Graphite stocks down 3rd week in a row, fundamentals be damned

**Graphite Market Review** — The graphite sector was down for the third week in a row, down -6.29% for the week ending October 3, 2014, based on the the stocks we are following listed below. As I said previously, graphite stocks are not immune from the overall selloff in natural resource stocks and the weakness in gold and silver was a downer as well. China’s growth rate is slowing, yet the offsetting decline in Chinese exports of graphite have not yet kicked in to boost pricing. Intuitively, everyone should want to see graphite prices go up, but in fact since there is so little graphite production outside of China, a low price keeps China’s production at bay. Of course, a higher price might get emerging projects funded, but most of the top 10 projects are still a few years from production. In other words, low prices are the best cure for low prices and higher prices should be in place right when key projects are ramping up in 2016-2017.

In two prior articles I laid out my thesis that BOTH the demand and supply of graphite could easily surprise to the upside and downside, respectively, creating a perfect storm for pricing. Without repeating too much of the other articles, I made the case that demand for electric vehicles alone could grow at Compound Annual Growth Rate “CAGR” well above the 10%-25% pundits and company management teams forecast. On the supply side, China’s a huge wild card, but all roads lead to China’s dominance of graphite exports, (it currently accounts for roughly 75% of global supply) coming to an end. Of the handful of graphite mines that will likely make it into production by 2020, most will take time to ramp up to
nameplate capacity. Some won’t reach nameplate capacity if they can’t sell the entire range of products they produce.

I also wrote an article last week about the uranium spot price being up close to 30%, yet many uranium stocks are languishing near 52-week lows. The same can be said for graphite stocks when it comes to stock prices getting hammered. The following chart shows some of the poorly performing stocks from recent 3 month highs, i.e. from this past summer, through October 3rd. Notice the average decline of this group is 34.4%.

Despite my bullish view on graphite fundamentals, the stocks are off significantly from 3-month highs

This unsavory performance makes little sense, albeit most likely tied to the rout in many natural resource sectors such as coal, iron ore, gold, silver and uranium. The fact that the gold price ended last week below the important sentiment level of $1,200/oz did not help any of the TSXV juniors or the Australian, “penny dreadfuls.” Comparing graphite to uranium is not particularly useful except to say two things. First, both uranium and graphite are explicitly stated as highly strategic and critical commodities by the EU and the U.S., not to mention China. Many believe that China is cleaning up its act in graphite for environmental reasons, but conserving domestic graphite reserves is a priority as well. That’s why China is not only closing and consolidating graphite mines, but also proposing to import flake graphite from companies like Syrah Resources Ltd. and Focus Graphite Inc. Some think China will become a net importer of flake graphite within 5-10 years. Think of the implications of that possible scenario. Second, both uranium and graphite are poised to see continued gains in pricing. The spot uranium price is already up 30% from it’s low, while graphite prices remain fairly close to multi-year lows. Of the two, I think that the fundamentals of graphite is more compelling in the short-to-intermediate term.
due to the lack of supply overhang in graphite compared to that of uranium.

With all the talk about electric vehicles, including by me, the market might be forgetting about other key end markets for graphite. End uses are described in most of the corporate presentations of the usual suspects such as Mason Graphite, Triton Minerals, Alabama Graphite, Graphite One, Focus Graphite, Northern Graphite, Great Lakes Graphite, Elcora Resources and Energizer Resources. Some of these presentations have been recently updated and contain excellent information for investors. One area that used to receive more airtime (hard to believe) than electric vehicles was fuel cells. In fact, there’s a famous quote from five years ago that the global demand for graphite for fuel cells could be greater than the demand for all other uses combined. This obviously has not happened. But, fuel cells have not gone away like VHS machines or tape recorders. The prospects for fuel cell cars remains quite a strong, albeit currently taking a back seat to electric vehicles for the time being. That said, Northern Graphite reports that more graphite is used in fuel cell cars than in electric vehicles. Therefore yet another growing market to watch out for. Substantially more fuel cell cars, buses, taxi fleets, forklifts, etc. will be hitting the market in the next five years, i.e. at the same time that electric vehicles are massively more deployed. As an aside, it’s been reported that California alone will have 1 million zero-to-near-zero emission vehicles within 10 years and China 5 million by the end of 2020.

**Fuel cell cars are still coming, not to mention aerospace and military applications for graphite**

Another market not discussed nearly as much as others is aerospace and military applications. Graphite composites are lighter and stronger than steel for use in the bodies of modern aircraft and for military applications. Graphite and a host of other high tech materials are already being deployed
in the aerospace and military markets. Globally, new aircraft designs don’t come out each year, but new composites, including graphite are spec’d into all new aircraft. Not only are high tech composites safer, their lighter weight saves on fuel and therefore fossil fuel emissions.

Turning back to the performance, or lack thereof of graphite stocks, an upcoming headwind if not already at play, could be tax loss selling in North America. Here we are in the 4th quarter of the year and the stocks are tumbling. I had hoped that this year would witness less tax loss selling, because natural resource juniors looked a lot healthier earlier in the summer. But, looking at the TSX Venture exchange index on October 3rd suggests otherwise. Still, after technically driven stock declines like tax loss selling as opposed to fundamental headwinds underlying the industry—buying opportunities arise. Notice I’m not saying which stocks to buy or when, but the end of last year marked a bottom that resulted in a rally in the first quarter of 2015. It makes sense to watch the graphite stocks closely and consider dollar-cost averaging (or doubling down) into one’s favorite names.

**Graphite Market Review, for the week ending October 3, 2014:**

As mentioned the weekly performance of the graphite stocks we cover was poor, down 6.29%. Relative out-performers included, **Elcora Resources Corp.** (TSXV: ERA) up 11.63%, **Energizer Resources Inc.** (OTCQX: ENZR) up 1.25%, (TSXV:EGZ) unchanged, **Great Lakes Graphite** (TSXV: GLK) unchanged and **Valence Industries Ltd.** (ASX: VXL) unchanged.

On October 1st, **Alabama Graphite** (TSXV: ALP) down 15.09% and (OTCQB: ABGPF) down 16.97%, announced that it has begun surface exploration at its Bama Mine Project in Alabama, USA. The Company is currently conducting detailed channel sampling on its recently acquired mineral leases. Of the 6 samples taken, 4 were from the existing pit wall of the prior
producing Bama Mine and showed grades ranging from 2.81% to 5.24% C(g). In addition, KLM Geosciences is concurrently performing a ground-based GEM2 geophysical survey. Follow-up sonic drilling at the Coosa Project discovered several new occurrences outside the existing resource based on these two surveys. The Company’s plan at the Bama Mine Project is to use the results of the GEM2 and surface-sample programs to guide a preliminary round of sonic drilling in the coming months.

On October 3rd, Grafoil Inc. announced it has reached a final agreement and closed its acquisition of ALCERECO Inc., a technology leader in advanced composite materials, alloys and coatings and a company focused on the development, testing and production of advanced materials. Under the terms of Agreement, Grafoil purchased all of the issued and outstanding shares of ALCERECO from the shareholders of ALCERECO in exchange for 250,000 common shares of Grafoil at a price of US$5.00 per share, for a total value of US$1,250,000. Based in Kingston, Ontario, ALCERECO provides independent technical expertise, contract research, analytical and testing services. Notably, Focus Graphite Inc (TSXV: FMS) & (OTCQX: FCSMF) both down 14.0%., “holds a significant interest in Grafoil on behalf of its shareholders.”

Energizer Resources Inc. released its annual 10-k filing last week. The company has a June 30th fiscal yearend. Pages 12-16 have a good overview of the graphite and vanadium markets. I believe that annual 10k reports contain the most detailed descriptions of a company’s projects, opportunities and risk factors.

On September 29th, Great Lakes Graphite, unchanged on the week, announced that it has staked an additional 12 claims contiguous with the main block of claims included in the Company’s Lochaber Graphite Project in southwestern Québec. The Lochaber Graphite Project comprised 151 mineral claims, in four contiguous blocks, covering 9,062 ha. The Company is earning a 100% interest in the property as per an option and
purchase agreement with Rock Tech Lithium Inc. The new claims add an additional 720 ha to the Project area. CEO Paul Gorman commented,

“The additional claims that the Company has staked are on trend with the mineralization that is the focus of our ongoing resource estimate. Given the positive results from beneficiation and graphite-flake classification studies that Great Lakes announced last week, we moved quickly to add these claims to our land package.”

On September 29th, Valence Industries Limited, (ASX: VXL) unchanged on the week, announced it’s nearing completion of the refurbishment of the Phase 1 Plant at its flagship Uley Graphite facilities in South Australia. Over the past week Valence Industries received delivery of the new mill that forms part of the primary processing circuit in the Phase I Plant. The installation of the mill along with the remainder of the primary processing circuit will be completed over the coming weeks. Work on the secondary processing circuit is effectively complete and ready for recommissioning using the stockpiled fines materials once final governmental approval is received. Completion of the Phase I refurbishment program is an exciting stage for the company and will be a significant milestone. The capacity to run the only graphite processing facility in Australia with Phase I to produce up to 14,000 tonnes of graphite each year is a significant step forward.

In an October 1st corporate presentation, Syrah Resources Ltd. (ASX: SYR) down 13.17%, announced it demerged its Tanzanian assets from the company. The demerged assets include Mineral Sands, Graphite, Nickel and Coal prospects. An IPO is planned to raise $10 million for further exploration of the Tanzanian assets.

On September 30th, Kibaran Resources Ltd. (ASX: KNL) down 3.57%, announced that its Environmental and Social Impact
Assessment for its Epanko Graphite Project in Tanzania has been completed and officially lodged with the National Environmental Management Council of Tanzania. Under Tanzanian environmental legislation, NEMC have up to 90 days to review the ESIA and recommend to the Ministry of Environment that an Environmental Certificate be issued for the project. Kibaran anticipates it will receive the certificate for Epanko prior to calendar year-end.

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