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HALLGARTEN & COMPANY

Portfolio Strategy

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Model Resources Portfolio:
On the Cusp

Performance Review – August 2021

Model Resources Portfolio

On the Cusp

- + **Base metals largely remained static over the last months of the summer**
- + **Gold and silver tended to the upside over the last month, with gold reestablishing itself above $1800**
- + **Met coal continues to move higher despite the confusion sown by uninformed pundits that cannot discriminate between it and thermal coal**
- + **Tungsten continues its belated rally**
- + **Recovery in Western economies being thrown into doubt by Delta variant with some Asian economies with poor vaccination rates now suffering belated 2nd and 3rd waves**
- ✗ **Silver/gold ratio (at 73.85) has slipped to silver's detriment (having been 62.8 in February of this year)**
- ✗ **New listings of mining on TMX-controlled exchanges have been exceptionally poor in 2021**

Seeking Direction

As the markets come out of a summer pause/lull, the tealeaves are being read as to whether the whole global equities markets will take a step back (due to withdrawal or QE and probably higher interest rates) or fire up again to meet the expectations of several months ago that we were in the early throes of a new Commodity Supercycle.

To add further mystery to this conundrum we have some sneaking suspicions that Chairman Xi is plotting a Great Leap Backward as China takes a turn towards a politically orthodox stand not seen since the days of the Gang of Four. A few years back it was taken as a given that China could not engineer a slowdown (or even impose a credit crunch) as this would create violent pushback from the aspirational masses. Xi maybe feels he can now play with fire in reining in the economy (and its excesses) and yet not stir up internal tensions. Indeed he may feel he will lower tensions by a turn towards a "fairer" society.

What this might mean/ for mining remains a mystery.

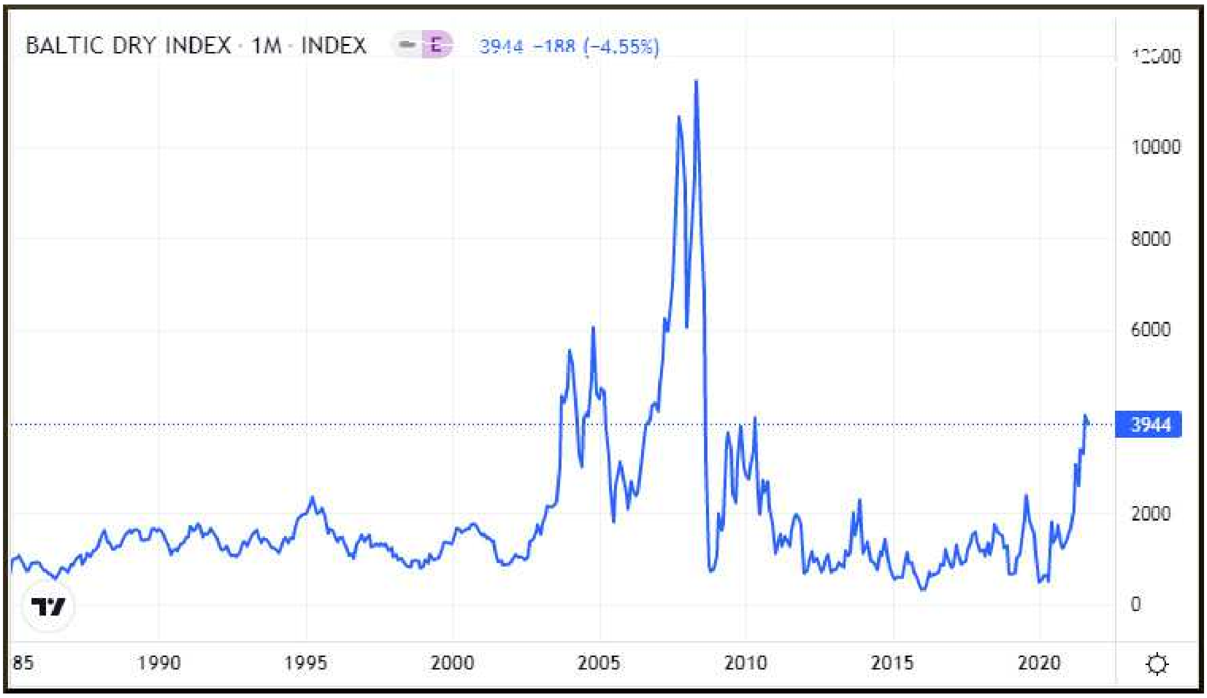
On interest rates, we feel that the only way is up despite much wishful thinking to the contrary. This should not impact demand for minerals despite what purists/alarmists might like to claim. We most definitely do not feel it's a negative for gold. If anything it signals that the decades-long period of inflation-denial is at an end.

Despite these two likely developments, there is no need to head for the lifeboats.

The Rise and Rise of Shipping

Back in January we highlighted the issue of shipping (and the resurgence of shipping rates as an issue for miners) but since then the issue has gained more poignancy as the rates have continued to rise even as the worst of the pandemic dislocation to trade has been left behind us. In short shipping rates are changing the way that trade is conducted and they are starting to impact (and distort) metals prices.

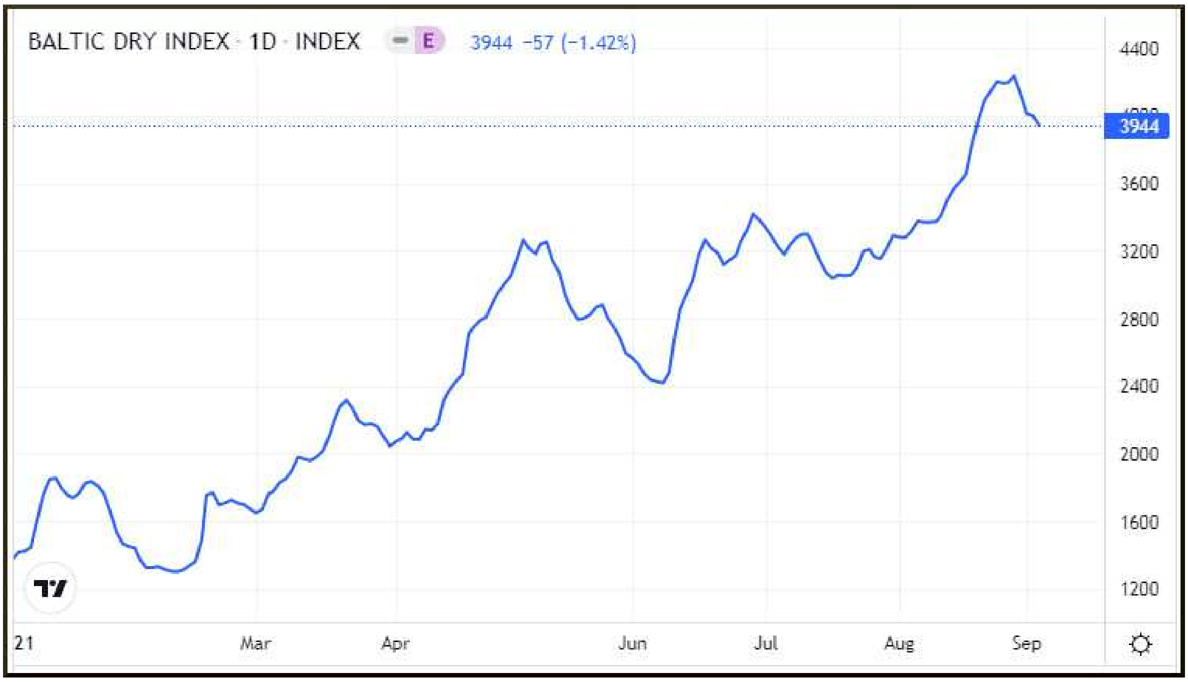
The Baltic Dry Index was largely rangebound between 2012 and 2020 (as shown in the chart on the following page). In the space between September of last year and October the index moved between 1200 to nearly 2200 and then nearly halved to 1100 in mid-November.



Source: Trading Economics

These dramatic movements provided sleepless nights for those in the mineral trades because it is the dry bulk cargo category into which most DSO ores (and others) fall. Some claimed that the pandemic caused first the slump in demand and then the soaring price as reactivated economic activity from mid-

2020 found many unwanted ships suddenly in demand but not positioned where they were really wanted/needed. This created a price crunch and a rush for capacity.



Source: Trading Economics

What caused this crunch… Over and above the pandemic, there was the long-foretold shrinkage of the global shipping fleet due to the IMO 2020 ruling. The IMO estimated that the new limit – of 0.5% sulphur content compared with the previous limit of 3.5%, enforced under the international convention for the prevention of pollution from ships – would cut sulphur oxide emissions from ships by 77%, an annual reduction of about 8.5m tonnes.

Shipping analysts predicted that the difference between Heavy Fuel Oil (HFO) and Low Sulphur Fuel Oil (LSFO) would be in the region of $200 per ton, adding substantially to operating costs. Is it no wonder then operators wanted higher freight rates or were scrapping their most inefficient ships? The high cost of installation of scrubbers to older ships prompted a surprising response, which was that owners decided to run their ships slower to reduce emissions rather than pay for scrubbers.

This combination of factors produced the best period since around the peak of the Commodity Supercycle in 2008 when capacity could not be had for love nor money and the Baltic Dry Index soared to eye-watering levels. The chart clearly shows just how high it went in the years before the 2008 meltdown. Might it repeat that spike again? With talk of a revived Supercycle, another supercycle for shipping rates might be a fair corollary to expect.

However, one boom can provoke other booms or undermine them. Shipping rates at too high a level might detract from minerals prices if it ends up dampening down demand when higher metals and higher shipping rates prove to be the straw that breaks the camel's back.

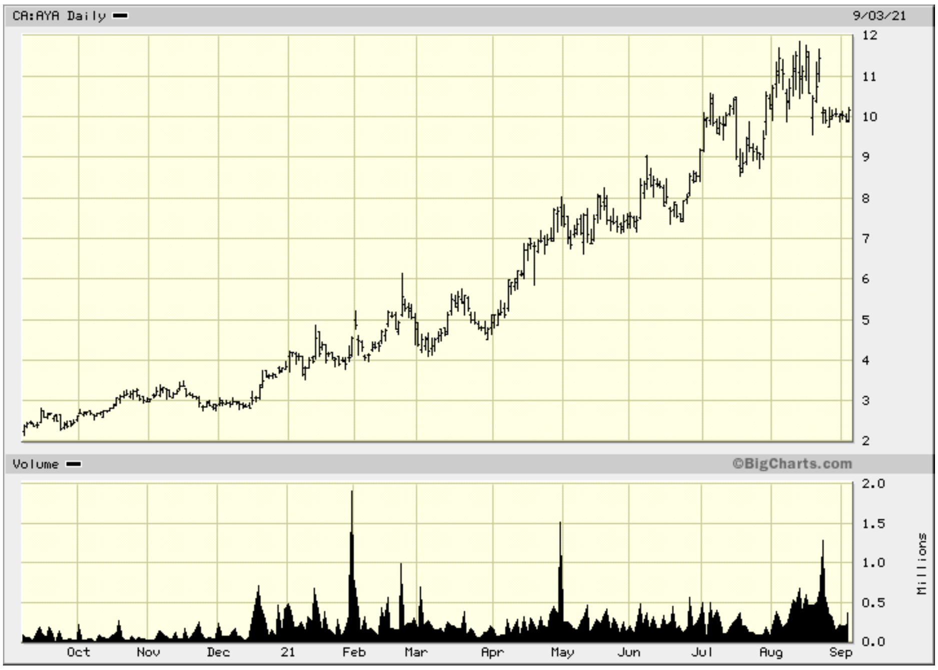
Then, lo and behold, the rates on the Baltic Dry have continued their upward surge since the start of the year reaching levels last seen in 2010 (whereas in 2020 they only reached levels last seen in 2012).

Meanwhile, in specialty metals, another brewing problem is a reported shipping container shortage. This space is prone to containers being in the wrong places at the wrong times and massive piles of the things ending up in Western ports when they are needed in Chinese ports. If there is nothing in the way of exports to backload these containers with, then they sit where they are. So we are starting to see some quite remarkable prices differences opening up between different locations that are far greater than the shipping costs. Thus Antimony in China was around $9,800 per tonne in China, $1,000 higher in Rotterdam and deliveries to the US quoted at over $11,000. Then that switched over and Rotterdam was at a $1000 over the US. A veritable feeding frenzy. This is impacting other non-bulk metals like Rare Earths which also travel in shipping containers.

We raised the issue in January of the further twist if the West starts to de-Sinoise its supply chains. We predicted then that if one thing is certain, it would be that shipping would cost more going forward rather than less.

Portfolio Changes

Since our last Review we have added a SHORT position in Aya Gold & Silver (TSX:AYA). This stock which we covered and recommended (in its guise as Maya Gold & Silver) as far back as 2012 had a management change that brought in the famed Benoit LaSalle to refresh the direction. However the asset base was the same old, same old. The market in its enthusiasm pushed the stock to over a $1bn market cap.



The company is aiming to produce five million ounces of Silver, which at $25 implies some $125mn per annum of gross revenues. Why such a company should be worth over a billion confounds us. Clearly others also had the same wake-up call as the stock loss $2 off it ritzy stock price in the last month.

Altus Strategies/La Mancha – Reshuffling the Deck

After a long period of drifting lower, a combination of developments lit a fire under project generator Altus in the last two months as the chart shows. Firstly there was the restructuring as discussed and then a strange purchase of a royalty on a Chilean copper mine (which frankly seemed opportunistic more than strategic as it took the company outside its African comfort zone).

The relationship between Altus (AIM: ALS & TSX-V: ALTS) and La Mancha goes back to December of 2019 when Altus, the Africa focused project and royalty generator, announced it had entered into a Strategic Investment Agreement with La Mancha Holdings S.à.r.l, a Luxembourg-incorporated private gold investment company. The deal was that La Mancha was to subscribe for 124,229,389 ordinary shares in Altus at a price of CAD$0.09, for aggregate gross proceeds of CAD$11.2mn.

La Mancha Investment was buying in at an approximate 20% premium to the closing market price and an approximate 30% premium to the 30-day VWAP. On completion La Mancha ended up with around 34.5% of the then enlarged issued share capital of Altus. Despite this chunky shareholding which well-exceeded that of any other holder the new entrant to the register only received one out of the six board seats.

At the time of the Altus deal the name La Mancha resonated with us (not just due to echoes of tilting at windmills) but as there had been a company with a Paris quotation, of the same name, in the orbit of the French nuclear player Areva. We were not mistaken as this is indeed the same entity.

La Mancha was the result of a transformational deal in 2006 when it merged with the gold interests of Areva. The French giant, despite its nuclear focus in recent decades, once had interests in many other commodities, particularly in Africa. The 2006 deal propelled La Mancha from a mineral exploration junior on the TSX-V to a TSX-listed stock with two producing gold mines and over 30 exploration projects. Areva became the largest shareholder in La Mancha, with around 63% of the issued capital, and Areva appointed one of its people as CEO and President of La Mancha.

After the deal was completed in 2006, La Mancha focused on increasing gold production at its more mature assets, while continuing to investigate its large package of exploration projects. The production profile prior to the Sawiris takeover came from three mines. The Hassaï Mine in Sudan was the largest contributor, generating approximately 32,000 ounces of gold (net) to La Mancha in 2008. La Mancha had a 40% stake in the operation.

La Mancha's second largest producer was the Ity Gold Mine in Cote d'Ivoire, which is expected to contribute 23,000 ounces. La Mancha has a 45.9% interest and is operator.

The other principal asset was the Frog's Leg mine, where La Mancha had a 51% stake. White Foil was the group's second project in Australia.

La Mancha was taken private in July 2012 by the Sawiris family. Areva made CAD$315 million from selling its stake in La Mancha Resources to Weather II Investments, an entity managed by Egyptian entrepreneur Naguib Sawiris. Weather II agreed to buy La Mancha at a price of CAD$3.50 per share in cash, which represented a premium of 55.6% to the closing price at the time.

After slicing and dicing these various inherited assets out to other listed entities La Mancha ended up with investments (over and above their play in Altus) in Endeavour Mining Corp, Golden Star Resources and Evolution Mining Ltd which have operations in Mali, Burkina Faso and Côte d'Ivoire, Ghana and Australia. The transactions with Evolution and Endeavour took place in 2015.

As a result, La Mancha is invested in mining companies with total production exceeding 1.8 million gold equivalent ounces per annum.

Continuing the trend of constant change, in late July, La Mancha announced the creation of La Mancha Fund SCSp, a Luxembourg-based long-only fund dedicated primarily to gold mining. The new entity will be advised by La Mancha Capital Advisory LLP.

The first closing was completed with the transfer of all of La Mancha's gold mining assets as well as an investment of US$100mn from a strategic partner now investing alongside the Sawiris family. According to the release, the fund is invested in excess of US$1.4bn in assets.

LMCA will be supported by an advisory committee, chaired by a member of the Sawiris family, and will include a number of “well-known personalities” in the mining sector.

Obviously the primary focus of the Fund is to provide exposure to the gold and precious metals mining sector but in a nod to the times we live in, it will also “have the flexibility to invest” in EV battery metals.

There is a whiff of the activist/controlling aspect to the strategy as the fund “will seek to acquire significant stakes in junior mineral resource companies with strong managerial and geological potential to implement a 3-to-5-year value creation strategy”.

What do the machinations at the largest shareholder mean for Altus? Well, if the discount to real value at the company continues, the temptation will be there for the new fund of La Mancha to fold the project generator into the new asset management entity. Time will tell….

We reiterate our **LONG** rating on Altus and our 12-month target price at GBP 1.00.

Parting Shot

The summer months brought yet another swoon to mining markets, just as observers had started to laud an incipient “Commodity Supercycle”, reviving memories of the first decade of this century and its resurgence of mining markets after many decades of somnolence.

We are reminded more of the old saying that history does not repeat itself, but instead it rhymes. For us the bull market is far from over as we stumble into an inflationary period where long term underinvestment in new mines meets the inflationary bubble created by government attempts to mitigate the shocks of the pandemic by pump priming. The usual medicine for an inflationary outburst is of course interest rate hikes, but that is being soft-pedalled due to the desperation to keep the false construct of the global property boom from having its reckoning with reality.

But back to mining we were pondering the long-held dichotomy in the mining industry between the explorers and the producers (with developers being a subset of the latter rather than the former, unless they are just faking it). Like mushrooms after the rain, new listings are proliferating despite the ossified nature of the exchanges which is slowing down the progress of many.

The “gold explorer” is a perennial, now joined by the “copper explorer” having risen from the dead. However, there is a slight change of vibe in the more rarified (pardon the pun) specialty metals. We are on the cusp of a real eye-gouging fight for survival in the Lithium and Rare Earth spaces.

We have always sustained that the race will go to the swift and that the slower horses will be put out of their misery and the carcasses sent to the glue factory. In the lithium space the efflorescence of new companies has been stronger than in the Rare Earth space. In the latter the problem has been to come up with something new. Sure there were the projects left behind in the dust by the 200-300 players in the first REE boom of 2009-11 but most of those projects were discredited or too skinny on grade (or had other fatal flaws).

This time around the focus has been on the midstream and processing “innovations”. However again it’s a case of first movers being the eventual winners. Unfortunately some players think that “first mover” status comes from putting out a press release before anyone else. Just as we said in the first boom there will be five players to come out of the current scrum and already they are becoming evident. With MP materials, Energy Fuels and then Rainbow (with Phalaborwa) likely to provide meaningful quantities of REEs the space left for lesser wannabes is restricted. Most REE companies have abandoned releases on exploration as a strategy as to be still an explorer in the REE space means that the company is way behind the times.

In Lithium we find players still wanting to enter the space but it is largely a knee-jerk reaction. You cannot keep a good promoter down. They hear there is a resurgence and just must be present no matter how many other players there are. The fatal flaw in this and other specialty metals is that you can never have enough gold companies, they may compete for capital but they do not compete to sell. However, too much Lithium or, worse, too much Lithium from the wrong type of deposit in the wrong jurisdiction can be fatal. We well recall the mistaken call by a certain Wall Street bank that ended the 2017 battery revival with claims of over-supply by 2025. Ironically that ended the boom and ensured that there would NOT be oversupply by their target date. However, if even one quarter of the Lithium plays currently made it to production then there certainly would be oversupply by 2030.

MODEL RESOURCES PORTFOLIO @ END AUGUST

	Security	Ticker	Currency	Price	Change last 12 mths	Change last mth	12-mth Target
LONG EQUITIES							
Diversified Large/Mid-Cap	Teck Resources	Teck.B	CAD	28.84	92%	1%	$30.00
	Hochschild	HOC.L	GBP	1.499	-37%	-3%	£3.40
Uranium	Sprott Physical Uranium	U.UN.to	CAD	12.01	159%	4%	$15.00
	GoviEx	GXU.v	CAD	0.28	100%	17%	$0.30
Zinc/Lead Plays	WisdomTree Zinc ETF	ZINC.L	USD	9.03	11%	0%	$9.00
	Altaley Mining	ATLY.v	CAD	0.62	210%	-19%	$1.20
Silver Explorer	Southern Silver Exploration	SSV.v	CAD	1.2	82%	-1%	$1.80
Silver ETF	IShares Silver ETF	SLV	USD	22.37	-15%	-5%	$26.00
Gold Producer	Soma Gold	SOMA.v	CAD	0.3	-52%	-12%	$1.20
Metallurgical Coal	Colonial Coal	CAD.v	CAD	0.86	25%	0%	$1.10
Project Generator	Altus Strategies	ALS.L	GBP	0.81	-99%	35%	£1.00
Copper Explorers	Panoro Minerals	PML.v	CAD	0.14	0%	17%	$0.30
	Phoenix Copper	PXC.L	GBP	0.673	68%	4%	£0.65
	C3 Metals	CCCM.v	CAD	0.17	143%	-6%	$0.44
Tungsten Producer	Almonty Industries	AII.v	CAD	0.93	41%	-7%	$1.25
Vanadium Developer	Vanadium Resources	VRB.ax	AUD	0.06	100%	20%	$0.05

MODEL RESOURCES PORTFOLIO @ END AUGUST

	Security	Ticker	Currency	Price	Change last 12 mths	Change last mth	12-mth Target
LONG EQUITIES							
Lithium	Neometals	NMT.ax	AUD	0.71	294%	8%	$0.60
	Lithium Power Intl	LPI.ax	AUD	0.28	75%	4%	$0.30
Scandium Developer	Scandium International	SCY.to	CAD	0.19	58%	-5%	$0.25
Gold Explorer	Cabral Gold	CBR.v	CAD	0.48	0%	-4%	$0.60
	BTU Metals	BTU.v	CAD	0.09	-59%	-25%	$0.42
	Gunpoint Exploration	GUN.v	CAD	0.57	-37%	-12%	$0.75
	Bold Ventures	BOL.v	CAD	0.11	83%	10%	$0.18
	MetalsTech	MTC.ax	AUD	0.25	32%	0%	$0.68
Fertilizers	Verde Agritech	NPK.to	CAD	1.2	82%	-1%	$2.00
Cesium et al.	Essential Metals	EXX.ax	AUD	0.18	100%	29%	$0.30
Rare Earths	Rainbow Rare Earths	RBW.L	GBP	0.1076	207%	-8%	£0.30
	Neo Performance Materials	NEO.to	CAD	18.98	78%	1%	$24.00
Tin Miner	Alphamin	AFM.v	CAD	0.79	182%	-6%	$0.80
	Metals X	MLX.ax	AUD	0.32	300%	14%	$0.30
Oil & Gas	Shell A	RDSA.L	GBP	14.382	37%	1%	£14.90
Royalties	Elemental Royalties	ELE.v	CAD	1.39	n/a	4%	$2.30
SHORT EQUITIES							
Shorts	NioCorp	NIO.to	CAD	1.23	45%	-5%	$0.40
	Aya Gold & Silver	AYA.to	CAD	10.05	4468%	-4%	$0.40
	Galane Gold	GG.v	CAD	0.16	-30%	-16%	$0.15
	Texas Mineral Resources	TMRC	USD	1.38	-12%	-8%	$0.30

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