Stashing it Away – FEM, UPC and Dacha

The chorus of those criticizing the U.S. policy of the last four decades of running down the stockpiles (that had been built up in the preceding three decades) has been growing. In times of austerity though it's a tough call and those politicians and citizens concerned by the strategic risks of not having a homegrown stash have been far outnumbered by those who frankly don't care or those who are opposed (though the latter group are small). The stockpiles had their origin in the bitter experience of the Second World War and the prolonged Cold War. The WW2 experience was that the U.S. suddenly realized that while it may be the land of abundance there were some things it did not have easily to hand, a good example being tin. It was interesting recently to read that when the Second World War started the U.S. had no tin production and the only deposits it had in Alaska were inadequate for its needs, so it was dependent on Bolivia. I might note that relations with Bolivia these days are not as rosy as they were in 1942 and that the South American nation is barely a shadow now of what it was in the tin production stakes back then.

The US once had great mountains of commodities stored away for a rainy day. The stocking of these caches had the added benefit that it justified mining of some of these minerals in the U.S. thus creating a symbiotic relationship between the government and the miners. Is it any coincidence that the decline of the US as a great mining nation (and the brutal shrinkage in the number of top miners based in the U.S.) has coincided with the abandonment on the stockpiling strategies in the 1970s and 1980s? The most notable stockpile still extant is the Strategic Petroleum Reserve. Though as I shall note in an upcoming piece Beryllium is something the U.S. also still squirrels away. Ironically in the latter metal, it is the only metal I can think of where the U.S. dominates global mine production and processing.

Defacto Stockpilers

I shall look here at some examples of proxy stockpilers that, in a pinch, might almost pass for de facto national strategic reserves. They are the opposite though of the old U.S. reserves which ended up being "bought high and sold low" when these commercial operators aim to do the opposite!

Uranium Participation Corp – Symbiotic with Denison

Uranium Participation Corp. is an entity that has not come to the attention of institutional investors, at least not US investors. It is a quasi-ETF and its best parallel would be Dacha Capital in the Rare Earth space. Officially it is an investment holding company which invests most of its assets in uranium, either in the form of uranium oxide in concentrates (U_3O_8) or uranium hexafluoride (UF_6), with the primary investment objective of achieving appreciation in the value of its uranium holdings.

It is essentially a stockpiler and does not have an ETF's elasticity of capital. As such it can fall to a discount during a bear market and rise to premium when its space is hotly sought. It provides an investment alternative for investors interested in holding uranium, which is not exactly the type of material that more mainstream ETF managers can handle. Therefore the manager of Uranium Participation Corporation is Denison Mines (TSX: DML, NYSE: DNN), the well-known and long-established Canadian uranium miner.

This company did not escape the Uranium blues and fell into a hole during the slump (well, the slump before the latest slump). A look-alike company from the bull market days called Uranium Ltd suffered a similar fate and eventually joined forces with UPC in a merger which was consummated in March 2010 via a share exchange (0.5 shares UPC for each UL share). This deal valued Uranium Limited at $139.4 M. Via this transaction UPC acquired 1,725,000 lbs of U_3O_8 and 412,000 Kg of UF_6 essentially at the bottom of the market.

Uranium Participation Corp. estimated net asset value at April 30, 2014 was CAD$524.2 million or CAD$4.49 per share. As at April 30, 2014, UPC’s investment portfolio consisted as follows:

This entity has passed under the radar of many investors but represents an almost faultless exposure to uranium in a way that we do not feel any of the individual stocks do. In theory the company should move in tandem with the Uranium spot price. The table above comes from the company’s most recent valuation for the portfolio as at the end of April 2014. Looking at the valuation of the U_3O_8 holdings, one notes that it is being bought (and valued) at spot which may undervalue the holdings when one considers that the long-term contract price, which is the level at which one would liquidate such a portfolio, is above $50 at the current time.

After a long period of somnolence (and having completed a $57.6 million bought deal financing in early February), UPC made its first purchase of uranium in four years. The company announced that it had purchased 850,000 pounds of U_3O_8 at an average cost of US$34.74. UPC noted that 250,000 pounds have already been delivered, the remainder will be delivered by the end of June. The company’s management expects to undertake another purchase of 800,000–900,000 pounds of uranium sometime in the next month or two.

Being a proxy in a sub-sector where the bulk of investors do not understand the product let alone the companies we would expect that any shining of the spotlight back onto the resurgent Uranium space would result in Uranium Participation, with its ETF-like qualities being the first port-of-call.

First European Minerals Ltd. (FEM) – a Model to Emulate

It has become clear to me that the tight communities surrounding the various strategic metals the secret to success of certain executives and traders is, metaphorically speaking, “knowing where the bodies are buried”. FEM has essentially been created as a vehicle for channeling the skillsets and contacts of Alastair Neill. His background is as the former VP/GM, Rare Earth Division and VP Business Development for AMR (which became NeoMaterial Technologies and merged with Molycorp). He has over 15 years of direct rare earth experience with downstream end-users in Korea, Japan, Europe and North America and with suppliers in China. He was also formerly involved with Dacha Strategic Metals. He holds a master of business administration from York University and a Bachelor of Engineering in material science from the University of Western Ontario. Interestingly he resides in Beijing reflecting a perception on FEM’s part of where the fulcrum of power on strategic metals has shifted.

FEM is an interesting animal, quite unlike the universe of listed companies I usually encounter. In some ways it is like a mini-version of the trading houses I wrote about last week. It has an inventory of metals that its trades (the list of what is available is even up on their website with tonnages and delivery locations) and yet it also has interests in mining projects in strategic metals (chromite and REEs in Turkey and Tungsten in Kazakhstan), so essentially it is going where many of the larger traders fear to tread. This is a strategy I cannot fault and one that I wish there were more companies pursuing (though not hundreds.. please).

Dacha Strategic Metals (TSXV: DSM) – The Luxury of Picking and Choosing

Dacha was a creation of its time (though it had existed before the REE boom). Its real surge to prominence took place at the height of the boom when it was, in some eyes, the only “real” REE story (besides Neo-materials) because Dacha was actually a stockpile of Rare Earths. Unlike the miners (or wannabe miners) Dacha could pick and choose what it held and could focus on those REEs for its portfolio that were such scarce and sought after items. It could eschew the whole Lanthanum/Cerium problem by accumulating only what it thought “hot”. In many respects it can still do that and the number of “real” REE miners has only expanded by Lynas and Molycorp getting across the line into production. Dacha actually makes money (though not always) in some quarters.

The company was part of the Forbes & Manhattan stable but of late has taken on a more independent course. As at September 30, 2013, Dacha held 42,450 kilograms of rare earth metals with an estimated fair market value, based upon pricing reported by two independent news sources for the strategic metals industry, of $14.2 million.

As at September 30, 2013, Dacha had net assets of $18.5 million (or $0.25 per basic share), principally comprising its metals inventories plus cash of $4.4 million, accounts receivable of $606,324, prepaid expenses and deposits of $69,604, accounts payable and accrued liabilities of $430,545, income taxes payable of $122,375 and deferred income taxes of $133,771. It made a profit of $1.1mn in that quarter.

An example of the type of trades the company does is the sale, in 4Q13 of a portion of its inventory of Terbium Oxide. These metals were sold for approximately $250,000 more than their original cost, although market conditions at the time of this sale were such that the metals were sold for less than their estimated fair market value as at September 30, 2013. This is always the danger in the lumpy and non-transparent world of REE trading where odd-lots are almost the rule rather than the exception.

Conclusion

Nature abhors a vacuum. The U.S. government (and they are not the only guilty party) have largely abandoned stockpiling of strategic metals as a defence strategy. However with rising tensions with Russia and China the "peace dividend" that we were supposed to be paid at the end of the Cold War has turned out to just be a series of proxy wars now compounded with tense relations with major suppliers of strategic metals. The difference between now and 1989 is that back then Western economies were NOT dependent upon the parties they were lined up against militarily. Now the same cannot be said.

So the vacuum is, in some small way, being inhabited by companies such as FEM, Dacha and Uranium Participation Corp. The latter has size on its side and can throw its weight around in the uranium space, should it need or want to, Dacha in its own way has one of the largest stashes of REEs around but has not effectively seized the nettle and become a minor sun in the REE universe. If anything it has fallen off many radar screens. It could however be a prime playing piece in a REE roll-up. Such a roll-up has been talked of for years but never eventuated. Then there is FEM, maybe it might be the instigator of such a consolidation. However we note that it does not want to get itself hemmed in as a "REE story" and instead wants to be a free range rooster stalking about the barnyard of strategic metals in general. Backdooring the currently unlisted FEM into the Dacha vehicle might be a canny mixture of brains and brawn.