Avalon's Don Bubar on developing a rare earths supply chain in Canada

"Interest in rare earths continues to ramp up. There is real concern about the security of supply of these critical materials outside of China. With the Executive Order that Trump implemented this summer means there is now funding available for companies aspiring to participate in developing that supply chain in the United States." States Don Bubar, President, CEO and Director of Avalon Advanced Materials Inc. (TSX: AVL | OTCQB: AVLNF), in an interview with InvestorIntel's Tracy Weslosky.

Don went on to provide an update on Avalon's collaborative development agreement on Nechalacho Rare Earth Elements Project with Cheetah Resources of Australia. He said that Cheetah Resources has taken ownership of one small part of the property where the resource was well suited for developing at a very small scale to get something in production quickly, make a concentrate that can be shipped and rare earths extracted to provide another source of rare earths to rapidly serve the needs in markets outside of China. Don also provided update on Avalon's East Kemptville Tin-Indium Project and Separation Rapids Lithium Project. He said that the company is planning to use sensor-based ore sorting at the East Kemptville Tin-Indium Project. The work is in progress for testing the material to be able to use the technology and the initial results are encouraging.

To access the complete interview, click here

Don Bubar on advancing Avalon’s rare earths, lithium and tin-indium projects towards small scale production

“We are making a lot of progress – moving all the three projects forward with that goal of achieving initial small-scale production within the next year or so…”, started Don Bubar, President, CEO and Director of Avalon Advanced Materials Inc. (TSX: AVL | OTCQB: AVLNF), in an interview with InvestorIntel’s Tracy Weslosky.

Tracy Weslosky: Don, I want to start by congratulating you for winning PDAC’s distinguished service award. But first I want to congratulate you on the news you just announced where you provided an update on three of your projects as you race towards small scale production. How about we start with that?

Don Bubar: We are making a lot of progress. We haven’t had a tremendous amount of news flow over the last couple of months but that’s not because we have been working really hard. We are moving all the three projects forward with that goal of achieving initial small-scale production within the next year or so.

Tracy Weslosky: I continue to pound the issue of sustainability with our audience. We need these critical materials for technology applications. Let’s start with Nechalacho. What is happening there?

Don Bubar: We have a new partner there in Cheetah Resources, an Australian private company. They share our vision for the need for small scale rapid production to serve this rapidly growing deficit of the market for rare earths as soon as possible. They have agreed to work with us on that project. We actually have sold them one small part of it to allow them to take the lead on getting that going with our support of course to help them get started and create long term possibilities to grow that project.

Tracy Weslosky: And their investment is $5 million is that correct?

Don Bubar: That’s the initial purchase price. They will also be investing in whats needed to take the project to next stage of feasibility work and put it in production.

Tracy Weslosky: How did you get the Australians attracted to investing in North West Territories…to access the complete interview, click here

Disclaimer: Avalon Advanced Materials Inc. is an advertorial member of InvestorIntel Corp.

Avalon helping to meet the lithium and rare earths demand

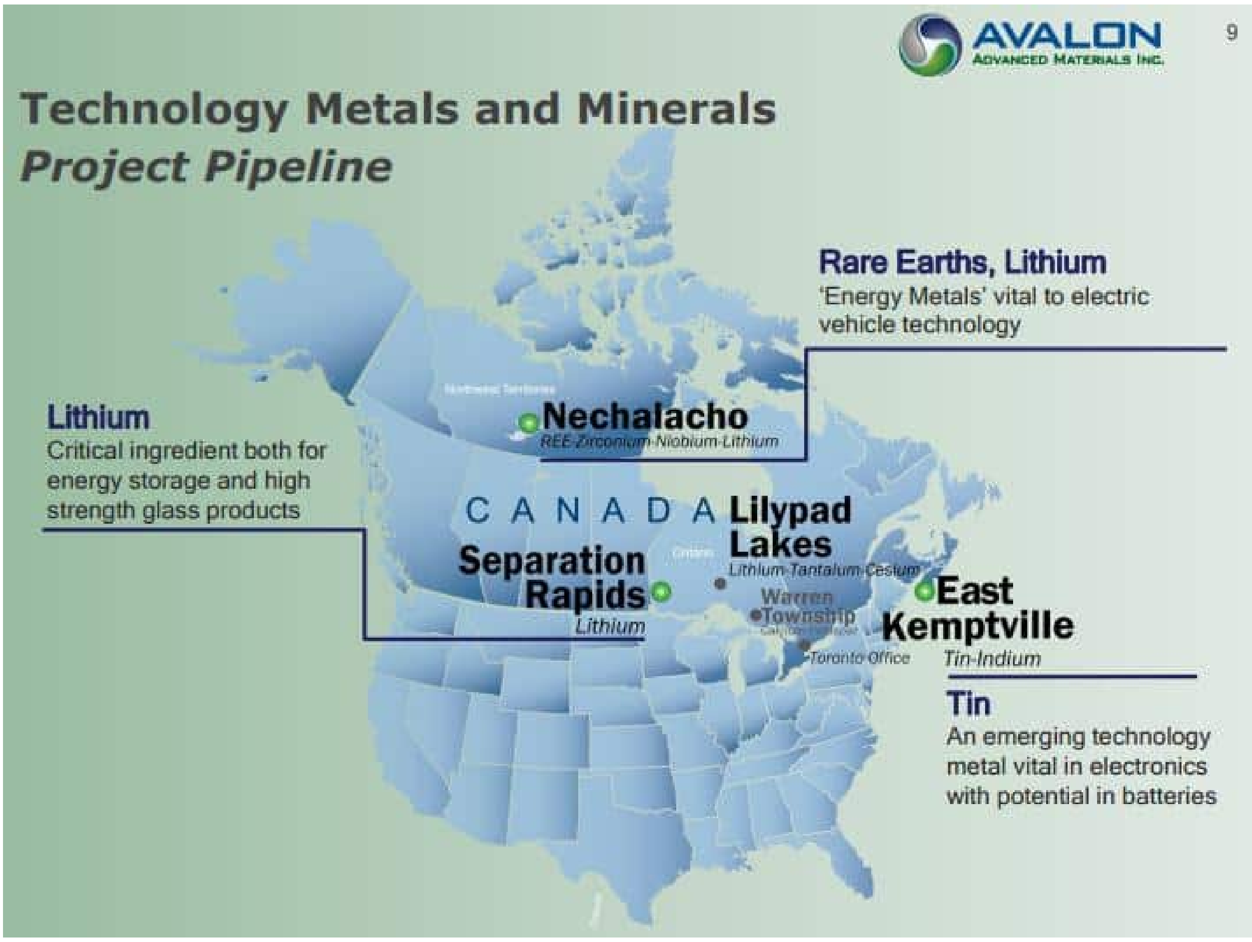
[Note from the Publisher: I was delighted to see that Matthew Bohlsen had elected to write an update on Avalon Advanced Materials, especially in lieu of the column published yesterday The Single Biggest Legislative Development in the

Rare Earths Market since 2010. While this column highlights the latest in their Separation Rapids Lithium Project, I would like to remind our readers that InvestorIntel.com was the blending of 29 blogs, including RareMetalBlog.com in 2012. That particularly blog, and the associated rare earth education sites were inspired by conversations I had with the CEO of Avalon Advanced Materials Inc. Don Bubar. The **Nechalacho** Project is Avalon's flagship rare metals NA project and is exceptional for its high concentrations of the more scarce heavy rare earth elements or rare earths – enjoy Matthew's update!]

Avalon Advanced Materials Inc. (TSX: AVL | OTCQX: AVLNF) ("Avalon") offer investors exposure primarily to lithium, in addition to tin, indium, silica, rubidium, cesium, tantalum, neodymium and praseodymium.

Lithium is the lightest known metal, and it can also lighten your mood. Lithium, atomic number 3, is an element of many uses. It's used in aircraft manufacture and in certain batteries. Lithium is a special metal in many ways. It's light and soft, so soft that it can be cut with a kitchen knife, and so low in density that it floats on water. Lithium-ion batteries are the key to lightweight, rechargeable power for laptops, phones and other digital devices. Growing demand for rechargeable batteries in electric vehicles and home energy storage is expected to result in continued rapid growth in global consumption of lithium. Many industry analysts are predicting that the demand for lithium will increase substantially over the next 5-10 years, possibly creating a supply deficit, as existing producers struggle to meet the new demand.

Avalon could be in a position to benefit from this demand with their Separation Rapids Lithium Project having the potential to produce high purity lithium compounds for two distinct markets – An industrial mineral product for glass-ceramics, and lithium chemicals for energy storage. The lithium petalite found at the Separation Rapids lithium deposit also offers potential to provide a high purity lithium chemical product at a relatively low-cost to serve the needs of lithium ion re-chargeable battery manufacturers. It also has potential for several by-products including feldspar’s, silica, rubidium, cesium and tantalum. The Company’s by-product recovery offers the possibility of significantly increased revenues and reducing the amounts of waste material having to be disposed. Petalite is the preferred lithium mineral feed-stock for certain specialty glass-ceramic products for technical reasons, notably its consistently low impurity levels.



Avalon’s Canadian based projects

Separation Rapids Lithium Project

On September 2016, Avalon announced the results of a positive Preliminary Economic Assessment on the Separation Rapids lithium project. The results confirm a technically viable process and positive economics for the recovery of a battery-grade lithium hydroxide product. The Project has a net present value ("NPV") of C$ 228 million after-tax, an IRR of 16% after tax, while construction capital costs are estimated at $514 million, inclusive of $86 million in contingencies and $7 million in sustaining capital. The PEA was based on annual production of 14,600 tonnes of lithium hydroxide for 10 years, 100,000 tonnes per year of feldspar mineral concentrate for 20 years, with low production costs (estimates to be below US$5,000/t).

East Kemptville Tin-Indium Project

Avalon's other focus is their East Kemptville Tin-Indium Project. In July 2018, Avalon finalized its Preliminary Economic Assessment (PEA) on that project. The re-development model, as presently conceived, is an environmental remediation project that will be financed through the sale of tin concentrates recovered in large part from previously-mined mineralized material on the site supporting economic recovery of tin concentrates for at least 15 years. Total estimated Measured and Indicated Mineral Resources are now 22.97 million tonnes at 0.153% Sn, with an additional Inferred Resource estimate of 14.25 million tonnes at 0.139% Sn at a cut-off grade of 0.1% Sn.

Avalon – An emerging technology metals producer

Avalon also recently announced they will re-activate their 100% owned Nechalacho Rare Earth Elements Project, Thor Lake, NWT ("Nechalacho" or "the Project") in 2018 due to strong demand for the 'magnet rare earths' neodymium and praseodymium.

Avalon Advanced Materials Inc. has a market cap of C$ 16 m. The Company is a Canadian mineral development company headquartered in Toronto, Ontario. Avalon specializes in critical metals and minerals with growing demand in new technology. One to follow.

Specialty Metals: There is a Season – Turn, Turn, Turn

With the blizzard of noise in the Lithium space and the generalized feel-good in the mining space in general, it is easy to fall into the trap of thinking that all is well in the world. As we all know Uranium remains in the dog house but quite a lot of specialty metals are not exactly in the rudest of health either.

A key factor missing from the specialty metals scene, that would give it an upward boost, is a generalized economic recovery. Sure the US is doing OK and Europe is struggling out of its mire but many emerging economies (e.g. Brazil) have been going backwards and China is still in its swoon.

Tin

The price of this key minor metal has moved up by a third from its lows around the start of this year. To get back to its average price over the last five years it would need to rise another 20%. Therefore it looks like there is still good upside potential. The fact that should be overlaid upon this proposition is that the supply situation has considerably weakened over the last five years with the still-dominant Indonesian and Malaysian alluvial deposits in terminal decline and with the former country particularly intent upon squeezing the supply situation by insisting that concentrates be processed and upgraded within the country rather than in China.

The best upcoming Tin deposits are in Africa, most particularly in the DRC and Burundi, neither of which inspire massive confidence in investors. Some underground mines are on the drawing boards (or are old mines that might be reactivated) but they will inevitability skew the average cash cost of production higher. Tin is destined to be a tighter market with higher prices.

Tungsten

It is simplistic to link Tungsten’s fate solely to machine tools and thus to activity or lack thereof in the Chinese economy. More countries' economies use machine tools than just China's. Additionally the use in drill-bits etc. took a double blow in 2015 with miners virtually ceasing to do exploration while the oil industry's long boom came to an end with the steep falls in oil and natgas prices. While oil remains in the dog house, mining is stirring to life and while the drilling is not as frenzied as before it is reviving and there is money to fund it. That alone gives encouragement to those keen on this tough metal.

The chart below shows the Ferro-Tungsten price and it's clear that this is far from being in boom mode with a rise of only 10% off its bottom and half the level of four years ago.

Antimony

This metal largely has its application in alloys (with Lead amongst others) and in fire retardants. The plunge from early last year to its nadir in early 2016 was brutal and I believe prompted by the FANYA debacle. The applications that Antimony is used for are not in any sort of swoon and indeed the auto industry (a major fire retardant user) is booming all around the world. Therefore the blame can most probably be laid at the door of FANYA. The problem with that issue is that the market place never really knew the extent of the FANYA overhang and probably never will. The fact that prices have rebounded nearly 30% in recent months probably means that the overhang is gone.

Supplies are reputedly tight and therefore the chances of the price returning to early 2015 levels is good, not that $8,000 per tonne is all that ritzy a price for this commodity.

Rare Earths

This group is down and out purely at the discretion of the Chinese who have decided to bankrupt and drive out the Western players. The turn in this group of metals could be as basic as some Beijing official getting out of the bed one morning and thinking it’s time to lift prices. It has very little to do with supply/demand and almost everything to do with an industrial policy. However the policy has now gone beyond beggaring the *Gweilo* and China is now beggaring itself in a scarce resource.

The scene is ripe for this bedside conversion as the Chinese could easily hike prices by 50% in the entire Lanthanide group (excepting Cerium and Lanthanum) and there would be no negative effect on demand and only one non-Chinese company would benefit (Lynas) while all the Chinese producers would be banking significantly higher incomes. There is no chance that even such a hefty rise would bring another Western player into contention for 3-4 years and even then whatever new source of production appeared would not be disruptive in terms of volumes added to the global supply.

Therefore, with timing unknown, we would still sustain that a REE breakout is more likely to happen than not with the decision not in the “lap of the gods” but within the purview of a Chinese apparatchik.

Niobium

This metal is joined at the hip with the steel complex and frankly it’s hard to see why there should be an upsurge in demand for the foreseeable future. Added to that is that the biggest player in the metal keeps a tight rein on prices and operates on a Goldilocks principle of “Not too cold, not too hot, just right”.

One matter that is rarely mentioned is that CBMM is like a one-company cartel (somewhat like Materion in Beryllium) and that it tolerates Niobec and the other small players in the interests of an “orderly market” and not appearing to be a total monopoly. That said, one should not discount that CBMM controls the levers of the Niobium price and if it sees a threat to its dominance from too many players appearing on the scene then it may well (and certainly could afford to) lower the price 20-30% to throw wannabe producers into confusion. Thus any new Niobium player that appears and talks about their massive potential production then that wannabe and its shareholders should watch out that the Brazilians don’t decide to play Whackamole with their project via the pricing mechanism.

Conclusion

One should not discount that the FANYA Exchange debacle is still having some lingering effects on specialty metals and it has definitely sidelined a lot of the speculative players in China who lost their shirts and ended, metaphorically, up to their eyeballs in Bismuth and Indium (and Antimony). The overhangs may have been cleared away but the creative destruction of “locals” in the marketplace for specialty metals has returned trading to the producers and end-users who have failed to provide liquidity to specialty metals in the past and who indeed seem to prefer prices that are set by a combination of smoke signals, nods & winks and Masonic handshakes.

Despite this the signs are there that specialty metals were oversold at their worst and are now in recuperation mode even though the words “boom” or “surge” could not be employed. And that is probably all to the best after past “pump and dumps” in thinly traded commodities.

The lack of pure plays continues to be a problem in some spaces and we continue to admire the consolidation strategy pursued by the likes of Almonty which should be a model for those companies operating in all the specialty metal subspaces.

The tide has lifted (almost) all boats in the precious metals space and specialty metals now await their turn. The lack of investment in recent years and the exhaustion of some traditional sources of supply means that any resurgence in prices will need to be fed with new projects to ensure that supply crises do not eventuate again sending prices to the levels seen late last decade. Its up to the hardy survivors to re-emerge from the bunkers and set to work providing this new supply.

2015 – China’s Annus Horribilis

For the Japanese, their *anni horribili* at the end of the 1980s are chiefly remembered for overpaying for the Rockefeller Center and golf club acreage. When the Brazilians come a cropper, it’s a case of party like its 1959, and return to the basics of fresh air, coconuts and sunshine. But when it comes to *hubris* the Chinese, as in everything, outdo everyone. The new self-proclaimed *Masters of the Universe* have managed to end the year choking themselves, and their economy, to death in a cloud of Purple Fumes (cue the Performer once known as Prince) and shown that as for regulation (and development) of financial markets the Chinese, to put it more politely, could not run a booze-up in a brewery.

The last weeks of 2016 saw several prominent financial market figures disappear and then reappear (including the reputed Chinese version of Warren Buffett), the aforementioned pollution disaster and the start of criminal investigations relating to the FANYA schemozzle. There is an innate tendency for institutions in the capitalist side of the Chinese economy to deteriorate into illegality and irregularity with remarkable speed. In this aspect the Chinese system appears most akin to the rip-roaring US markets of the late 19th century when Robber Barons ruled the roost on Wall Street and established suffocating and anti-competitive cartels/trusts.

FANYA

For the mining community the most important thing about China is the demand aspect as this has driven so much of the global mining industry's thought process over the past 20 years, however for the

The establishment of the FANYA Exchange with its focus on specialty metals seemed like a logical and inevitable evolution of the Chinese dominance of the production of (many) specialty metals and the substantial position it also held as a processor and end-user. FANYA initially started out with specialty metals and then diversified into fixed income products. The problems in the Bismuth, Indium and Antimony trading by the exchange's investor base are well documented now.

In mid-July Metal Bulletin reported that the Fanya Metal Exchange had suspended accepting applications from companies to sell Indium, Germanium and Bismuth on the exchange between June 23 and August 31. An official from Fanya, who refused to be named, cited "Liquidity-related problems" were the major reason for the decision. That there should be "liquidity problems" in trading notoriously illiquid metals in the pre-FANYA era, comes as no surprise to participants in the global market for specialty metals.

While FANYA has been most (in)famous its metals trading, it has also had a fixed-income element, which not unsurprisingly has reputedly also gone bad. The Financial Times reported in

September that “hundreds of well-heeled urban professionals who had purchased high-interest rate products from the Fanya Metal Exchange united with distribution agents who sold them in an unusual protest….in the financial heart of Beijing”.

The FT captured the moment at which the head of FANYA, Shan Juiliang was manhandled by a crowd in Shanghai. They dragged him off to the police to have him arrested. Whether his potential fate at the hands of the crowd or in the Chinese legal system will be a better one will remain to be seen.

The big question, as everyone knew six months ago that FANYA was going down in a welter of financial irregularities, is why did it take so long to look into the matter? Obviously people in high places wanted to cover their behinds (and unwind positions) before the Great Unwashed cottoned on. However, the public are now so far ahead of the authorities in catching a whiff of scandal that the Powers that Be are last to know.

Chinese “Statistics”

Time and again we have seen the Chinese “issue” with deceptive practices on bonded warehouses and the collateralization and double-counting of fictitious or “massaged” inventories. It is very easy to create theoretical liquidity by miscounting (read exaggerating) warehouse numbers then creating paper instruments based on the bogus holdings, trade them fast and furiously and voila, liquidity. The whole scheme (never let the word “Ponzi” cross our lips) comes apart at the seams when someone wants physical delivery and then the game is over. In China of course the small and medium sized investor can be stalled for a while, while the big fish exit their positions and when the curtain is eventually pulled back to reveal that the “cupboard is bare” then the recriminations start flying. A few random death sentences may be meted out (involuntary organ donations, anyone?) and the matter is regarded as swept under the rug until the next time.

The result though is that China has blown up chances of being taken seriously as a locale for trading of commodities due to this repeated flaunting of warehouse statistics which are at the root of the credibility of any market in the metals trading world.

Bubbles

The Chinese cannot be criticized for having “bubbles” in their stock exchange(s) for the US is a repeat offender in this regard, with Alan Greenspan being a notorious bubble-blower with a goodly part of the US economy and the High Net Worth sector regularly refilling their coffers through repeated pump and dumps on a truly grand scale. However in the case of China a casino-ish atmosphere has not only existed, but been encouraged. The closest that the US has come to this was the dot-com era market of 1998-2000, which was mainly tech/media/telecoms (rather than a whole market) and 1929, which was a very long time ago and before hardly any legislation governed markets.

While regulators in the West, in the wake of a market bust, go into a frenzy of reregulating and attempting to close the gate after the horse has bolted, the Chinese on the other hand are quite shameless with the goal being to reinflate the bubble as fast as possible. Investors in the West go into soul-searching wondering why they were suckered or why they suckered themselves, whilst in China introspection seemingly has no place and mass amnesia is seen as the cure for all ills.

Robber Barons

China looks like the US in the Age of the Robber Barons in the late 1800s. The trouble for China is that we are talking about 130 years ago. It is not that hard in this day and age to be up to date in regulatory and supervisory matters and systems. If you can have stock tickers wrapped around office blocks then why can’t you buy in some skillsets on market regulation? The answer is largely because the authorities don’t want to appear to be taking advice from the *Gwai Lo*. Frankly they could save themselves (and everyone else) a lot of grief is they forsook the financial Wild West (East?) and got their house in order in 2016.

Riding the S-Curve

Or we could less charitably say going down the S-bend! We found an interesting thesis, posited by a Charles Hugh Smith, that tallied with our own view that China is following a well-trodden path down which Japan, Taiwan and South Korea have already travelled. China would like to think it is different and heading down some Middle Kingdom version of the Thousand Year Reich (oops!) when in fact it is just doing what all economies have done since the dawn of time, and that is pursuing an S-shaped trajectory.

We have seen this process described as being somewhat akin to a rocket’s trajectory with an ignition phase as the fuel of financialization and untapped productive capacity is ignited. The high growth rate of credit and production overwhelms all other factors, as rising profits and production increases wages which then support further expansion of credit and consumption which then supports more production (or excess-capacity).

After this the thrust that comes from “financialisation” is exhausted, and the previously fast-growing economy moves forward on momentum alone. As the economy weakens, this momentum is to the downside. This is where we find ourselves now in the China cycle as everything that worked in the boost phase reverses, as nothing works any more. Investors in China’s “markets” lose every bet and officialdom’s efforts to reverse the decline end in repeated failure.

Conclusion

While many in Western markets (and particularly in the US) are used to complaints that the system is rigged against the investor class by the Powers that Be, the complaints are usually just hyperbole and blame-searching after the one a decade meltdowns that we have become inured to. In China though, like all casinos, the House always ends up winning and the punters, by and large, end up going home without their shirts. The markets in the West may end up occasionally ripping off investors whereas in China they seem to be set up with the explicit purpose of fleecing the lambs. The results is that the middle and lower middle classes keep having their savings confiscated for the greater good of those higher up the totem pole that mastermind, tolerate, encourage and then cover-up the scams. It is like China is in the grip of a horde of Bernie Madoff clones.

If 2015 was bad then 2016 has got off to an even worse start with two suspensions of trading on the Stock Exchange in the first few days of the New Year. This was followed by the same old intervention which obviously failed in the first instance because it had to be applied again a few days later. The "Street cred" of the Chinese "powers that be" that pull the financial levers is totally shot. Major figures on the financial stage appear and disappear like characters in a Feydeau farce. Re-education used to involve years in the paddy-fields and now consists of a weekend of being brow-beaten in a board room at the Ministry of Finance. Maybe the old ways were better!

Once a soap bubble is burst there is no reinflating it. The Chinese should face the fact and move on. They are now in a new place that the rest of us in the Western economies have been in all too frequently in recent decades and they may care to learn from it… even if it means having to lose a little face.

FANYA – Good Girl Gone Bad

As we have written in the past the Chinese are not as infallible as they would like everyone to believe. Economic booms of the intensity of that which the Chinese have experienced over the last 15 years can bring the tendency to become self-declared Masters of the Universe. Look at the Japanese in the late 1980s, where pride definitely came before a fall and a long and depressing two lost decades for the Japanese economy. One could also say that the Vietnam War was the Waterloo of the US dominance after twenty years of post-War economic mastery over the global economy. That war saw the baton of net savings/wealth pass to the oil states of the Middle East and to the Japanese.

One of the attributes of these periods of fleeting dominance is an attitude *internally* of superiority over other economic systems (particularly over that of the displaced power). Then the attitude is manifested *externally* with criticisms about how other economies, have become fat or lazy or decadent.

FANYA – Good Girl Gone Bad

The establishment of the FANYA Exchange with its focus on specialty metals would seem a logical and inevitable evolution of the Chinese dominance of the production of (many) specialty metals and the substantial position it also held as a processor and end-user. Alas though there is an innate tendency for institutions in the capitalist side of the Chinese economy to deteriorate into illegality and irregularity with remarkable speed. In this aspect the Chinese system appears most akin to the rip-roaring US markets of the late 19th century when Robber Barons ruled the roost on Wall Street via massive cartels/trusts and rampant stock market manipulation schemes.

FANYA initially started out with specialty metals and then diversified into fixed income products. The problems in the Bismuth, Indium and Antimony trading by the exchange’s investor base are well documented now. In mid-July Metal Bulletin reported that the Fanya Metal Exchange had suspended accepting applications from companies to sell Indium, Germanium and Bismuth on the exchange between June 23 and August 31. An official from FANYA, who refused to be named, cited “Liquidity-related problems” were the major reason for the decision. That there should be “liquidity problems” in trading what were regarded as notoriously illiquid metals in the pre-FANYA era, comes as no surprise to participants in the global market for specialty metals.

Once again we have seen the Chinese “issue” with deceptive practices on bonded warehouses and the collateralization and double-counting of fictitious or “massaged” inventories. It is very easy to create theoretical liquidity by miscounting (read exaggerating) warehouse numbers then creating paper instruments based on the bogus holdings, trade them fast and furiously and, voila, liquidity. The whole scheme (never let the word “Ponzi” cross our lips) comes apart at the seams when someone wants physical delivery and then the game is over. In China of course the small and medium sized investor can be stalled for a while, while the big fish exit their positions and when the curtain is eventually pulled back to reveal that the “cupboard is bare” then the recriminations start flying. A few random death sentences may be meted out (involuntary organ donations, anyone?) and the matter is regarded as swept under the rug until the next time.

Not just Metals

Like any good scheme, over-reaching (mission-creep?) sets in. While FANYA has been most famous its metals trading, it has also had a fixed-income element, which not unsurprisingly has reputedly also gone bad. The Financial Times reported this week that earlier this week “hundreds of well-heeled urban professionals who had purchased high-interest rate products from the Fanya Metal Exchange united with distribution agents who sold them in an unusual protest….in the financial heart of Beijing”.

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Conclusion

The collateral damage to the metals markets has been brutal but hopefully short-lived. Antimony and Bismuth have seen large amounts of product tipped out into markets that are illiquid at the best of times with particularly damaging effects for Antimony that has gone from $9,000 per tonne down to $6,000 in a the space of a few months.

While the FANYA bust-up looks like a Chinese Madoff-like moment that will pass quickly, we doubt it. China was well positioned five years ago to have the Shanghai Metals Exchange become the leading global market for metals. Repeated scandals (most notably the copper inventory scam that caught Standard Chartered and Citibank amongst others) mean that the SME’s warehouses have zero credibility. The LME has shown through its long existence that credibility is everything and the SME had a chance to grab some of that credibility for itself. It should take at least ten years to rebuild that trust, but maybe the moment has been lost.

As for FANYA, there is no chance of redemption. China’s own position as the dominant force in the specialty metals world is slipping away due to over-exploitation and erratic export/import duties and other examples of unreliability. FANYA's arrival meant there was a chance to create a legacy overlordship by creating a financial dominance, even as a role as a leading producer leaked away (much as Britain did with the LME). Instead the sleazy operators at the FANYA put on their suicide vest and blew up any chance of China controlling the "trade" in specialty metals. In a world of increasing "discovery" in both price and volumes in so many products, the Chinese authorities let some cowboys essentially create a noxious fog of misinformation which has choked a large group of investors and justified Western observers' growing belief that there are "lies, damned lies and Chinese inventory statistics".

Trafigura – Playing Cat & Mouse with Nyrstar

For those who recall the Glencore takeover of Xstrata a key feature was the disposals forced upon the predator to get the deal past regulators and the Chinese. The main thing that concerned regulators was the dominance of Glencore in the zinc trading space where it had confessed to having something like 65% of the global zinc trading activity pass through its hands at the time that it "opened the kimono" in its prospectus for listing on the LSE. This set alarm bells ringing when end-users started envisioning what Xstrata's Zinc mines combined with Glencore's trading weight might imply. The chief result was a requirement that Glencore release some of its contracted market share and liquidate its shareholding in Nyrstar (NYR.BR) the leading zinc/lead refiner.

Ironically the way things are going the company that Glencore was told to distance itself from has now fallen into the orbit of Glencore's main competitor with implications as well for those suppliers and end-users dependent upon Nyrstar's strategic position in the supply-chain.

In this note I shall look at the implications and potential outcomes.

Trafigura

This company is a Dutch-based trader and mimics Glencore in many ways. It has been the most forward in following in the footsteps "of the Master" in acquiring control of mining properties. It also has its roots in the Marc Rich empire. Initially focused on three regional markets – South America (oil and minerals), Eastern Europe (metals) and Africa (oil) – Trafigura has since diversified and expanded globally and operates from 81 offices in 56 countries. Positioning itself in oil makes it distinct from Glencore where coal has been the main energy exposure. It has, for instance, a vast service station empire in Africa.

The company has also been notable for making mine purchases in Peru, acquiring the Azulcocha mine from Vena Resources and then acquiring all of Iberian Minerals to get itself positioned in base metals in Peru. This brought Trafigura the Condestable copper mine and the Aguas Tenidas mine, which produces copper, as well as zinc. Trafigura is obviously as comfortable in being 100% owner of mines as Glencore and we should see more of these types of deals in the future. A combination between Trafigura and Nyrstar would make lots of sense.

Nyrstar's Sorry State

The company was formed from merging the Zinc/Lead smelting businesses of Belgium's Umicore and Australia's Zinifex. It was floated in 2007 at 20 euros per share, but currently languishes at ten percent of its initial issue price. In recent times the company has been weighed down by the low Zinc & Lead prices, setbacks with its mining expansion and the failure of its Finnish supplier Talvivaara, which applied for bankruptcy in the latter half of 2014. Most recently, Nyrstar vended its Coricancha mine in Peru to Great Panther, in what was the first retreat from the "soup to nuts" strategy put together by the management in the wake of the listing of Nyrstar on the Brussels Stock Exchange.

Nyrstar has since September raised 600 million euros with a bond yielding 9% (primarily to replace maturing debt) and a share issue to transform its site in Port Pirie, Australia and to upgrade its smelters.

We might also mention that Nystar's refineries are also major producers of the by-product specialty metals that occur in Lead/Zinc mineralisations, such as Indium.

Nrystar and Trafigura – Having it Both Ways

With Glencore out of the way at Nyrstar, Trafigura has worked itself out a pretty nifty relationship with Nyrstar, but the problem is that Nyrstar's shareholders might not be similarly so thrilled with the way it is playing out. Market reports indicate that Trafigura started, in September 2014, to build a stake which now amounts to at least 15%, making it the company's largest shareholder. Of course a merger between the two would make the most sense, as it would be synergistic and create a stronger competitor for Glencore in the Zinc trading space. As we have already noted competition authorities forced Glencore to divest its stake in Nyrstar and unravel some trading relationships with Nyrstar when it took over Xstrata in the process becoming even more dominant in the metals Nyrstar smelts. Thus one could see that maybe pressure would be put on Trafigura in a proper merger with Nyrstar to reduce its strong position also.

Out with the Old…

This was made more obvious in November 2014 when Nyrstar "ousted" its chief executive, Roland Junck, and replaced him temporarily with its Chief Financial Officer Heinz Eigner. Nystar claimed that Trafigura had no bearing on the move while Trafigura declined to comment.

Reuters had reported earlier that market sources had told it that Trafigura was aiming to influence board decisions and tighten its grip on the world's largest zinc producer.

Junck's track record at the helm Nyrstar had been disappointing, arguing his strategy to invest in buying mines in particular was poorly executed and failed to achieve its stated objective on production or costs.

Trafigura has already tried to influence the composition of the board of another company in which it invested. After building an 18 percent stake in EMED Mining it proposed last month to oust all but one of its directors and substitute them with its own nominees.

The New Helmsman

Considering that Junck was ousted in November of last year and replaced with a temporary CEO, a new one did not start in the job until August 2015 when Bill Scotting was appointed to the role. Prior to joining Nyrstar he was Chief Executive Mining at ArcelorMittal. He joined that group in 2002 as Director of Continuous Improvement, and subsequently also held the positions of Head of Performance Enhancement and Head of Strategy. He started his career as a metallurgist with BHP in Australia and has also worked at McKinsey & Company and CRU International. He holds a Masters of Business Administration from Warwick Business School in the UK and a Bachelor of Science (Metallurgy) degree from the University of Newcastle in Australia.

Conclusion

The issue of who controls Nyrstar is a key one for users of Zinc and Lead around the world. Having seen the welcome unwinding of the Glencore relationship only a couple of years ago we now see it being put together again but with another major trader as the puppetmaster. Moreover at least in Glencore’s case there was an element of arms-length distance to the arrangement. In the case of the latest interloper, it is seemingly playing the role of kingmaker in selection of Nyrstar’s key personnel. If this was a proper takeover alarm bells would be ringing in the corridors of anti-trust agencies in the EU and beyond. Instead there might have been a *de facto coup d’état* with effective control passing to the trader without any red flags on market dominance having been run up.

Thus, for the moment nothing is happening on the official takeover front and instead we are getting that current bugbear of ours, the unofficial takeover, where holding a small percentage gives a major player all the benefits of having control without having to make other shareholders a decent offer.

So for players in the Lead/Zinc space (and for regulators) the question of the day should be T+N = ?