Li Ni Co
Forest Hills

Saturday, September 30, 2017

To start your weekend as September and Q3 closes, enjoy (with headphones!) some musical automobile metaphors which capture September lithium sentiment:

"Let the Good Times Roll"
https://www.youtube.com/watch?v=8QfwyqjENnA

Traffic:

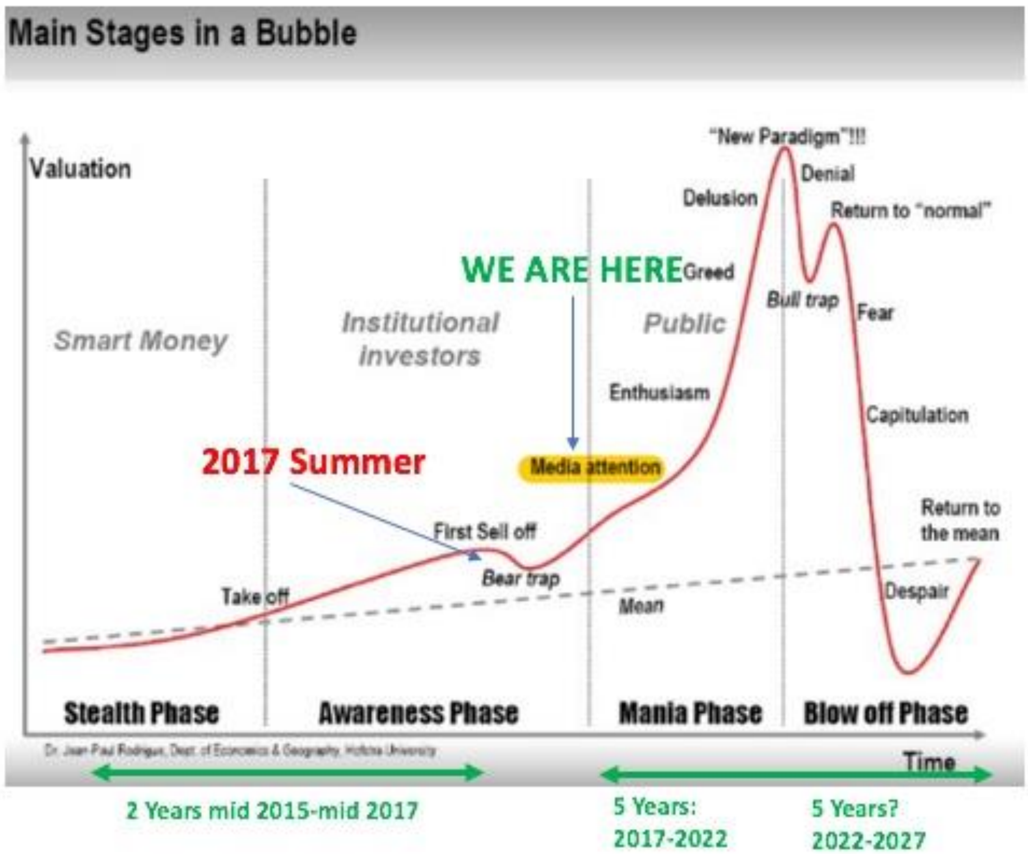
"Feelin' Alright"
https://www.youtube.com/watch?time_continue=211&v=xJcIjG9N1Qs

Tomorrow night – ie, Monday morning, at the ASX open, I will share my traditional start of the month/quarter thoughts about lithium developments, and the information Mr. Market is digesting or not digesting about select lithium stock narratives.

But first, as I join Monday in Toronto a Mines and Money lithium panel – only my second ever public appearance -- I found of interest to review what I said in my first appearance at New York's 121 Mining conference June 8, now available on my website, libull.com:

http://libull.com/Lithium-Bull-Prsentation.pdf

And second, a familiar, and adapted visual, of where I think we are in the lithium cycle and the time horizons.



Plus, a new 5-pager on **Neometals**, followed by a similar note I prepared earlier this week and distributed on LinkedIn on **Kidman**, updated slightly with comments on the **Pilbara** deal with Great Wall. More on Pilbara in my Monday note.

Enjoy, and hope you have a great weekend wherever you reside.

Neometals – Lithium and Titanium

Neometals (ASX: NMT) deserves greater market attention and appreciation. NMT is down 15% over the last 12 months despite roaring lithium prices and lithium equities, especially those with producing and cash flowing operations.

Reed Industrial Minerals (RIM), the Joint Venture which operates Mt Marion, is fully commissioned, at Stage One capacity, and highly and sustainably profitable. A new pricing formula was recently agreed tied to lithium carbonate and hydroxide prices, not spodumene. NMT, founder and minority owner of RIM/Mt. Marion, is now a cash machine.

The JV also provides substantial optionality to NMT beyond its 14% Mt. Marion project interest:

- **Strategic value:** with Mineral Resources and Ganfeng at ~43% each, NMT's ~14% is a swing/control block
- **Off-take:** NMT has rights to a minimum of ~13% off-take from Mt. Marion from 2020, which at Stage One 400K production equates to ~7.6 t/year LCE. A potential Stage Two, 600K production – for which, importantly, NMT is free-carried with MIN covering capital costs – would take NMT's LCE off-take entitlement to ~10Kt LCE.
    - Further, under certain circumstances NMT's off-take rights to Mt. Marion could be multiples of 14% – a large quantum which would be highly valuable.
- **Downstream plant:** with SQM/Kidman and Tianqi in Kwinana, downstream carbonate and hydroxide is becoming a reality in Western Australia. In about 2 years - 2020 -when NMT's off-take rights kick in, Mt. Marion concentrates will have been successfully converted for three years. NMT is currently completing vendor testwork on run-of-mine concentrates before committing to a Front-End Engineering and Design Study using proven flow sheet similar to Tianqi/Ganfeng's for a 10Kt+ per year hydroxide refinery in WA.

Outside Mt. Marion, NMT has a substantial portfolio of valuable assets and intellectual property for which meaningful progress has been announced in recent weeks and months, but for which the market is affixing zero value:

- **Lithium Titanate (LTO)** – recently lodged patents following successfully pouch cell testing in the US of LTO produced from its proprietary process flowsheet. LTO is a premium anode material which allows superfast, wireless charging capability with superior life and safety characteristics.
- **Lithium Battery Recycling** to recover Cobalt, Lithium, Nickel and Copper Consumer and EV batteries - scoping study, pilot plant under construction at their R&D facility in Montreal.
- **Lithium Brine** – Direct extraction of lithium and potassium from brines via adsorption and nanofiltration, potentially replacing the traditional evaporation/carbonation process. Conversion of Lithium Chloride solutions (or hard rock) to Lithium Hydroxide via electrolysis via its patented ELi process. NMT's planned business model is to license to existing producers in return for a royalty stream.
- **Barrambie** – is the world's second richest titanium deposit behind Rio's Lac Tio mine in Canada. PFS indicates it can produce TiO_2 in the lowest quartile, currently producing concentrates at scale for pilot plant testing of 'Neomet Process' in Montreal in Q1 of 2018. New Chief Development Officer appointed September 2017.

I like free lunches. Especially when offered by such a proven creator of shareholder value.

Some background:

- NMT founder/managers -- CEO Chris Reed and his father David -- control 12% of NMT and care deeply about dividends and earnings per share and operate with the highest corporate governance and integrity standards.
- NMT has invested only AUD 3M itself in Mt. Marion and relied on its partners to fund the rest, a strategy the company expects to continue.
- NMT has realized AUD 88M through sell-down to Mineral Resources and Ganfeng, while retaining 14% interest and 13% off-take rights and possible a multiple of that from 2020.
- NMT has returned almost AUD 30M in capital to shareholders through dividends and share buy-backs. Buybacks have continued on a weekly basis at prices from AUD 0.26 to 0.33, with AUD 6M so far.

Neometals August Presentation:

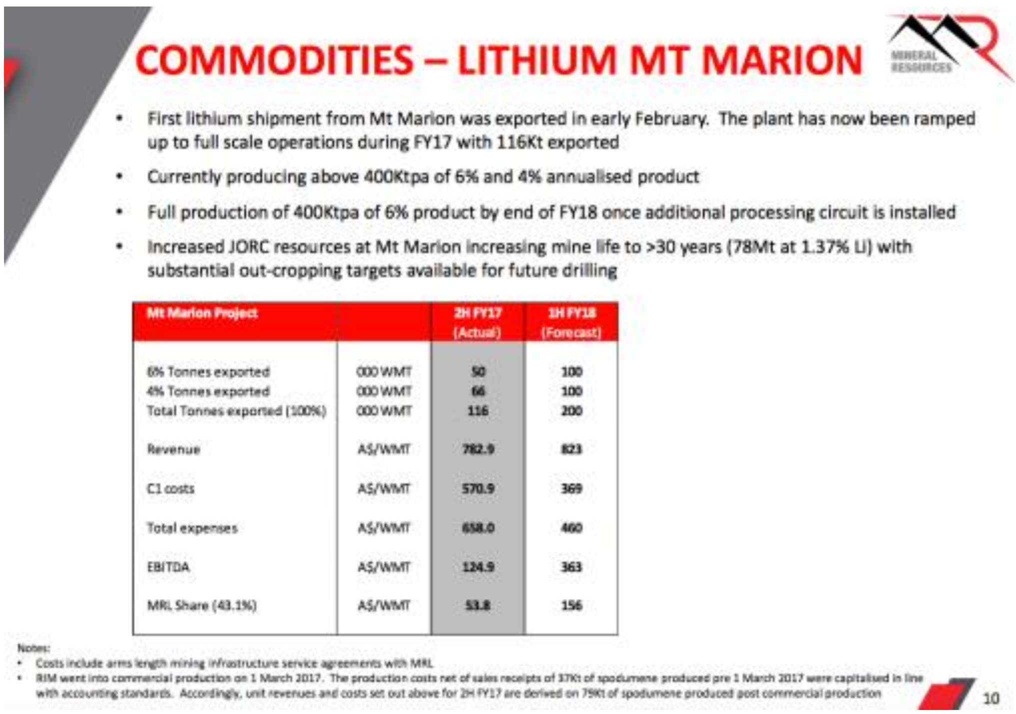
http://www.neometals.com.au/reports/805-InvestorPresentationAug2017.pdf

Mt. Marion – Youtube video:

https://www.youtube.com/watch?time_continue=3&v=R-Kk7dB9b1Q

Mt. Marion - Financial Highlights

Mineral Resources reported that in the six-month period through June, Mt. Marion generated AUD14M in EBITDA and in the July-December 2017 period EBITDA is expected to be AUD 72M. Neometals announced August 16 that this equates to 10M EBITDA for NMT for this trailing six-month period. With spodumene pricing at or above the USD 844/ton agreed in June for Mt. Marion, NMT is guiding its JV share will produce AUD 20M+ in EBITDA over the next 12 months and AUD 30M in 2019. Mt Marion will produce ~400ktpa of 6% Li_2O, equivalent to ~60ktpa LCE from early 2018.



COMMODITIES – LITHIUM MT MARION

- First lithium shipment from Mt Marion was exported in early February. The plant has now been ramped up to full scale operations during FY17 with 116Kt exported
- Currently producing above 400Ktpa of 6% and 4% annualised product
- Full production of 400Ktpa of 6% product by end of FY18 once additional processing circuit is installed
- Increased JORC resources at Mt Marion increasing mine life to >30 years (78Mt at 1.37% Li) with substantial out-cropping targets available for future drilling

Mt Marion Project		2H FY17 (Actual)	1H FY18 (Forecast)
6% Tonnes exported	000 WMT	50	100
4% Tonnes exported	000 WMT	66	100
Total Tonnes exported (100%)	000 WMT	116	200
Revenue	A$/WMT	782.9	823
C1 costs	A$/WMT	570.9	369
Total expenses	A$/WMT	658.0	460
EBITDA	A$/WMT	124.9	363
MRL Share (43.1%)	A$/WMT	53.8	156

Notes:
- Costs include arms length mining infrastructure service agreements with MRL
- RIM went into commercial production on 1 March 2017. The production costs net of sales receipts of 37Kt of spodumene produced pre 1 March 2017 were capitalised in line with accounting standards. Accordingly, unit revenues and costs set out above for 2H FY17 are derived on 79Kt of spodumene produced post commercial production

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At AUD 158M market cap (USD 130M as of this writing), and with AUD 46M in cash and zero debt, NMT is trading at only AUD 112 (USD 92M) Enterprise Value. This equates to only 5.6X 2018 EV/EBITDA and 3.7X 2019 EBITDA. Which compares to **Orocobre** at about 10X, **SQM, Albemarle, FMC** at 15-20X and **Ganfeng** and **Tianqi** at 25X+.

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I have previously been skeptical that Mr. Market should give NMT much valuation for “only” a 14% interest, but I have changed this view having witnessed the performance of **Katanga Mining.**

Katanga Mining is listed on TSX with only 14% free float (86% owned by Glencore International). It is a copper/cobalt project in war-torn, conflict-mineral-plagued, non-Democratic Republic of Congo. Katanga has not produced since 2015 and had negative EBITDA of USD 250M in 2016 and 2015. Re-commissioning is planned in 2018. They are currently processing waste. Yet, Katanga stock is up 5X+ this year and currently has a **$1.5B market cap** with 1.8M average daily volume.

One-year performance: NMT – 15%; KAT + 617%

Scarcity value – i.e., there are few pure-play cobalt stories compared to a plethora of lithium plays – is not a sufficient argument to justify this disparity with NMT, a large, high margin, low cost project in Western Australia, one of the world’s best jurisdictions.

The Great Prize

Neometals announced March 23 its plan to sell its 14% stake in Mt. Marion for USD$96M (AUD 120M) and its partner Ganfeng announced April 6 that its board had approved the purchase.

April 6 (Reuters) - Jiangxi Ganfeng Lithium Co Ltd 002460.SZ

- Says board elects Li Liangbin as chairman, Wang Xiaoshen as vice chairman
- Says board approves unit to buy up to 13.8 percent stake in Australia's Reed Industrial Minerals Pty Ltd (RIM) for up to $96.0 million from Neometals Ltd (NMT)
- Says unit expects to own up to 56.9 percent stake in Reed Industrial Minerals after transaction

Source text in Chinese: http://bit.ly/2nH0pHp; http://bit.ly/2oGHXDn

But Ganfeng did not follow through. It is unclear why, but around the time this transaction was mooted, China's out-bound foreign investment rules were less clear and Ganfeng was figuring out how to meet its cash commitments to Lithium Americas while also finalizing a new off-take and investment with Pilbara.

The AUD 120M offer price is above Neometals' current Enterprise Value. It also reflected prior spodumene pricing of USD 750, not current pricing of USD 844 and future pricing formula linked to carbonate and hydroxide prices. In the context of further rising price trajectory for lithium carbonate, hydroxide and spodumene concentrate, the strategic value and downstream optionality articulated above, multiple re-ratings of lithium producers, Unicorn or near Unicorn status for ASX comps Galaxy, Pilbara and Orocobre, NMT's April offer looks to be low, should NMT seek again to divest.

But this doesn't seem the plan, as per NMT's July press release focused on going downstream:

http://www.neometals.com.au/reports/772-MM10072017.pdf

I have discussed throughout this year my **Inefficient Market Hypothesis**, which stems in part from differences in how certain capital markets value certain cash flows. For example – if the market will give US-traded **SQM** a 15X+ multiple for the cash flows from its **Lithium Americas** and **Kidman** JVs, then investors in TSX-listed LAC and ASX-listed KDR should affix similar ratings.

And if they don't, and instead affix 4-6X base metals multiples, then the answer is for TSX and ASX listed lithium companies to pursue the **Great Prize** – a US listing. NMT has publicly stated in June such an interest:

http://www.cnbc.com/2017/06/15/reuters-america-australian-lithium-miner-neometals-plans-us-listing.html

Kidman Resources – Who's Next

Best hard-rock project in Australia, long-life, world-class – SQM's Patricio de Solminac

It's no secret that I have been a big fan of **Lithium Americas**, a stock for which – unlike Galaxy, or Pilbara, or Orocobre – Mr. Market has never given the benefit of the doubt and always seems to interpret events through a glass-half-empty prism. That's changed, a bit, in September. But on the following continuum…

- Deep Value
- Value
- Growth at a Reasonable Price
- Aggressive Growth
- Over Valued
- Growth at Any Price – Sir John Templeton's Euphoria

…LAC has simply moved up one notch from Deep Value, in my view, to Value. More thoughts about valuation methodologies underpinning such assessment in future.

I sense Mr. Market has used the LAC playbook in analyzing **Kidman Resources.**

The knee-jerk SQM skepticism, for which EYES WIDE SHUT Lithium-ion Bull was as guilty as anyone, resulted in a sharp sell-off that proved to be a dip buy gift. Note: any time you see a lithium stock trading near or below the price a known-quantity-strategic is paying, seize it. Like LAC at $0.86 (price of Ganfeng/Bangchak equity financing) -- and available at or below that price for much of the summer -- KDR's initial convertible note with SQM equated to a worst-case scenario equity investment at $0.68 cents. Yet KDR stock traded in the low $0.50's for much of July through mid-August.

Like LAC, KDR has now signed a definitive 50:50 agreement with the lithium world's smoothest operator and greatest JV partner - on September 11, the same day China lit a fire in lithium land telegraphing a day at which they put all ICE vehicles on ice. It's worth noting, however, that KDR managed to extract 4-5X in financing commitments from SQM to earn their 50% project share. More on that below.

Like LAC, KDR has ensured significant protections as an equal, though much smaller, partner to SQM:

> "Kidman is also pleased to confirm it will retain marketing rights to its share of the production from the planned lithium refinery which will greatly enhance funding optionality for the Company. We consider the refinery will be of significant strategic value to Kidman and its shareholders well into the future."
>
> The structure of the JV requires the formation of a JV Management Committee (**Committee**) that is comprised of two Kidman and two SQM representatives to oversee the development of the Earl Grey mine, concentrator and refinery. There is no casting vote afforded to the Chairman of the Committee and the Chairmanship is rotated on a bi-annual basis, with a Kidman representative being the inaugural Chair. Kidman is afforded protection against future dilution, as any proposed expansion in operations may only be done by unanimous management committee decision.

Like LAC in January - post Ganfeng/Bangchak financing announcement - but before April's updated 43-101 Feasibility Study and receipt in July of funds from its partners, there still is some fog around the economics of the Mt. Holland JV and capex and opex figures. And, unlike LAC, KDR is only just about to put out a scoping study, whereas SQM had LAC's 2012 BFS to work from.

But, let's not kid ourselves, it didn't take a rocket scientist to read the tea leaves and ballpark LAC's DFS based on public pronouncements – Galaxy, too, had very recently produced a very good comp DFS. Likewise, it shouldn't take a rocket scientist to make a reasonable guesstimate of what Mt. Holland capex and opex might look like, in particular given the recent comps at Pilbara, Altura, Greenbushes expansion and Tianqi's Kwinana refinery.

I haven't seen much KDR tea leave reading in the public domain as of yet, however, so am taking this opportunity to be among the first to provide one.

Should LAC and PLS be worth 2-3X KDR today?

At $0.97.5 cents, KDR today is AUD 320M (USD 260M) market cap, exactly the same market cap at which LAC took in its full funding at $0.86 cents. LAC's valuation is more than twice KDRs at CAD 727M (USD 580M). LAC will have first meaningful lithium carbonate production in 2020, while KDR should be producing at almost exactly the same time, spodumene concentrate. LAC is fully funded. Is KDR for spodumene? I think so.

There's been some confusion as to how the SQM funds will flow into KDR and the JV, but it's actually relatively simple. SQM is providing $110M to develop the project. $30M of this is going to KDR directly. The remaining $80M goes in as equity into the project. If KDR needs to use the $30M from SQM for JV equity, SQM would have to contribute another $30M as well, so in total there is $140M project equity commitment from SQM. The JV could easily raise $200M off that $140M equity (60/40 debt/equity ratio) if not more, which would be USD 340M in total. I doubt the mine will cost this much. Consider: Pilbara's full funding was for similarly scaled ~300K tons/year spod con plant which was about USD 260M all-in, though its DFS from last year suggested it would be only USD 170M.

Given KDR's less remote location and infrastructure, they will not have to incur certain costs (eg. Accommodation camps) and given their grade and continuity – 1.9 strip ratio according to SQM, their flow sheet may have fewer steps. In other words, KDR/SQM might be cheaper capex than PLS.

So, LAC and KDR are very similar looking into 2019/20 first production. What will their cash flows be?

For LAC, assuming $12,000 LCE price - a reasonable assumption as it is below prevailing price and that below that some of the most accurate forecasters are predicting in 2020/21 - and, assuming the JV meets the DFS $2,500 cash cost, LAC will be generating ~$50M at initial 2020 ramp and USD 110M into 2021 at full ramp up Stage One - this is for LAC's 11.6K tons equivalent from the 25K JV LCE production.

For KDR, assuming $750 spodumene concentrate price, a reasonable assumption as it is below the $844 Ganfeng most recently agreed to pay Neometals and Mineral Resources at Mt. Marion, and KDR's cash costs come in on par with Altura's $250/ton estimate (a reasonable assumption, again, given grade, flow sheet, infrastructure), KDR, given faster ramp of hard rock, should be generating USD 75M in 2020 before moving to carbonate and hydroxide production in 2021/2022. By 2022, KDR should be considered a 20K LCE producer, while LAC would be 23K LCE producer.

If there's one thing that most everyone who's studied lithium knows it is that brines have cheaper opex than hard rock. My sense is that KDR opex will be higher than LAC's, but not by too much. And from a valuation perspective, I believe LAC's lower opex and slightly higher LCE tons could be off-set by some other factors, which could translate into lower discount rate/slight premium valuation for KDR, namely:

- Sovereign Risk - Australia vs. Argentina
- LAC carbonate only vs. KDR carbonate/hydroxide flexibility
- China vs. non-China alignment
  - SQM/KDR is the only WA producer with no Chinese strategic partner
  - SQM/KDR is the only carbonate and hydroxide from hard rock processed outside China.

Now, is KDR fully equity funded for the JV's 40K downstream plans? Very possibly, and if not, the equity dilution would be quite small and would occur in 2020 -- nearly three years from now.

Consider: based on Tianqi's USD 300M capex for 24,000 tons/year hydroxide refinery in Western Australia ($12.5K/ton capital intensity), a 40,000 SQM/KDR refinery should cost about USD 500M. KDR's half share would be USD 250M. Assuming KDR sells one year's worth of spodumene concentrate while the refinery is being built and the cash flows are USD 75M in 2020 as per above, and this USD 75m is used as KDR's equity contribution into the refinery, KDR could likely borrow USD175M (70/30 debt/equity) and would need no more funding.

Based on this analysis, I think the discrepancy between KDR and LAC's valuations USD 260 vs. USD 580 should not be this wide. #relativevalue.

But as I articulated at the opening, I see LAC still as very much a Value stock, and therefore #absolutevalue in both LAC and KDR.

By further comparison, Should Pilbara at ~USD 800M, be worth nearly 3X KDR today?

Pilbara is an excellent project that should generate substantial cash flows feeding their Chinese off-take partners spodumene concentrate. Their growth plan is focused on a 250% increase from 300K to 800K in spodumene production – a large undertaking with a not insignificant possibility of execution risk. They don't have a clear downstream path, which is fine, so long as their pricing continues to be tied to carbonate and hydroxide prices, which the Great Wall announcement says it will, but also references that it could change to market pricing if an index develops. I'd be careful before pricing in anything into PLS for its stage 2 until I see them executing consistently at stage 1 -- walk before running. So, I think of PLS as a 300K spodumene producer at full ramp in 2019, which is one year before KDR at similar spodumene production. Paying 3X more to buy PLS for one year seems too high, which is not to say PLS doesn't provide good value at USD 800M market cap, but begs the question should KDR at USD 260M market cap catch up and narrow this yawning gap.

KDR: New Nickname, September 2017

"I call that a **Bargain**, the best I ever had…THE BEST I EVER HAD!"

Live from Forest Hills, July 2015, THE WHO:

https://www.youtube.com/watch?v=aS9aefv2cPA

1971

#28 of the #500 Greatest Rock Albums of all Time – Rolling Stone, 2003

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