Issue 65: November 16, 2020

Tianqi Chinese Checkers & ROC-Solid ALB

If 2020 has proved anything, it is to expect the unexpected.

With EVs and batteries atop the Made in China 2025 priority list and the country's studious foresight in controlling the supply of upstream raw materials, it seems almost inconceivable that China could let the world's greatest hard rock lithium mine – **Talison Lithium's Greenbushes** – escape its grasp. And yet.

A distressed debt investor friend shared with me that an unsecured **Tianqi** bond sold to international investors off-shore China is currently trading at ***30 cents*** on the dollar. But of greater relevance is the posture of Tianqi's ***secured*** creditors – led by Chinese state-owned banks. I excerpt from an article earlier this week from Asia Core Credit:

> *It was reported this week that Tianqi Lithium had hired Alvarez and Marsal as financial advisor as it is unable to meet the looming $1.88 billion loan maturity on Nov. 29, while all strategic investors have dropped out of negotiations with the company. Ahead of the looming Nov. 29 maturity,* ***China CITIC Bank International*** *has begun* ***sounding interest from hedge fund buyers*** *for its $485.5 million hold of an originally $1 billion mezzanine loan… Tianqi had told its credit investors in the past few months that* ***the central government owned China Non-ferrous Metal Company Limited****, and Sichuan* ***state-owned Sichuan Development Holding Co., Ltd****. were prospective strategic investors, but it is understood that* ***negotiations with both parties have ceased*** *since mid-October. It was at that point that lenders and Tianqi began formal talks about asset disposals, a potential amendment and extension of the maturing loans, and a potential restructuring for the broader company, but lenders have yet to decide on granting an extension. The major holder of the mezzanine loan, China CITIC Bank International has been sounding the market to auction the $485.5 million mezzanine loan hold of Tianqi and sought pricing in the mid-80s but initial indications have* ***prospective buyers looking at pricing in the 60s and 70s.*** *However,* ***the ability of lenders to enforce and gain control of*** *the shares and assets pledged as* ***collatera****l to the loan* ***is still unclear.***

Let that sink in. Government-backed industrial companies are snubbing Tottering Tianqi. One of the most important state institutions/banks in the country – CITIC – is "sounding out" "hedge fund buyers" with a wide 60-85 bid-ask. If, say, Oaktree or other blue-chip distressed debt players who navigated, say, the Molycorp rare earth bankruptcy (reborn November 13 through the **MP Materials**/FVAC SPAC approval) bought debt from a China state lender for which all of Tianqi's non-China assets are held as collateral, then it would seem not just possible, but probable that Tianqi could experience a western-style bankruptcy. And Western debt buyers could sell off the pieces to non-Chinese buyers.

> **Collateral:** 51% stake in Talison/Greenbushes (est $1-3B value); 24% SQM stake (est $2.6B); Kwinana refinery (est $500-700M)

No one was more vocal than me and Julio (Ponce) down by the Santiago schoolyard working throughout 2018 against the Big Chill-e: the folly of Tianqi borrowing heavily to pay $65/share and $4.1B for a passive 24% minority interest in SQM. Except, perhaps, Mr. Ponce’s (SQM's major shareholder) strange political bedfellow (CORFO regulator) Dr. Eduardo Bitran. Little did I/we know that we were doing Tianqi the favor!

Recall China was muscling the Chilean state – which controls Salar de Atacama lithium and simply rents it to SQM. Belt & Road sticks – unsubtle hints about Chilean copper purchases – but not many carrots. And then Trump Trade Wars kicked in in earnest in 2019.

> **Wondering** – is Mr. Ponce puppeteering SQM’s predatory China price war in part to hurt Tianqi (via depressed carbonate prices and low SQM share price)?

It was against the law
What the mama saw
It was against the law
Goodbye to Rosie, the queen of Corona
Seein' me and Julio
Down by the schoolyard

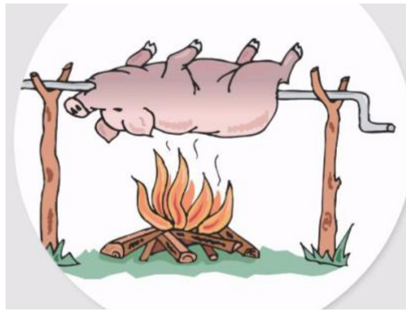
Flashback to December 31, 2018 Lithium-ion Bull, New Year's Day Animals, as the 2018 Year of the Dog turned into 2019's Year of the Pig.

Capitalist Pig | Communist Pig

ALB/MIN: $2B
Wizards of Oz

Tianqi/SQM: $4.1B
ChiNationalization of The People’s Lithium

So…checkmate for ALBemerica?! Red White and Blue Sky in Greenbushes?! Albemarle has a Right of First Refusal on Tianqi's 51% stake in Talison on preferential terms on any change of control transaction.



Tianqi Christmas Ham @AlbemarleCorp?

Not so fast. This is a game of Chinese checkers, not chess. I'm smelling a Szechuan Chicken strategy. Tianqi's severely out-of-favor Chairman and major shareholder Jiang Weiping and his daughter are for sure sweating as they seemingly run out of options. But I see a number of potential red flags still to unfold. Lithium is hard. No surprise China Non Ferrous Metal or Sichuan Development Holdings don't want to touch Toxic Tianqi. But no doubt the savviest Chinese billionaires running EV-tied companies with inflated equity values are watching very closely. And could be preparing a Pilbara/Altura-like move.

Vulture – the sacred bird of Tibet

Battery champion **CATL** in coordination with its hydroxide affiliate **Yibin Tianyi**? Perhaps.

But more logical and strategic would be for China to facilitate **China Girl Ganfeng**'s leapfrog to the world's #1 lithium producer. Pure speculation, but an outcome in which Ganfeng ($1772) controls Talison/Greenbushes and Tianqi's 40kta conversion plants in China (mostly carbonate) has massive strategic logic. The SQM stake could be sold off. The botched Kwinana hydroxide plant can be fixed or sold (to, e.g., SQM/Wesfarmers). CITIC could exchange its debt for Ganfeng's richly priced equity. Or Ganfeng could issue equity for cash to pay back CITIC. Multiple outcomes look both highly accretive and strategic.

No one has more experience in ChinAustralia mine-to-lithium chemicals than Ganfeng. It is their number one core competence. Ganfeng's recent strategy has been to migrate its (relatively expensive) Mt Marion spodumene to 'specialty hydroxide' for western OEMs (e.g. VW, BMW, Tesla). It plans the same for its Pilgangoora off-takes. The logic of Ganfeng's ambitious foray into Argentina brine is to lower its costs for China-focused 'commodity carbonate'.

Altura's bankruptcy puts their Pilgangoora high quality SC6 up for grabs – leaving Ganfeng somewhat exposed. Talison would solve that SC6 problem. Further, Tianqi's 40kta (mostly) carbonate capacity in China is likely as or lower cost – and far less risky – than the 40kta greenfield Ganfeng has underway at its 51%-controlled Cauchari project with **Lithium Americas.**

Lithium Pigs – 3 Different Ones
U.S.

& Them
The Dark Side of the Money

Should my speculation about a national lithium champion Ganfeng eventuate, it is conceivable that, like **Livent** postponing 2021 Argentina capex to focus on **Nemaska/Quebec** rock, Ganfeng could slow play and wait a few more years before giving the market a taste of its fine Cauchari brine.

Ganfeng demonstrated November 13 its full commitment to **Bacanora**'s Mexico clay, exercising its option to take 50% of the Sonora Project, up from 22.5%, for USD 29M. Which of hydroxide or carbonate (or both) Ganfeng will produce is unclear. But if they've cracked the clay code for hydroxide, Sonora's proximity to the USMCA market could make this project much more relevant than Argentina carbonate. Following a Ganfeng conference call this week **Morgan Stanley's** analyst **Rachel Zhang** wrote that Sonora clay is expected to commence operation in 2023 with ***cost of hydroxide similar to their current hard rock-based production routes***.

Lithium ion (soft) Rocks! May 28, 2019

[E14: Ganfeng's Big Adventure. Bacanora. Tequila!]

ROC-Solid ALB

Citi's PJ Juvekar upgraded **Albemarle** and Livent from Neutral to Buy this week with some commentary that looks like it's pulled from this newsletter and Rodney Hooper's proprietary client monthlies (for subscriptions, please reach out) ☺

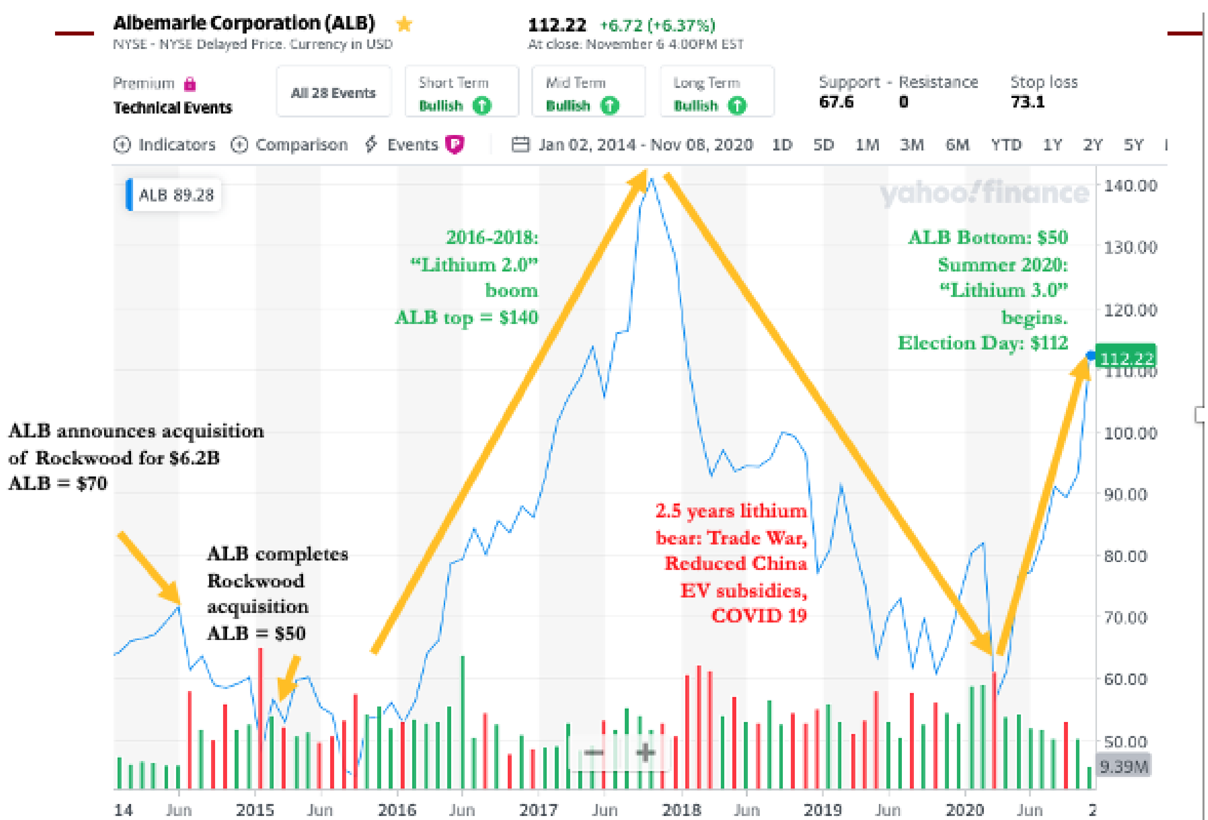
> *We are upgrading ALB and LTHM to Buy from Neutral as our analysis shows that lithium supply/demand should meaningfully tighten over the next two years from current trough conditions. In essence, we anticipate 2021 to be a year when volumes turn around, and 2022 to be a year when pricing inflects.*
>
> ***Why Not Upgrade SQM?***
>
> *SQM is primarily focused on the more commoditized Lithium carbonate market in China, whereas ALB and LTHM have more exposure to the more "specialty" hydroxide market. We expect hydroxide prices to inflect sooner than lithium carbonate given carbonate inventory levels are elevated.*
>
> *Therefore, SQM is unlikely to see the same immediate positive impact of an inflection in lithium demand to its Lithium segment results.*
>
> *SQM's larger exposure to shorter-term, spot price contracts is likely to lead to increased volatility. Spot-based short-term contracts could lead to more of an immediate benefit vs. long-term contracts if lithium spot prices spike; however, generally we think the industry is moving more towards longer-term contracts. This is likely due to auto OEM or battery manufacturer preferences for supply security.*

A big debate about lithium is about whether it is a "commodity" or "specialty chemical". I call it lithium a **"specialty commodity".**

It is not yet conventional wisdom on Wall Street, but it is my view that SQM's lithium busines should trade at a meaningfully lower multiple than ALB's because SQM has lower quality, more volatile earnings. It is selling an increasing amount of lower value commodity carbonate into the short-dated China market; its hydroxide is generally not battery quality and is also a lower priced commodity. ALB sells more higher quality specialty hydroxide to higher quality customers at longer term, more predictable prices. These higher quality products, customers, and earnings deserve a premium.

Tianqi outbid Albemarle's predecessor **Rockwood** in its 100% purchase of Talison in 2013 -- with the help of China state debt funding. Tianqi then welcomed Rockwood in for 49% to pay off that debt. The $1.1B valuation Rockwood paid for Talison equated to 16.7X trailing EV/EBITDA – a high water mark M&A multiple at the time for a producing asset in the tiny lithium industry. The following year, "It's Good to Be King" **KISSam Luke** kissed Seifi Ghashemi's solid ROC with an ALB $6.2B bid which equated to 14.4X trailing EV/EBITDA.

In the nearly 5 years since merger consummation, ALB, an SP500 constituent, has underperformed the broader market. How will the next five years look for ALB in the context of other EV-themed equities? Will ALB survive as a standalone company or be acquired and/or be broken up? Time will tell. But I'm focused first on the next 5 ***weeks*** to see if ALB can eat Tianqi's Talison bacon.



I conclude with some quick summary and analysis from Albemarle's Q3 earnings call last week.

- #1 Priority – sustained and rising dividend – maintained. 38 cent per share.
- Bullish EV outlook - highlighting 90% increase in EV sales in September, led by Europe
- Unclear whether spot pricing is up-ticking - different price reporting agencies reporting different things.
- No meaningful carbonate price uptick before 2022 but hydroxide price rise sooner. Too soon to tell on the outcome of current price negotiations
- 'We're sold out; no volume' is the party line. Not worried about lost market share in immediate term - will make up in 2022/23 if need be. Mexican standoff. Are they taking advice from ex-Albemarle Gerrit Fuelling as shared on Lithium-ion Rocks GF2?
  We shall see
- Phrase of the day "favorable re-investment economics" re: price contracts; upbeat on hydroxide prices with new customers
- 3 pricing tiers: 1. long-term, fixed price (above current market); 2. some price volatility (floor & ceiling price - to ensure it meets ALB's re-investment economics); 3. free market volatility. 80% of contracts are in tier 1 and 2; ALB will only invest in new capacity based on Tier 1 and 2 contracts.
- One recently signed new customer for Kemerton wants little price volatility and have fixed long-term contract (Tesla?!)
- Who is buying and where are they buying matters: China carbonate much shorter duration/volatile market - less concerned with security of supply
- However, battery and auto OEMs - whether buying LiOH or carbonate - want longer term security
- Inventories about 5 months (guess). More carbonate than LiOH (Rodney Hooper thinks 4 months carb, 1 month LiOH)
- Cathode buyers are getting less involved in purchasing. Increasingly being told what to do by battery/auto OEM; also being squeezed by battery companies making their own cathode. Cathode market quite volatile with players/market share moving around a lot. (RK comment: this likely explains Umicore's relatively bearish commentary)
- Due to more favorable hydroxide market, ALB is restarting Kings Mountain hydroxide now - earlier than expected; Silverpeak from Q1
- For conversion assets in China ALB still looking to buy rather than build and no longer will "toll" hydroxide as they seemed to have learned a lesson about giving away this IP
- Assuming 6 month qualification, La Negra carbonate sales to begin by late 2022, Kemerton hydroxide sales into 2023
- ALB hasn't determined whether Kemerton will be fed by Greenbushes or Wodgina yet. Says it depends on how fast market grows/long-term volume/price contracts.

RK Equity **Research, Capital Raising, Advisory, Merchant Banking**

11 Years Experience with Lithium Battery Materials Developers

Disclaimer

Lithium-ion Rocks, Rock Stock Channel and Lithium-ion Bull are periodic publications, written and/or produced by RK Equity Advisors, LLC. In this article/episode and any other newsletters, podcasts or videos Howard Klein and/or RK Equity affiliate Rodney Hooper may share some rationale for a stock in which we have some conviction – for or against – and may own directly in our own retirement or taxable accounts. If you agree or disagree with and act on or against the rationale of anything written in this or any other Lithium-ion Bull or Lithium-ion Rocks! podcast or Rock Stock Channel video, that is your free choice. But to be clear, the commentary you're reading, hearing or seeing is not investment advice, nor a recommendation and may not be unbiased. RK Equity, Howard Klein and Rodney Hooper are not registered investment advisors nor a broker-dealer. We may act, or may have acted in the past, as a financial advisor, or capital raiser for certain of the companies mentioned herein and may receive, or may have received, remuneration for services from those companies. Howard Klein, Rodney Hooper, RK Equity may make purchases and/or sales of securities mentioned here-in from time to time, subject, of course, to restricted periods in which we may possess material, non-public information. As of November 15, 2020 RK Equity, Howard Klein or Rodney Hooper own securities in Mineral Resources, Piedmont Lithium, E3 Metals Corp, Albermarle, Livent, European Metals Holdings, Bacanora, Critical Elements, Frontier Lithium, Camino Corp, Talon Metals and have or have had over the past 60 months fee-paying advisory assignments with Western Lithium/Lithium Americas, CleanTeq, Millennial Lithium, Altura Mining, E3 Metals Corp, NeoMetals, Critical Elements, Nouveau Monde Graphite, Kidman Resources, Nemaska, Camino Corp, Bacanora, European Metals Holdings, Savannah Resources, Talon Metals, Lithium Power International and Piedmont Lithium. The information contained herein is not financial advice and whether in part or in its entirety, neither constitutes an offer nor makes any recommendation to buy or sell any securities.