Tuesday, March 19, 2019

HALLGARTEN & COMPANY

Initiation of Coverage

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Bearing Lithium

(TSX-V: BRZ, OTCQB:BLILF, FSE: B6K2)

Strategy: LONG

Key Metrics	
Price (CAD)	$0.240
12-Month Target Price (CAD)	$0.36
Upside to Target	50%
12mth hi-low	$0.21 - 0.68
Market Cap (CAD mn)	**$15.408**
Shares Issued (millions)	64.2
Listed Options (@63cts)	2.9
Warrants (@31cts)	4.7
Fully Diluted (millions)	**71.8**

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Bearing Lithium

Coat-tailing on LPI

- + The Salar de Maricunga project is the most advanced new project in the Chilean Lithium space
- + First mover advantage at Maricunga goes to Lithium Power (and its partners) as the other two stakeholders in the *salar* are essentially inactive
- + Bearing owns 18.02% of the JV having increased its stake in mid-2018
- + The Maricunga JV board is composed of three seats for LPI, two for the Chilean partners and one for Bearing
- + Recently released Feasibility Study reveals a pre-tax NPV of USD$1.302bn
- + Operating costs estimated at US$3,772 per tonne of LCE
- + Projected production of 20,000 tpa of Lithium carbonate (LCE) and 74,000 tpa Potassium Chloride (KCl) makes the project a Lithium major ***and*** a mid-sized fertilizer producer
- × Mushy Lithium prices have afflicted the sector for well over a year now despite the strong uptake of EVs in China and a trend that way in other major economies
- × Financing is subject to the offtakers more than the equities market these days
- × Bearing is essentially in the backseat in the JV
- × Share of CapEx for Bearing is US$101mn, ergo Bearing risks being substantially diluted if it cannot keep up with capex commitment

The Power of Persistence

Chilean Lithium prospects have been relatively overshadowed in recent years by the rising Argentine Lithium scene. This has been because the Chilean scene was perceived to be locked up between the majors of the now moribund "cartel" and because there were a plethora of undeveloped *salares* on the Argentine side of the Andes. However in a case of quality over quantity the Chilean side had relatively few available areas to stake but has more ideal climatic conditions and better access and infrastructure.

In mid-2017 we were introduced to the Maricunga *salar* and its developer, Lithium Power International (ASX:LPI). In this joint venture, LPI has two partners (a Chilean partner and a TSX-V listed junior, Bearing Lithium). In October of 2017 we went to visit the site and then wrote a site visit report and an initiation of coverage on LPI in early 2018

In this review we shall briefly discuss the project (as this was elaborated upon in great detail in our LPI note of last year) and focus upon where Bearing Lithium stands in the mix. We shall not be reiterating the obvious on the current evolution of the Lithium demand space.

Maricunga

Maricunga is the most advanced undeveloped lithium project in Chile. It's direct comparable is the famed Atacama lithium brine deposit (exploited by SQM and Albemarle) which is over 300kms to the north. The salar is located 170km north-east of the mining town of Copiapó and 250km from the Chilean coast. In addition, it is adjacent to International Highway 31, which connects northern Chile and Argentina.

The Maricunga salar lies at over 3,750 metres above sea level near to the Argentine border in the high Atacama desert, one of the driest places on the planet, with attendant advantages for evaporation rates, while enjoying the heightened confidence that investors have in the Chilean mining regime. It was this aspect that prompted Lithium Power International (LPI) to farm out its Argentine assets and focus its attentions on the Salar de Maricunga JV.

The Transactions

A series of transactions in recent years have brought the asset to its current ownership structure. The project had been long mired in the financial misfortunes of the TSX-V listed entity called Li3 Energy (since absorbed by Bearing Lithium) which had lacked the funds to advance the project beyond some initial exploration that petered out several years ago. Meanwhile exploration of the rest of the *salar* was non-existent as it was held by the long disinterested majors, CODELCO and SQM. This has changed in recent times with CODELCO (the massive state-owned copper miner) having decided to energise interest in its holdings on the salar by putting them out to public tender.

LPI signed its JV earn-in agreements in the second half of 2016 and has since been engaged in upgrading data and "mine"-planning that has taken it to the point where a production decision is within sight and the project is in a state that potential offtakers can have confidence that Maricunga is one of the real projects in a universe of over-promoted projects that have little prospect of coming to fruition.

The Background to the Maricunga JV

In July 2016, Minera Salar Blanco, which had hitherto been a JV between the Borda family interests and Li3 Energy, entered into a binding and exclusive agreement with LPI to form a joint venture to explore and develop the Maricunga Project.

Li3 Energy and MSB contributed their Maricunga lithium brine assets to a new Maricunga JV and LPI was to contribute $27.5 million in staged cash payments to the Maricunga JV to cover exploration and development costs until the completion of a Definitive Feasibility Study in late 2018 (though this came out in early 2019).

Following the completion of the transaction, Li3 was to own a direct 17.67% equity interest of the Maricunga JV, with LPI and MSB owning 50% and 32.34%, respectively. Li3 was entitled to appoint one director to the board of the Maricunga JV (so long as it maintained a stake of at least 10% of the equity interest in the joint venture), with LPI and MSB holding three and two director seats, respectively.

Additionally, MSB agreed to sell three options over the San Francisco, Salamina and Despreciada tenements in exchange for 16mn shares in LPI, voluntarily escrowed until June 2018.

Minera Salar Blanco

This company which holds 30.98% (formerly 32.3%) of the Maricunga project is owned by Martin Borda Mingo. He is Executive Director & Founding Partner at Multiexport Foods SA, Chairman at Salmones Multiexport SA, and Chairman at Multiexport Pacific Farms S.A. He is regarded as the "king" of Chilean salmon farmers and seaweed/algae processors.

He is on the Board of Directors at Multiexport Foods SA, Cia Molinera San Cristobal SA, and Alimentos Multiexport Ltda. He also served on the board at Scotiabank Chile, which is the latest incarnation of Banco Sudamericano that his family sold to Bank of Nova Scotia. The family, of Basque origins, were also the largest bread bakers in the country until they sold those interests over to Grupo Bimbo of Mexico.

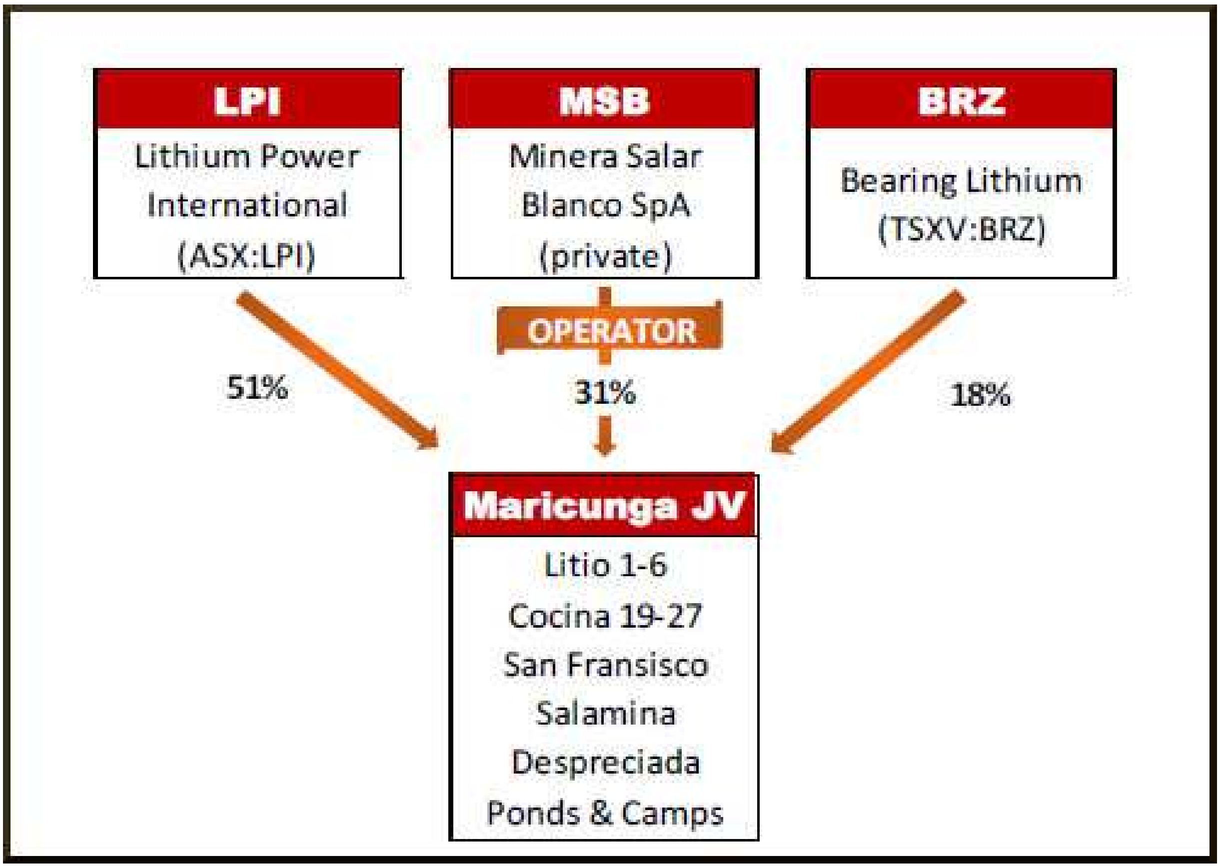
In the relatively tightly-knit heights of the Chilean economy his connections have proved to be indispensable for advancing the project thus far (and into the development phase).

Accumulation

In late August of 2018, Bearing announced that it had completed the acquired an additional interest in the Maricunga Project, bringing its interest to 18.02%.

The increased ownership was a result of Bearing exercising its pro-rata right of first refusal within the joint venture. This followed the announcement of Minera Salar Blanco SpA's intent to sell 1.35% of its shares in the Maricunga joint venture company, Minera Salar Blanco S.A., for total consideration of AUD$2.03 million or AUD$0.53 million (CAD$0.52 million) for Bearing's pro-rata share.

As a result the current ownership of the Project is as follows: Lithium Power International at 51%, Minera Salar Blanco SpA at 30.98%, and Bearing at 18.02%.



Waning Relevance?

This TSX-V listed entity is the final resting place (well, for now) of the remnant of the Li3 stake in the Maricunga project. In September of 2017 it received approval to acquire via a stock issuance all the shares of Li3 Energy Inc. With completion of the transaction Bearing ended up with an undivided 17.7% interest in the project, with Lithium Power International earning into the project by funding project expenditures to through to the delivery of a Definitive Feasibility Study. The talks to cement the Li3 takeover dragged on for around a year with the stock of BRZ peaking at over $1.50 per share in February 2017 and now standing at one sixth of that level.

While Bearing had a free carry until LPI's expenditure commitment was fulfilled (now complete) after that point Bearing must invest pro-rata in all works, or face dilution.

Financial Situation

The latest fund raising by the company was in mid-August 2018 and was primarily aimed at paying for its acquisition of a further stake in the project from MSB. At that time it closed of the second and final tranche of the non-brokered private placement announced a month before. The two tranches resulted in an aggregate of 9,130,000 Units were issued for gross proceeds of $2,282,500.

The latest financial statements, which are unfortunately rather old (being those for 3Q18 as at 31st of July 2018) show that, the company had a working capital of $2,300,762.

For the nine months ended July 31, 2018, cash outflow for the year from operating activities was $2,015,961 (2017 -$2,147,457) principally resulting from repayment of Li3 related liabilities as well as expenses related to consulting fees, audit and legal fees, management fees, public company regulatory related costs and office costs. Costs were higher than the previous year as a result of increased operating activities. There were $1,574,122 (2017 - $2,335,856) cash inflows from financing activities. There were $202,530 cash inflows from investing activities derived primarily from the sale of marketable securities and receiving option payments from its First Division option agreement (discussed anon).

On November 22, 2017 Bearing paid US$620,963 (CAD$792,348) to settle the balance outstanding owed on the loan from Minera Salar Blanco SpA to Li3 Energy, Inc.

The Yukon/Nevada Spin-Out

The company has been trying to narrow down its focus to just the Maricunga JV exposure. To this end on July 23, 2018, the company completed a spin-out transaction in which Bearing transferred its interests in exploration projects in the gold district of the Yukon and a lithium project in Nevada to Lions Bay Mining (CSE:LBM) in exchange for 5,510,000 common shares of Lions Bay.

In turn, Bearing distributed 2,754,882 shares in LBM to Bearing shareholders and retained 2,755,000 shares. Bearing shareholders received 0.049921 of a Lions Bay share for each existing common share of Bearing held.

The Fish Lake Valley Option

The LBM transaction was not the first of the disposals though as in September of 2017, the company entered into an asset purchase agreement to vend a 100% interest in 81 lode claims located in Esmeralda County, Nevada, covering 1,620 acres in the north-eastern corner of Fish Lake Valley, situated in central-western Nevada. The claims lie on tuffaceous sedimentary rocks of the Esmeralda Formation which are considered to be prospective lithium, boron and potassium mineralization.

The acquirer of the option was First Division Ventures Inc. that agreed to acquire a 100% interest in the mining claims. To exercise the option, First Division made a cash payment in the initial amount of $20,000 and issued 20,000 common shares to Bearing. Thereafter it would issue an additional 4,000,000 common shares to Bearing by the third anniversary of the Agreement. First Division must also carry out a $3mn work program prior to the third anniversary of the agreement. Bearing retained a 3% NSR which was not subject to a buy-back or repurchase right.

Less felicitously, the acquirer changed their mind somewhat, as in May of 2018, the parties entered into an amending agreement whereby the acquisition by First Division would be reduced to a 50% interest in the 81 lode claims. The consideration required to obtain the 50% interest would include the consideration already received of $20,000 and 20,000 common shares to Bearing. The remaining consideration would be reduced as follows: additional 3,000,000 common shares to Bearing on or before September 25, 2020. First Division must also carry out a $1,500,000 work program on the Claims prior to the third anniversary of the Agreement: $60,000 on or before September 25, 2018, $440,000 on or before September 25, 2019 and $1,000,000 on or before September 25, 2020. In order for the obligation to be satisfied, the shares of First Division must be listed on an Exchange.

Life as a project generator was proving more difficult than expected for Bearing.

Arbitrage

This stock would appear over-valued in comparison to LPI (or one could easily contend that both are undervalued). If one puts an enterprise value of US$10.82mn (market cap less cash) on BRZ for a 18.02% stake then LPI with 51% of the project has an enterprise value of nearly $28mn, taking the EV per percentage point of the project then LPI is around 10% "cheaper" than BRZ as an exposure to the Maricunga JV.

	Mkt Cap	Less cash & equiv	EV	EV US$mn	% JV	Value per % point US$mn
LPI	56.44	-17.00	39.44	28.00	51%	0.55
Bearing	15.41	-1.00	14.41	10.81	18.02%	0.60

The overvaluation of BRZ is however much reduced from where it was at the start of last year when we calculated that BRZ was 50% overvalued.

Risks

We would note the following risks:

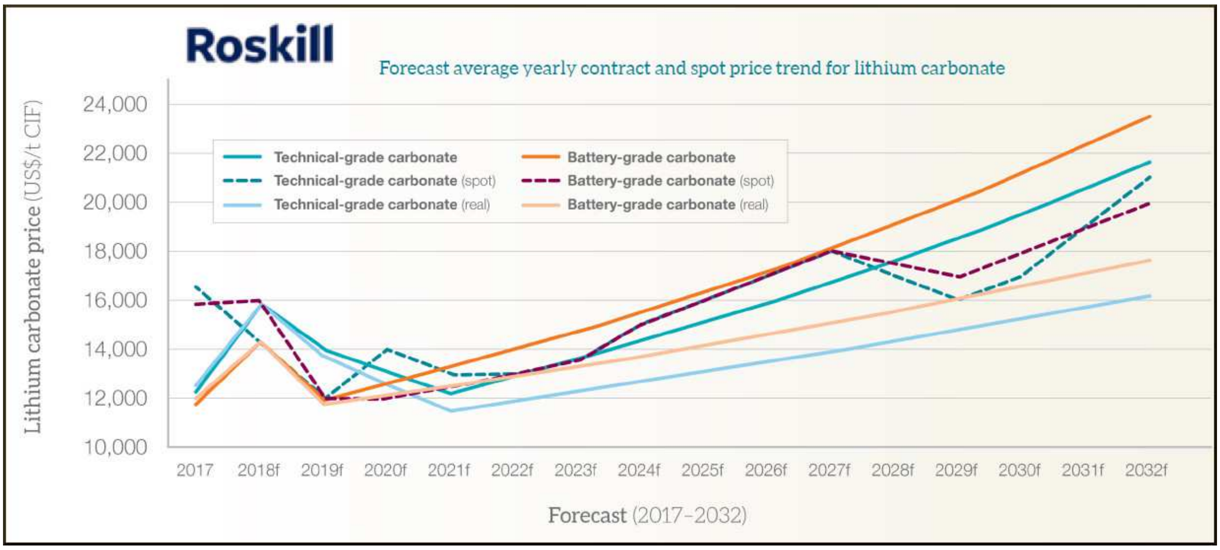
- Lithium prices retreat
- Financing of Lithium project's capex proves to be problematical

- Spoiling action by SQM

Prices retreated in 2018 just as several projects moving into production. Erroneous and misinformed commentary by a Wall Street analyst, with no Lithium or indeed mining credentials, sent Lithium prices into a downward spiral, which created a drought of capital, a slowing of projects and cast a pall over the battery sub-space which, even if one had believed the Wall Street commentary, meant that the effect was to delay production of the very projects that the analyst in question claimed would overwhelm the market. Out of the mouths of babes…

Demand is expanding with significant vigour and as noted many projects are delayed (or indeed doomed) by the price retreat. As in Lithium 1.0, many of the "likely" projects will not be built as they are in the hands of pure promoters. As weeks and months go by with scant sign of an upturn in speculative interest in Lithium microcaps the attrition rate in juniors accelerates. Fortunately for promoters they can "die" and go to Cannabis Heaven through an RTO.

We remain bullish on a Lithium price turnaround and would subscribe to these Roskill projections on the likely price progression of the mineral.



Source: LPI/Roskill

Financing is not coming from markets but from end-users or processors. In the case of Maricunga we would see the offtaker being Japanese (or Korean) as the Chinese have seriously wrong-footed the Japanese (witness the Galaxy "bait and switch" with Mitsubishi) and the Japanese are wising up and Chile is one of the few countries in their "comfort zone..

SQM would have been a definite risk two years ago but it became something of a rooster converted to a feather-duster in 2017, and into early 2018, due to its *macho* posturing to an unimpressed Chilean government. A change of government in Chile lowered the tone of the shoving match but the "national champion" has definitely been taken down a peg (or two) and the arrival of more players, like Lithium Power, enhances Chile's chances of maintaining its status in the Lithium space against Argentina.

It is worth mentioning that local communities do not constitute a risk in any form. The area is largely free of inhabitants and the very few that exist have been kept well-informed of developments by LPI and its partners. It is envisaged that some form of *ex gratia* royalty will be paid to indigenous locals for their inconvenience and collaboration.

Conclusion

Bearing's fate is inextricably tied up with the actions and fate of Lithium Power International. No amount of window-dressing will change this. That Bearing has not sought out other assets or pursued other opportunities would signal that it lives on in the hope that LPI will take it out, or that some other strategic partner that LPI might bring on board will seek to bolster its position by taking out Bearing. In all scenarios Bearing is reduced to a passive entity waiting for something to happen to it.

Chile was once (in very recent memory) synonymous with Lithium production from *salares*. Chile let the ball drop because it was perceived to be "cartel" territory (i.e. at the mercy of the diktats of the Big Three) and also that the prospective follow-up properties were in the hands of the majors (SQM and Codelco), the distracted (Talison post-takeover by Tianqi/Rockwood) and the moribund (Li3 Energy). Quite simply Chile fell off the map of future places for Lithium and was regarded as the Lithium past.

In a relatively short span of time LPI has revivified Maricunga and put Chile back in contention in the Lithium race.

The issue here is does one bet on the driver (LPI) of the race-car or on the passenger (Bearing) in the back seat? LPI has a majority of the shares and management of the project. It's LPI that a buyer of the asset must bargain with. The best Bearing can hope for is to be a playing piece for a passive investor to acquire and get positioned. Such positioning will need to come soon as Bearing also faces the danger, from here on out, of dilution as the partners must fund pro-rata their share of the future development and Bearing is not exactly cashed up. Beyond this, on a valuation per percentage point of exposure to the project, LPI is cheaper than Bearing at the current time.

As the whole project is valued at less than US$80mn at this juncture. We concede the price retreat at Bearing has made the arbitrage between its former valuation and that of LPI much smaller now and as an exposure to the project for investors who lack another way to acquire shares of LPI (unless LPI gets a TSX secondary listing) then Bearing just squeaks into the Long category, as it is likely to rise as Lithium recovers and the Maricunga partners are rerated upwards. However we reiterate our **Long** position in Lithium Power International as the preferred exposure to the evolution of the Chilean Lithium industry.


Historic Chart for Cdn:BRZ by Stockwatch.com 604.687.1500 - (c) 2019
Mon Mar 18 2019 Op=0.235 Hi=0.245 Lo=0.235 Cl=0.24 Vol=47,200 Year hi=0.62 lo=0.205
Cdn:BRZ
0.65
0.625
0.60
0.575
0.55
0.525
0.50
0.475
0.45
0.425
0.40
0.375
0.35
0.325
0.30
0.275
0.25
0.225
0.20
Volume
450 k
300 k
150 k
Mar
Apr
May
Jun
Jul
Aug
Sep
Oct
Nov
Dec
Jan
Feb
Mar
2018
2019

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