buy First, Finance Later* thinking amongst junior managements, because the purchaser is already in over their head (in the dire current financing conditions) and thus must accept what appears to be a deal that indeed involved more than the proverbial “pound of flesh”.

Default & Response

In early July, Fortune and Fortune Revenue Silver Mines Inc. received notice from Lascaux that events of default had occurred under the amended and restated senior secured metal prepay agreement. The notice stated that all amounts and deliveries owing under the prepay agreement were immediately due and payable. As RSMI's obligations under the prepay agreement were secured by all of Fortune's assets and guaranteed by the company and certain of its other subsidiaries, which also received notices of default from Lascaux.

Fortune and Lascaux then entered into discussions with respect to a settlement of the company's obligations under the prepay agreement. Discussions were also held with the company's other secured creditors that are parties to an intercreditor agreement with Lascaux. The company reached an understanding with its creditors in early July.

The Debt Restructuring

In the last few weeks Fortune Minerals entered into a restructuring agreement with Lascaux and its other secured creditors to settle its secured debt obligations.

The restructuring agreement with Lascaux and its other secured creditors to settle its secured debt obligations and release the security on Fortune's Canadian assets comprises two stages.

The first stage was completed on July 17, 2015 and consisted of:

- Fortune contributing to the capital of FRSMI all intercompany indebtedness owing by FRSMI to Fortune and transferred all of the shares of FRSMI to Lascaux.
- All obligations of Fortune and its Canadian subsidiaries under the Lascaux short-term facility have been released.
- FRSMI has paid US\$200,000 to Fortune.
- Fortune has agreed to provide certain purchasing, logistics and operations transition services to FRSMI and Lascaux to assist in the operation of the Revenue silver mine until July 31, 2015.

The second stage was completed in the first weeks of August under which Fortune will issue to Lascaux and the other secured creditors:

- Unsecured seven-year term debentures in the principal amount of \$5mn to Lascaux and \$3.75mn to the other secured creditors; the debentures will bear interest at 5% per year

accruing semi-annually and repayable at maturity

- 7.5 million Class A warrants and 21.019 million Class B warrants to Lascaux
- Lascaux will receive up to an additional 8,259,476 million Class B warrants, which will be exercisable if, and to the extent that, at the maturity of its debenture, Lascaux elects to exercise such warrants instead of being paid all or part of the interest due under its debenture
- Five million Class A warrants and 14 million Class B warrants to the other secured creditors
- Each Class A warrant will entitle the holder to purchase one Fortune common share at 15 cents and will expire on the fifth anniversary of the date of issuance
- Each Class B warrant will entitle the holder to purchase one Fortune common share at 25 cents and will expire on the seventh anniversary of the date of issuance; the Class B warrants can only be exercised for the purposes of setting off or financing the repayment of an equivalent amount owing under the debenture held by the warrant holder
- The debentures will be repayable in the event that Nico is sold, directly or indirectly.
- FRSMI paid US\$320,000 to Fortune (down from the previously agreed \$550,000)

As a result all remaining security over Fortune's and its subsidiaries' assets held by Lascaux under the prepay agreement and by the other secured creditors will be discharged.

Out Goes the Coal – Rustling Up Cash

In early May 2015, Fortune announced the completion of an agreement with the British Columbia Government with respect to their coal licenses at the Arctos Project, located in the Klappan area of northwest British Columbia. Fortune and POSCAN, through wholly-owned POSCO Klappan Coal Ltd were partners in the Arctos Anthracite Joint Venture.

The JV sold its interests in 61 contiguous coal licenses in the Klappan, totaling 16,411 hectares, to BC Rail for \$18.3mn. The AAJV partners maintained the exclusive right to purchase back the coal licenses at the same price for a 10-year option period. If both partners do not wish to exercise the repurchase option, each of them may do so individually. Fortune and POSCAN have also entered into an amending agreement to restructure the AAJV and share the proceeds from the sale of the Arctos coal licenses on an equal basis, after purchasing the royalty held by the previous owner of the property for \$308,000. Fortune's share of the proceeds (CAD\$9mn) from this sale were used for working capital and to repay debt.

First Nation problems were at the root of the sale though. Interestingly Fortune is one of the few who have managed to exit a First Nations' dilemma and be paid off to do so.

NICO – Back to Basics

After the value-destructive distraction of the Revenue Mine it will be almost a blessed relief for Fortune to return to its roots.

The NICO deposit contains open pit and underground Proven and Probable Mineral Reserves totalling 33 million tonnes containing 1,085,000 ounces of gold, 82 million pounds of cobalt, 102 million pounds of bismuth, and 27 million pounds of copper. At the planned mill throughput rate of 4,650 tonnes of ore per day, the mineral reserves will sustain operations for nearly 20 years.

More than \$110 million of work has already been conducted for the NICO project to delineate and engineer the deposit and reduce risks from the development, including completion of Front-End Engineering and Design studies by Jacobs Minerals Canada Inc. and other engineering companies, underground test mining, and several pilot plant tests.

Micon's PFS from 2014 had capital costs of CAD\$589mn, a rather chunky number for a specialty metal project in this age of tough financing conditions. It is a great pity therefore that so much time, effort and resources were blown on a rather humdrum silver project.

Key Shareholder Remains Key

Since May 2013, the largest shareholder of Fortune has been the aforementioned Procon Resources. Procon is a full-service mining contracting company headquartered in Vancouver, Canada. It is majority owned by China CAMC Engineering Co., Ltd., a leading provider of international engineering, procurement and construction services based in Beijing, China. Apparently the company still owns around 19% of Fortune. The potential exercise of the warrants by Lascaux would still not appear to topple Procon from the position as largest shareholder.

Risks

The prime risks we can envision at this stage are:

- ✗ Sustained Cobalt or Bismuth weakness
- ✗ Lascaux using its warrants to mount a predatory move
- ✗ Financing problems for the NICO mine build
- ✗ First Nations problems

We shall address these risks in a follow-up note specifically on the NICO project.

Conclusion

If it has fins and lots of very sharp teeth and circles you in the water then you should start swimming, and fast, in an opposite direction. We have seen over and over again in recent years that junior miners think that funds coming bringing promises of easy money (often disguised as streaming or pre-pay deals) is safe as houses, until they lose their house. At least Fortune has managed to rescue value from the Revenue debacle and is left with what looked like its best prospect anyway. This is quite distinct from the fate suffered by the unfortunate shareholders of Maudore Minerals. The only satisfaction from that crisis was that the predator ended up suffering a much larger loss than any of the individual shareholders. The same fate may very well befall Lascaux and well may shareholders someday thank Lascaux for getting them out of an ill-considered silver diversification.

Now Fortune is positioned to focus back on the project from which its attention should never have shifted in the first place. Discussion of the prospects of the very interesting NICO asset shall have to wait for a later date though.

Tuesday, August 18, 2015

At this stage we have Fortune as a “stock to watch” as its cobalt-bismuth project is very unique. However until we hear how the project will either be downsized to shrink the capex or how the existing proposed capex might be funded we shall maintain the stock as a **Neutral** rating with a 12-month target price of 8 cents.



Important disclosures

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