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Portfolio Strategy

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Model Mining Portfolio:

Life after the Virus

Performance Review – March 2020

Model Mining Portfolio

Life after the Virus

- **Life will not be the same after the crisis, and this may not be a bad thing**
- **Gold initially sold off in the liquidity event but has rebounded.**
- **Zinc price appears to have bottomed, underpinned by sheer lack of stocks and mine closures**
- **The Virus crisis has been a massive wake-up call on vulnerability to Chinese disruption**
- **China is now perceived in some circles as an Axis of Evil all of its own and there will inevitably be less dependence upon this market for sourcing and also as a customer**
- **Silver has disappointed having retreated strongly and not rebounded with gold**
- **Silver/gold ratio around 115/1 is ridiculous and makes silver one of the most attractive metals around at this time**
- **Specialty metals prices have weakened in some cases, with Tin being a notable victim**

An Inflection Point

One of the most quoted comments made at the start of the First World War was made by the British Foreign Secretary, Edward Grey when he said in August 1914: "The lights are going out all over Europe and we may not see them lit again in our lifetimes". A lot of things were said at the time but most of it was boosterism by jingoistic politicians and their acolytes and fellow travelers. In retrospect Grey's comments have stood the test of time for it turned out he was calling "Time" on an era that that had really run its course from the end of the Napoleonic Wars until that moment of collective global madness. What came after 1918 was an entirely different era with many of the pillars of pre-1914 life and society having been kicked away.

The current crisis won't last for four grueling years like the Frist World War (with its pandemic grand finale) but its cathartic kick could be enough to shake the equilibrium of the House of Cards cobbled together post-2008 and undermine the foundations of the globalization trend that dates from around the time that Volcker slew the inflation dragon in the 1980s.

So indulging in some random futurology what might things look like after this Crisis:

- Chance of a Depression rather than just a recession is high
- Service industries (the big winners since the 1980s) are the first-line casualties of the Crisis

- Government budgets will be ravaged by bailouts and benefits on the expense side and wipeouts of corporate, consumption and individuals' tax payments on the revenue side
- China dependency is being questioned like never before
- As a repeated source of new infections China will need to make cultural decisions to eradicate practices that have caused global disease (or localized) disease outbreaks in the last 20 years
- Specialty metals production outside China will be given even greater emphasis. The issue then is will battered corporates be able to wean themselves off China-dependency or impoverished governments be willing or able to create strategic metals' reserves?
- Will fetishism of house prices continue, or be allowed to continue?
- Mass unemployment will result from extensive corporate and small business "die-back"
- Climate change has been put in perspective as not the only (or even the major) threat to human existence
- The Euro may very well shed Italy, and possibly Greece. The damage to Spain's finances are still not clear
- Do not underestimate the impact of lost tourism revenues across the northern summer
- The ongoing existence of a marginalized workforce of (usually young) workers across the West will be seriously called into question
- Ultra-low oil prices, or even medium low oil prices, will put the EV revolution at least five years behind in the US, while switching to EVs in Europe may be seen as a luxury indulgence as government (and household) budgets collapse and various economies tumble into depression
- Lifestyle priorities across the West will be seriously questioned
- Lasting damage has been done to the prestige of the US economy

We could go on, as the longer the whole process takes the greater the destruction of the "old way of doing things" will be. The implications for mining are more subtle because there are cross-currents which (pardon the pun) muddy the waters.

- A depression, or a deep recession, will result in a fall in demand for industrial metals, particularly the base metals
- The EV revolution will be delayed (we have heard people in the US say "it's been cancelled")
- ETFs in precious metals will look like a poor alternative to the underlying (or not) physical metal

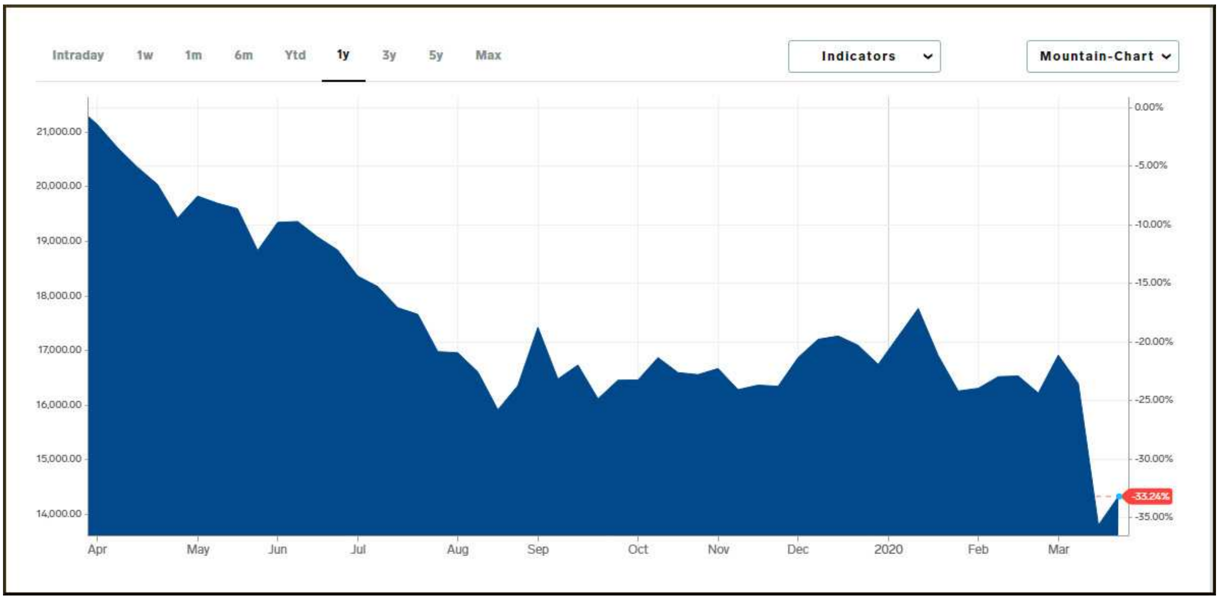
- Lasting damage has been done to China's image in the US. Even a change to a Democratic administration would not erase images and impressions created by the latest crisis
- "Buy American" or "Buy European" or "Buy Canadian/Australian/Brazilian" will be mirrored by similar campaigns in other jurisdictions and may end up enshrined in government contracts and tenders not just for the contracting suppliers, but for whole supply chains.
- Just as supply chains must be verified to be "conflict-free" since a decade now, so local content or sourcing will be demanded overtly or covertly. The "locavore" movement can be applied to supply chains for non-edibles as well

Beyond these factors there will be consequences to things that have not even happened yet. The Chinese thought they could get back to work but find the orders from the West have dried up. Thus they either need to stockpile finished goods for the "eventual" turn, or cut their production to match their ravaged order books. "Make it and they will come" is not a given these days.

The whole global scene is in flux. Where and how the pieces that have been flung into the air will fall remains to be seen. If one can say one thing it is that the mining industry is no stranger to hard times and verily may be able to adapt much better than the long-cosseted services and financial sectors.

Tin & the China Factor

The Tin price took a beating in the initial phases of the Coronavirus crisis. While many China-related metals actually saw price rises, Tin was beaten down as if with a mallet. The chart below shows the precipitate decline.



It’s interesting to look at what happened in China, both the largest user and the largest processor. The outbreak of the Coronavirus resulted in the Chinese government quarantining the country, halting the majority of domestic refined tin production. Only government-owned smelters, including Yunnan Tin, operated during the lockdown. Output was, however, much lower.

Curiously the price tanked, during the lockdown, despite China importing over 1,500 tonnes of refined tin. This was an increase of over 800% YoY and a continuation of the high imports seen in December 2019, the highest since early 2017. Exports of refined tin were reduced; China shipped out just 520 tonnes, down 69% YoY.

Imports of concentrates also fell during the period of lower smelter activity. According to the latest customs data, China imported 24,678 tonnes of tin ore and concentrates in January and February. The estimated tin content was down 22% YoY to 7,000 tonnes, with 89% of the material mined in neighbouring Myanmar. The ITA claimed that, according to sources in the country, the increased imports were due to a large import arbitrage between the LME and SHFE tin prices.

A key swing factor in the tin equation is Myanmar. The country is regarded as some sort of colonial treasure chest by the Chinese who send hordes of *gastarbeiter* across the border to rip our Myanmar’s resources. According to the International Tin Association workers returning to Burma from China are subject to a 14-day quarantine period, while the recent collapse in tin prices has seen some miners stop mining activity. Shipments from Burma were pre-holiday (Chinese New Year) stocks. However with China now restricting (re)entrants into China, this begs the question as to whether the Chinese workers will be willing to go to Burma if they may not be allowed back into China.

On the surface, according to the ITA, the picture in China appears to be heading back to normality. Smelters and downstream companies are ramping up to full production once again. While the short-term supply of refined tin is stable, medium-term supply is constricted by the constrained flow of concentrates. This is unlikely to concern those further down the tin supply chain, however. Demand will likely remain low as companies remain closed. The market balance in China is likely to shift to oversupply in the short-term, although concentrate shortages may begin to reduce smelter outputs later as the Western users swing back into production and thus competition with the Chinese tin users.

Portfolio Changes

There were no Portfolio changes during the month.

Developments

Verde Agritech, the sole fertilizer story in our Model Mining Portfolio, announced that its revenues in 2019 were $6.029mn, against a previously stated target of $5.3mn. The gross margin was 48% and the operating profit before non-cash events was $0.025mn. In 2018 the Verde’s revenues were $1.358mn, the gross margin was 21% and the operating loss before non-cash events was $1.444mn.

During FY19, Verde sold 119,809 tonnes of its multinutrient potassium fertilizer, marketed and sold in Brazil under the K Forte® brand and internationally as Super Greensand®. This was a massive surge compared to 2018, when it sold 29,648 tonnes of the product.

The company's sales target for 2020 is set at R$32 million (CAD$10.6mn). If achieved, this would represent a 76% growth YoY and management claims that this would generate a maiden net profit. We reiterate our **LONG** rating with 12-month target price of 90cts.

Telson (TSN.v) – a Gold Stock by Any Other Name

The sufferings of Telson Mining in the last two years are somewhat like the Trials of Job. Whatever could go wrong, did, and then there was the wildly oscillating Zinc price as infernal icing on the cake. Having written two reviews on the company, one in better days and one near the darkest hour we thought it useful to reconnect with management. Amongst the travails of the company were the wild gyrations in the Zinc price, the theft of concentrates *en route* its offtaker (Trafigura), a need for a management cleanout and the difficult financing situation.

The Zinc price was not the only problem but if it had stayed in the sweet spot between $1.20-1.60 per lb all else could have been solved. However with Zinc spending a lot of the last twelve months between $1 and $1.15 (before the more recent step-change down towards 80cts) the net cash flow was destined to be scrawny and the loss of $3-5mn from concentrate thefts only exacerbated the cash tightness. That in turn put the progress in building Tahuehueto, with its bias towards precious metals, way behind schedule as the financing environment for ostensibly Zinc-oriented projects went into full reverse.

The tailings at Camp Morado are fairly easy pickings:

Campo Morado Tailings

Tonnes	Au g/t	Ag g/t	Cu %	Au ozs	Ag ozs	AuEq
3,290,622	1.57	94	0.3	165,662	9,954,590	298,161

Meanwhile, Tahuehueto hosts probable reserves of 3.26 million tonnes, with grades of 3.40 g/t gold, 41.80 g/t silver, 0.35% copper, 1.19% Lead and 2.24% zinc.

With the Tahuehueto mill (see below) and the complex needing around $15mn to be completed and the Campo Morado tailings (with their preponderance of gold and silver) awaiting activation, it is not a stretch to see that Telson should be restyling itself as a precious metals play and hitching its wagon to the only moving part of the mining industry these days.

At least until recent days the Zinc mining at Campo Morado was back in operation, and shipping to Trafigura (with whom negotiations are on-going on an extension on their financing until mid-2021). Even with Zinc at its current woeful levels in the mid-80cts range the company is covering its production costs, which was surprising to us.

However, in line with actions taken by other miners, operations will need to be suspended in compliance with the directive of the Mexican Federal Government announced on March 31, 2020 to mitigate the spread of COVID-19.

Beyond the travails of this current time, it seems that a name change and a refocus on precious metals output (and some funding from a royalty company or streamer) might be just what the corporate doctor ordered.

At its current price of 7cts, we are reiterating our **LONG** stance on Telson with a 12-month target price of 25cts.

Parting Shot

There is nothing like hanging (or a rampant virus) to focus the mind, however for gold and silver bugs their focus is always upon their "Precious" and when they look at the various ways they can access the metal.

The three levels were physical, the ETFs and the miners. For a long while the miners have seemed like a distant third best, but the ETFs have been touted as "as good as gold" (or even better). The plunging price of the ETFs has been primarily responsible for the swingeing fall in the theoretical underlying price of the physical.

That fallacy that ETFs were “as good as gold” has come to grief with physical metal becoming as rare as hen’s teeth and global movements of bullion being stymied and disrupted by airline closures/suspension of routes and miscellaneous quarantine measures. This was then compounded by various mints suspending operations as “non-essential” (a total red rag to the gold bull).

Then Bloomberg revealed that an apparently commonplace tactic of traders shorting gold futures in New York, against being long physical gold in London, had come horribly unstuck. So veritably as they were pushing down the paper price of gold they were pushing up the physical price and suddenly the trades were mismatched by parties wanting physical delivery when the other side didn’t have it or could not get it at the “real” price. Regulators would hate to have to admit that they had allowed a “physical” market to exist and flourish that actually could not deliver physical when it was most wanted.

At the peak of this crunch there was a 10% for real gold over “physical” gold. This was really quite laughable, except if one was on the wrong side of the trade.

For the man in the street though, such sophisticated trades elude them, and they have had plenty of time while in lockdown to ponder the value of cash money, the resilience of electronic (cashless) banking and how they pay for their daily bread. One commented to us “I have my gold coins” to which we commented “good luck buying a loaf of bread with that”. In reality, silver coins are much more fungible when the apocalypse comes…. Just saying.

MODEL MINING PORTFOLIO @ END MARCH

	Security	Currency	Price	Change last 12 mths	Change last mth	12-mth Target
Long Equities						
Diversified Large/Mid-Cap	Teck Resources (TECK.B)	CAD	10.67	-65%	-21%	$18.00
	Metals X (MLX.ax)	AUD	0.07	-71%	0%	$0.14
Uranium	Uranium Participation Corp (U.to)	CAD	3.90	-13%	3%	$4.90
	GoviEx (GXU.v)	CAD	0.13	-19%	-7%	$0.17
Zinc/Lead Plays	Zinc ETF (Zinc.L)	USD	5.88	-33%	-9%	$8.10
	NorZinc (NZC.to)	CAD	0.04	-53%	-33%	$0.08
	Myanmar Metals (MYL.ax)	AUD	0.04	-50%	0%	$0.08
	Ascendant Resources (ASND.v)	CAD	0.12	-88%	-50%	$0.30
	Telson Mining (TSN.V)	CAD	0.06	-83%	-25%	$0.25
Silver Producer	Excellon Resources (EXN.to)	CAD	0.55	-35%	12%	$0.90
Silver Explorer	Southern Silver Exploration (SSV.v)	CAD	0.35	84%	6%	$0.65
Silver ETF	IShares Silver ETF (SLV)	USD	13.05	-8%	-16%	$18.50
Gold Producer	Para Resources (PBR.v)	CAD	0.02	-90%	-50%	$0.15
Coking Coal	Colonial Coal (CAD.v)	CAD	0.22	-55%	-21%	$1.10
Project Generator	Altus Strategies (ALS.L)	GBP	23.00	23%	-15%	£32.00
Copper Explorers	Western Copper & Gold (WRN.to)	CAD	0.56	-26%	-23%	$1.00
	Panoro Minerals (PML.v)	CAD	0.07	-67%	-13%	$0.18
Tungsten Producer	Almonty Industries (AII.v)	CAD	0.38	-53%	-24%	$0.80
Vanadium Developer	Vanadium Resources (VR8.ax)	AUD	0.01	-91%	-50%	$0.04
Lithium	Neometals (NMT.ax)	AUD	0.14	-39%	-26%	$0.23
	Lithium Power Intl (LPI.ax)	AUD	0.14	-33%	-42%	$0.30
Scandium Developer	Scandium International (SCY.to)	CAD	0.06	-63%	-25%	$0.12
Gold Explorer	Cabral Gold (CBR.v)	CAD	0.08	-62%	-38%	$0.15
	BTU Metals (BTU.v)	CAD	0.13	30%	-28%	$0.42
	Gunpoint Exploration (GUN.v)	CAD	0.53	26%	2%	$0.75
Fertilizers	Verde Agritech (NPK.to)	CAD	0.35	-49%	6%	$0.90
Cesium et al.	Pioneer Resources (PIO.ax)	AUD	0.01	-50%	0%	$0.04
Rare Earths	Northern Minerals (NTU.ax)	AUD	0.03	-63%	-25%	$0.10
	Neo Performance Materials (NEO.to)	CAD	6.13	-48%	-23%	$14.00
Mining Media/Events	Aspermont (ASP.ax)	AUD	0.01	0%	0%	$0.02
Short Equities						
Shorts	NioCorp (NIO.to)	CAD	0.65	8%	12%	$0.40
	Texas Mineral Resources (TMRC)	USD	0.66	30%	-8%	$0.30
	Abdn Standard Palladium Trust (PALL)	USD	222.19	63%	3%	$180.00
	Galane Gold (GG.v)	CAD	0.06	20%	-33%	$0.04

Important disclosures

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