

Cobalt Supply Chain Massively Disrupted by Glencore and China

written by Peter Clausi | March 15, 2018

China-based GEM is reported to have signed an agreement with Glencore PLC for 52,000 tonnes of cobalt hydroxide. This has massive real-world implications for the availability of cobalt and for pricing.

According to Bloomberg (the terminal, not the mayor), “GEM Co., Ltd. collects and recycles cobalt and nickel scraps into ultra-fine cobalt and nickel powder and other products.” Revenue for 2016 was 7.7 billion CNY (USD\$1.2B). Market cap is roughly 28B Yuan or USD\$4.4B. Glencore is a huge commodity trader, ranking 10th on the list of the largest companies in the world for 2015, and in 2016 ranked [16th in global revenue](#).

Initial reports were that Gem had agreed to buy 52,000 tonnes of cobalt from Glencore per year for 3 years, but other reports later gave it as 52,000 tonnes over three years. There is still a lack of clarity on this point. If it's the former, that's half of the world's cobalt supply being consumed by one consumer – that's highly unlikely given the dynamics of the cobalt market. But even 52,000 tonnes over three years sucks about one-third of the world's supply of cobalt out of the market, an amount that can't help but drive up the price.

Global consumption of cobalt is roughly 100,000 tonnes per year. (Glencore is forecasting a production increase, from which the supply is expected to come.) That's very small. Contrast that with copper production which was about [19.4 million tonnes in](#)

[2016](#) . Such a small market is very vulnerable to supply shocks, and this mass consumption of cobalt is a supply shock.

As with almost anything involving China, there are puzzles wrapped inside conundrums buried inside unreliable data. But this we do know. The world needs cobalt for the high-tech magic that is the cathode in a lithium-ion battery. If it's rapid charge / discharge, that battery has cobalt in it. That includes cell phones, rechargeable smart devices, laptops, toothbrushes, power tools, Bluetooth headphones and, most pointedly, electric vehicles. Hello, Tesla.

This agreement is another example of China looking far ahead – here, it's the pollution issues being solved by mandating electric vehicles. Cobalt is needed for the batteries in those vehicles. That cobalt going over the Big Red Wall through Gem will be consumed in China, and the rest of the world will have to fend for itself.

We've recently seen news that end user manufacturers like Apple, Tesla, Volkswagen and Samsung have been looking to secure long-term supplies of cobalt. You snooze, you lose. Gem pulled the trigger on a strategically critical purchase for a strategically critical metal. Panasonic and LG are back to playing catch-up. And since Panasonic supplies Tesla, expect continued production woes from that marketing machine.

The Congo hasn't helped this market tightness. Remember that the 2016 presidential elections are scheduled to be held sometime this year. Making things worse is the new tax and royalty regime introduced last week, creating a disincentive to produce the element falling as #27 on the periodic table.

Expect the multiyear bull market in cobalt to continue. Expect to see similar but smaller announcements from other multinationals. Expect the interest in northern Ontario (a

geologically bizarre region shockingly rich in cobalt) to continue.

Decriminalization of Cannabis Delayed Yet Again – Who's to Blame?

written by Peter Clausi | March 15, 2018

There's another delay in cannabis legalization. This time, it was because of the Liberals' failure to manage the Senate.

One of the Liberals' key campaign promises in 2015 was the decriminalization of cannabis. Off that promise, billions in stock market value has been created. A failure to deliver on that promise will wipe billions off. If decrim has not taken effect by the next federal election in 2019, expect this to be a painful campaign issue. The other parties know this.

In February, the government finally admitted it would miss its own July target date (See [Smoked!](#)) with a new soft target date of sometime in autumn. The precise date is still unclear. The Senate is partially responsible for that.

The Senate is the Upper House in the Canadian Parliament. Each Senator is appointed by the Governor General, on the advice of the Prime Minister. In theory without loyalty to any party and appointed to serve until 75 years of age, a Senator is supposed to bring sober second thought to legislation proposed by the

ruling party of the day. Think of a Senator as your smart grandmother who has been there, done that, and is ready to tell you.

It doesn't always work that way. Senators have long memories and most of them have a history in politics, whether on the front lines or behind the scenes. "Independent" is a fiction when you're still bearing a grudge against another political group from when you were appointed by your own party 20 years ago. Payback's a bitch.

Last week the Senate, dominated by members who historically were part of the right wing parties in Canada, got a chance to stick it to the Liberals.

Here's the background. Decriminalizing cannabis is governed by Bill C-45. That bill is winding its way through the system. At the same time, Parliament is considering Bill C-46, which creates new impaired driving charges related to cannabis. You can't have one without the other. Law enforcement needs Bill C-46 to pass. The Liberals have pushed Bill C-46 as hard as they can – the Senate is creating a roadblock.

The Senate, as part of its function to review proposed legislation, has held hearings and heard from roughly 40 persons related to C-46. What it has not done is begun its painstaking line-by-line analysis of C-46 and how it meshes with other existing legislation. It won't do that until at least May AFTER it finishes with C-45. Even at breakneck speed, C-46 will not go back to the House of Commons for 3rd Reading until June at the earliest.

The next part of the math is the new impaired driving regime as proposed will stagger into law over a six month period to allow for law enforcement to catch up. June (at the earliest) plus six

months is December, 2018 (at the earliest).

December, 2018 is the earliest you will see cannabis decriminalized in Canada. If the more conservative members of the Senate really want to see the Liberals squirm, they will try to use Parliamentary procedures to delay decrim until Parliament is prorogued for the next election. C-45 and C-46 would then die.

Map this out if you're a conservative Senator with party loyalties. You get to be seen as doing your job re-considering two major pieces of legislation, you get paid until you're 75 no matter what, you can't get fired, and you get to stick it to the hated Liberals. Do you think any of them will do that? Right.

What should the Liberals have done? Most of governing, true politics, happens behind the scenes. The Liberals failed to execute on true politics. If you want a give on something, you need to give on something. How do we know they failed? The Senate isn't sticking to the Liberals' script. The current state of affairs tells us they failed.

Decrim will happen, whether in this parliamentary term or next (assuming Canada can withdraw from the international treaties that govern cannabis). It should happen. Most Canadians either want it to happen or don't care. I fall into the "Don't Care" camp. But I care about the precise date for decrim because it affects market valuation. It affects cash flow. It affects human resources decisions. It affects investment banking decisions. Some of the licenced producers will not be able to survive into 2020 following the federal election if decrim does not happen as the Liberals promised it would. And imagine the limitations that would be on decrim if the Liberals were defeated in 2019 and the Conservatives were back in power.

As we've said before, this is a trader's market, not an

investor's market. We're on the record as having only two longterm picks to thrive in the inevitable carnage: Canopy Growth Corporation (WEED:T) and Aurora Cannabis Inc (ACB:T). Aphria Inc. (APH:T) is a distant third. Everyone else is a different flavour of fourth.

Smoked! Govt Finally Admits No Marijuana Legalization by July

written by Peter Clausi | March 15, 2018

The cannabis market continues to be a trader's market. It's not for investors. The difference is the inexplicable random gyrations in the trading of the public marijuana companies' shares. Up three dollars, down two, up four, down two, then sideways... that's the average weekly chart in the cannabis space.

It's a strange market. Good news can send share prices down. News that should crater the stock instead pushes it up. It brings back memories of the [internet boom in the late 1990's](#).

Canopy Growth Corporation (TSX: WEED) is the largest cannabis company in Canada. Its current market cap is \$5.5Billion, with close to 200,000,000 shares outstanding. Its year high was \$44 a share, but those same shares can be bought today for around \$28. That's a \$14 per share difference, and that share price difference represents about \$2.8Billion in market cap difference. But the company is substantially the same – that \$2.8B market cap delta was not driven by a fundamental change in anything except investor sentiment. Value created and destroyed by mere perception, not facts. And that, is a trader's market.

If further proof is needed, look at Aurora Cannabis Inc. (TSX: ACB | OTCQX: ACBFF). It's one of our long-term favourites to survive the inevitable carnage in this sector. Its low over the past 12 months was \$1.90. One hundred and ninety pennies. Today, it's trading about \$11, after stretching to hit a high of \$15.20. With 470M shares out, the market perceives Aurora having created about \$4.7B of value over the past 12 months. Not even Aladdin with his magic lamp could do that.

The main reason for the irrational exuberance (thank you Alan Greenspan) is the federal government's campaign promise to decriminalize cannabis. Investors know the medical market is limited in size, and the real \$\$\$ will be in the recreational space, if it ever happens. Almost everyone takes it for granted that decrim will happen, on schedule, on July 1, 2018, despite the well-known fact a politician on a campaign trail makes more empty promises than does Harold Hill.

Also take into account the potential size of the market. Don't trust the numbers from people in the market who have a clear vested interest in a huge number. Instead, look to independent data sources, such as the [survey of 1,500 Canadians](#) conducted by Abacus Data on behalf of *Maclean's* as part of [The Canada Project](#). It found that 84 per cent of respondents over 18 *never* smoke marijuana, and of the 16 per cent that do, daily users amount to only 5 per cent, and 3 per cent say they use a few times a week.

5 per cent of 32 million Canadians is 1.6M daily users. That sounds like a lot, but consider there are 89 licenced producers with many more applications in the pipeline. That's not a lot of users to spread around, and it gets worse when you consider that taxation and price controls have not yet been finalized. For many of the LP's, the only end game will be consolidation or bankruptcy.

Public consultation by the feds only closed three weeks ago on January 20, 2018. The infrastructure issues are so deep, so broad, so regulated by at least three other levels of government, that there is no way decrim can be implemented on the Liberals' schedule.

We've been warning about this since the Liberals started promising in 2014. This will be the fourth year that we've warned investors not to trust the government. Every time we've pointed this out, traders have objected: "The Liberals promised it and the govt needs the tax revenue. *Of course* cannabis will be decriminalized."

The Senate has already indicated it will not simply accept the Liberals' legislation, and there are still the persistent barriers created by international treaties like the [Single Convention](#) that need to be overcome. Even if those huge challenges are overcome, the implementation of the legislation requires a previously unheard-of level of co-operation at the municipal level, across Canada, across ten provinces and three territories.

But the federal government just told the market, NO. The first paragraph from an article in last week's [Globe and Mail](#) summarizes the facts: "Canadians will have to wait until late in the summer before they will be able to legally consume cannabis under a new timeline laid out by the federal government – even if the Senate votes in favour of the legislation by May or June."

In a slippery bit of news that fell sideways into the media, Health Minister Ginette Petitpas Taylor told certain members of the Senate that the feds will wait 8 to 12 weeks after the legislation is passed (if it ever is passed) before actually decriminalizing cannabis, to give provinces and municipalities

the time to create an implementation structure. If the legislation is passed for July 1/18, that means the earliest you can buy weed legally would be for your Thanksgiving party. This dovetails with our warnings that the government's timeline was impossible (see for example our detailed [article from Sept/17](#)).

That interim period is important. It matters because it negatively impacts cash flow. It negatively impacts balance sheets. It impacts business plans and human resources decisions. And those impacts will play out in the market. The market is always wrong in the short term and right in the long term.

If you're looking for comfort, the Liberals are not the place to look for it. How about [this](#) recent blumphus from Public Safety Minister Ralph Goodale: "Our goal is this summer in an orderly fashion with all the pieces sequenced in the right order so that they are effective." What does that even mean?

So what to do. One, be realistic. Recognize the reality of the real timetable for decrim. You will not be able to legally buy marijuana outside of the medical market on July 2, 2018. Second, avoid business plans whose survival depends on decrim happening at all. Third, avoid business plans whose survival depends on decrim happening in 2018. Fourth, be a nimble trader, not an investor. Wait to be an investor after the cannabis market has its inevitable severe correction.

Or, you can believe the government's election promise.