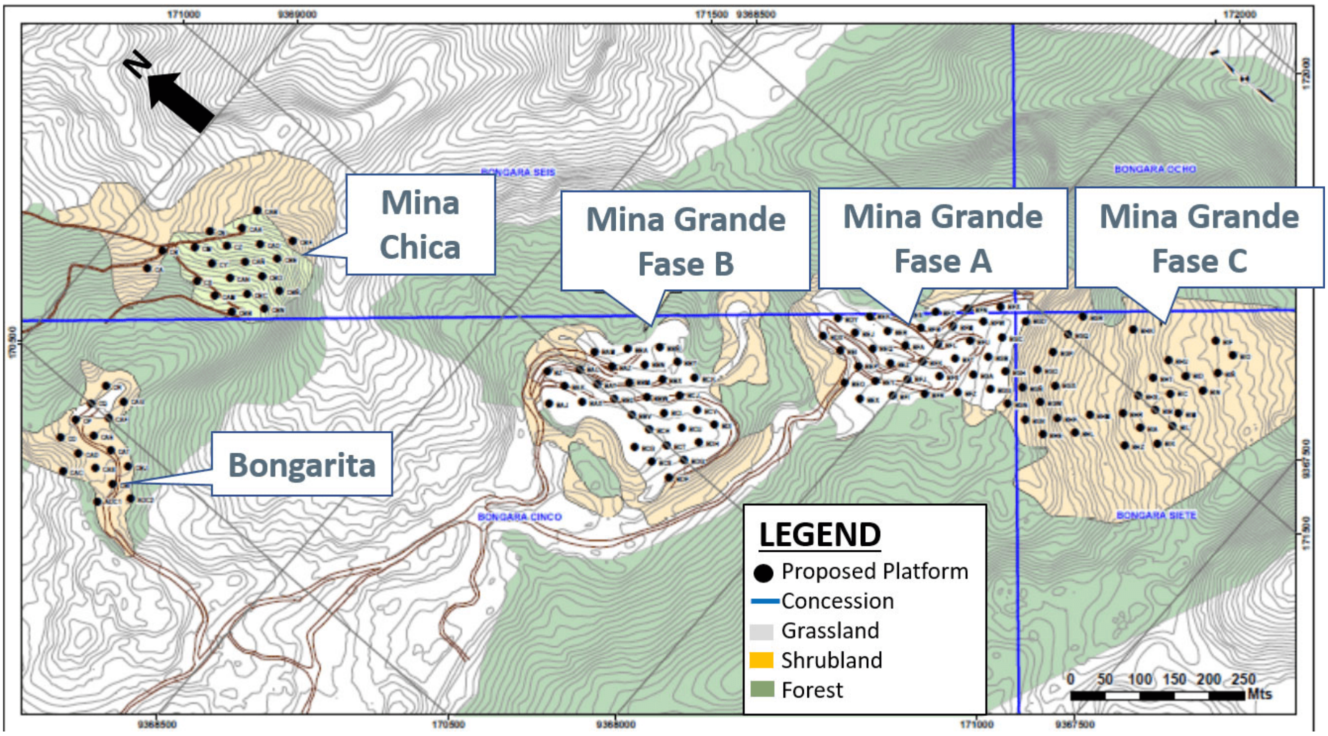
Zinc One Targets Renewed Zinc Market

As much as one must never try to predict either end of a market trend, some juniors have a knack for it. Last month, the London Metal Exchange recorded a 10-year high of US$3,308 per metric ton of zinc (US$1.50 per pound), while stockpiles on both the LME and SHFE have slumped to some of their lowest levels since the financial crisis.

Just recently Zinc One Resources Inc. (TSXV: Z) ("Zinc One") received approval from the Peruvian Ministry of Energy and Mines (MEM) to install 130 drill platforms at their high-grade Bongorá zinc deposit. The market requires new supply, and at times such as these, it's first come first served.

Drilling is expected to commence this month and continue throughout the rainy season in order to define a compliant resource by 2Q18. The planned program now includes holes for previously excluded areas of Mina Chica, Bongarita and south eastern Mina Grande which previous sampling suggested were high-grade.



The mine gave up 358 metric tonnes of ore per day, from which a simple kiln treatment produced up to 70% zinc. Historic results can only offer so much confidence, but more recent surface channel samples included one result of 47.73% zinc over 8.1 metres, another yielded 25.65% zinc over 19.7 metres from a dolomite breccia, and 32.50% zinc over a 3.8-metre depth was found in an exploration pit. The go-ahead for the drill project is still important to properly delineate the resource and potentially expand it, but they don't come much more proven than Bongará.

The company obtained the prospective Bongará site via the acquisition of Forrester Metals back in June, secured along with a $10 million private placement that was to fund exploration and development costs. The project was originally discovered in 1974 and briefly open-pit mined between 2007 and 2008, but only 37 acres were dug before the mine failed in late 2008 due to collapsing zinc prices.

The permits newly include areas in the southern extension of Mina Grande as well as the Bongaritá and Mina Chica. This gives the technical team more increased confidence in the probability of being able to outline a resource at least as good as the historical one. Zinc One has already hired Energold Drilling Corp., who, at the time of writing, are busy erecting the drilling camp. Quick movement on this project is essential if Zinc One are going to catch peak pricing and enjoy the benefits before the inevitable oversupply pushes prices back down.

I’d say they have a few years to get this project up and running, but they seem to have it covered. The company recently sold a Peruvian silver project to focus all attention on Bongará as a result of its outstanding potential given current market trends that favour technology and industry related sectors. Zinc demand is on the rise largely because the metal is increasingly finding itself in the technology and health sectors, as well as its conventional niches in brass making, as well as galvanizing and alloying steel.

More recently, it has been taken up by agriculture; the governments of China, India and Pakistan are adding zinc to fertilizer as a matter of policy since it is crucial to plant development, particularly in heavily-farmed areas. In addition, mine-closures have pushed zinc production to the point that long-held stockpiles are rapidly diminishing, resulting in the bullish price trend that began in late Spring and doesn’t seem to be stopping anytime soon. Zinc One represents an opportunity to make a large margin on peak zinc pricing for a bargain price; shares have already jumped somewhat over the last eighteen months, but get them while they’re still CAD$0.44 and enjoy the next few years.

Clausi on the Cobalt Bull Market

“60% of the world’s cobalt comes from the Congo, which has been suffering through a horrific war since the late 1990s. It’s called Africa’s War and over 6 million people have died there with the resulting geopolitical corruption and disruption of supply chain. As a result we have seen cobalt production fall out of the Congo…we must source this critical metal for the benefit of our modern world as cobalt is used in electric vehicles, nuclear reactors and even the smartphones we use every day.” — Peter Clausi, CBLT Inc.

Peter Clausi, President, CEO and Director of CBLT Inc. (TSXV: CBLT), in an interview with InvestorIntel’s CEO Tracy Weslosky discuss cobalt in the world. Cobalt has found its way into the hi-tech sectors of cell phone and electric vehicle batteries. Unfortunately, it isn’t easy to find. Cobalt is a trace by-product of copper and nickel production and is rarely, if ever, found on its own. The blue metal is currently sitting at $25 per pound as one of the top moving metals on the London Metal Exchange (LME). Peter will be discussing the world of cobalt in more detail at InvestorIntel’s 6th annual CleanTech and Technology Metals Summit on Monday, May 15th and Tuesday, May 16th (CTMS2017.com)…to access the complete interview, click here

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The Zinc Putsch is On

There was a curious juxtaposition this week that we noted on the kitcometals.com price page. While a story thundered that the World Bank was trimming global growth projections the reality of prices was very different with all base metals up for the day and Zinc up a stunning 2.5% to 93 cents, the highest level in years. It was only a couple of weeks ago crossing the 80 cts threshold and it is now a long way from the 67 cts at which it bottomed in the second half of last year.

It seems but a distant memory, but last October the obituaries were being written for Glencore, the world's largest Zinc trader with over 60% of global traded volumes. Now those fears are well in the past and Glencore, like Zinc, has arisen from its grave.

At this point in time we are looking at a nearly 50% uplift in the price in a period of a mere nine months. There is no other major metal, precious or base, that has managed such a rise in such a short amount of time in recent memory. If anything the pace has picked up in recent times. The rises are starting to look almost symmetrical with the diabolical fall from the middle of last year.

As the chart above shows, zinc has found resistance in previous years around the $1.10 per lb level and has then retreated. However the supply situation has never been as bad in the last ten years as it is now. Heavy underinvestment has taken its toll on the pipeline of new projects, to the effect that there aren't any to speak of. Therefore the International Lead and Zinc Study Group (the leading "thinkers" on this topic) have projected a shrinkage in supply for 2016, just as prices have started to surge. Here is their projection.

It may not be a large decline but it’s the second negative year in a row and reflects declining production from existing mines rather than mothballing or production cuts as a response to weak prices. We are gearing up for the long awaited perfect storm in zinc, where a modicum of demand growth encounters a chasm in the production pipeline. Though maybe we should rephrase that as there is NO production pipeline to speak of. This is the major metal where least money has been spent since 2006 in new discoveries or development than any other metal. Zinc is of course linked inextricably with the fortunes of Lead, where prices have lagged and production has also been impacted by closures of mines (and repurposing of refineries). This trend is shown in the chart below:

The year to contrast with is 2008, a bad year for every metal where the opening/closing was not even vaguely as unbalanced as now with an even greater accentuation of the closures in 2015.

Then if things couldn’t get worse in 2016 we are seeing:

- Glencore has reduced zinc mine output by 500kt/yr in Australia, Kazakhstan and Peru
- Reduced output at HZL’s Rampura Agucha operation in India due to technical difficulties
- CBH Resources and Perilya to reduce production at Endeavour and Broken Hill mines in Australia
- Suspension of output at Al Masane in Saudi Arabia

This trend is feeding through to LME warehouse levels as the chart below shows.

Statistics (always rubbery out of China) suggest that Shanghai stocks are not what they were either with a considerable shrinkage.

Conclusion

Added to this is the estimate for the trade study group of a 3.5% rise in demand in 2016, we can see a supply crunch that is motoring the price along nicely. With such a tailwind, and end users scrambling to write contracts to guarantee supply, I would expect the price to breach $1 per lb in the very near future and then head steadily towards the previously impenetrable $1.10 barrier. As they said on old maps "Beyond here there be monsters". What will happen is that no one in the mining industry shall stir from their behinds until prices breach $1.20 and even then they would rightly (on previous bad experience) want to see them hold there before getting over-excited about launching projects. This means an ever-worsening supply situation. For existing producers this will be a deeply profitable and long overdue development. The mood will fire up the hunt for juniors that have respectable projects. Many have been on the backburner so long they have melted onto the pot…. With an investor universe largely clueless on zinc's dynamics this will very likely degenerate into a blind rush in the direction of the best promoted offerings. Ever was it thus, but still zinc above $1.20 will be exciting territory and well worth positioning oneself for now.

Copper Stocks – Out for the Count

For over 100 years the warehouse numbers of the LME were regarded as a relatively accurate gauge to the amount of any particular metal that was potentially for sale and thus what the overhang on the market might be. The numbers could never be 100% accurate because there might be merchants with stocks in their yards for sale or miners/refiners with stocks awaiting delivery to the warehouses or end users, but generally it was a case of "what you see is what you (might potentially) get.

The reliability of warehouse numbers has been in steep decline since the turn of the century. Much of this decline can be attributed to China. Initially what had once been a monolithic LME statistics was eroded in value by the appearance of Chinese exchanges, most notably that of Shanghai with their own warehouses. This became the tail that wagged the dog both in demand and pricing. After a certain point the Western players lost control of copper pricing to the Chinese and we would attribute this to the traumas of 2008. At some point around then this new dominance was accompanied by the realization that having warehouse numbers that people outside China actually looked at when making pricing decisions meant that the numbers mattered. Moreover if they mattered then the possibility existed that sentiments could be massaged (let's say tactfully) by warehouse numbers in Chinese ports appearing to be of a "certain size". Oddly, warehouse stocks there never seem to drop to critical levels that might cause the type of price spikes that used to occur in say copper (but also nickel, lead and zinc) in the period pre-2008. Our wake-up call was when we were informed that the Chinese warehouses consisted of the "counted" warehouse and the much larger "uncounted" warehouse. Chinese traders and big miners could with the flourish of a forklift truck (or a fleet of them) move stocks in the adjoining "counted" warehouses up and down to suit where the price of copper was wanted to be seen.

After that point we never bothered to wonder anymore as to the mystery of why copper has traded between $3 and $3.50 per pound over that period. It is essentially because this is the price that the Chinese are prepared to pay. They know the Western miners will make miners (though not enormous amounts) and that there will be no surges or plunges in production or project pipelines from the West. Prices above $4 per lb only ever resulted in arrogant Western miners developing a swagger, started talking about $6 per lb and inevitably leading to a price plunge. The Chinese have taken to loaded pistol away from the monkeys and in the process the veracity of warehouse numbers, like truth in wartime, has become the first casualty.

The Shell Game

The classic trickster’s game for ripping off the unwary involves three rapidly moving walnut shells and pea. The warehouse “game” in China reminds us of this. The issue has come into greater focus with an event that seemingly surprised some international banks and yet seemed par for the course to us.

At the centre of this scandal is one wannabe commodity bigwig, Chen Jihong. He is currently in pre-involuntary organ donor status detained at the pleasure of their Celestial Majesties in Beijing for his troubles. Mr. Chen is owner and chairman of Decheng Mining and its parent, Dezheng Resources Holding Co., and is a director of Hong Kong-based Zhong Jun Resources Co., which has offices in Singapore.

Chinese authorities and bankers are investigating whether traders fraudulently used the same stockpiles of metals to secure multiple loans from Chinese and foreign banks. It is suspected that entities linked to Decheng Mining, which is based in the port city of Qingdao, illegally pledged the metals as collateral to get the loans. As a result foreign banks and commodities firms have exposure to potential losses of close to US$1 billion, while the estimated exposure for Chinese banks stretches into the billions of dollars.

Not surprisingly the matter has degenerated into a welter of lawsuits, many under the jurisdiction of Hong Kong courts. Everyone knew what that meant back in the old colonial days when British law reigned. It will be interesting to see though what happens when major Chinese banks are claimants and defendants. Even more intriguing is what will happen when the carefully constructed Chinese trading/warehouse scenario starts to come under the magnifying glass.

Other lawsuits have been filed in Singapore and London courts. Citigroup and Swiss-based trader Mercuria Energy Group Ltd. are engaged in legal proceedings against each other in a London court over payments relating to metals-backed financing arrangements in Qingdao and Penglai ports valued at more than $270 million.

Impala, the warehousing and logistics subsidiary of Trafigura, has filed at least six claims in London against a number of parties, including Mercuria Energy and Standard Chartered, to ensure any disputes over its contracts relating to metal held in Qingdao are fought in UK courts.

Standard Bank (of South Africa) and ABN Amro Bank have also launched cases. In Singapore, ABN Amro won a Singaporean court order for Mr. Chen to pay it $22 million owed under a loan agreement with Zhong Jun Resources and another of his companies.

HSBC has also launched legal proceedings against Zhong Jun Resources. Other foreign banks that have exposure to the deals are BNP Paribas SA and Natixis (of France). Standard Chartered has made provisions for about $175 million in potential losses from a total exposure to Qingdao port of $250 million.

It is claimed (surprise, surprise) that fake documents were provided to prove that metal promised as collateral was in place. To further complicate matters access to storage facilities in Qingdao and Penglai ports remains restricted.

It is said that banks involved in Chinese commodity trades are revisiting lending processes and increasing oversight of clients. Banks have tightened up on issuing letters of credit, which has made it harder for importers to get hold of metal.

The Smart Money Acts

The London-based hedge fund Red Kite Group is scarcely a household name outside trading circles and the more sophisticated mining managements. The current team is the results of the break-up of the old Red Kite with the equity staketakers creating Orion and the "physical" people continuing to operate under the old moniker with the many offtake, VPP and other contracts that they accumulated over time through funding projects.

The name has come into the news again lately as Red Kite currently holds more than half of London Metal Exchange copper inventories according to press reports.

Date from the LME shows that there is a dominant holder of the LME's copper stocks, accounting for between 50-80% of total metal holdings (which currently stand at 159,550 tonnes). That would be worth around $534-$854mn based on prices of $6,675 per tonne.

While it's not confirmed officially that it's Red Kite buying, a survey by the Wall Street Journal found brokers and traders overwhelmingly confirming the evidence. This begs the question of why so large a position and why now? For us the events in China were a perfect storm. They show that Chinese stockpiles cannot be trusted. If even Chinese banks get taken down in such a scam and they could (in theory) verify what is held in warehouses within the country then the brief rise of China as a trading destination may have been stopped in its tracks. Warehouse numbers must be unimpeachable. We wonder if Red Kite is betting here that unofficial warehouses will fall into disrepute and that the latest “double counting” scandal might not just be the tip of the iceberg with more players in China having to buy copper to back up the theoretical holdings that they have so liberally offered as collateral.

Conclusion

People say to us that copper is “weak”. Frankly we don’t see it. Where were these people when copper was 72 cts a pound back in the late 1990s. They should brush up on their history books.

One has to face the fact that a trader when cornered by a journalist will start to blather. To claim that its “bad news” that some non-existent or scarcely existent copper stocks have been used as collateral over and over again is hogwash. Any product that has been sold (and a defaulted loan is “sold”) many times over and the physical does not exist in quantity to satisfy that loan is not an excuse for the guilty party to “sell” copper as the pundits insist, but is a requirement to cover. Now whether the guilty party ends up on a slab and thus is not able to close his margin calls is another matter.

It would seem Red Kite is of the same persuasion as us that this is a bullish sign for copper, not a bearish one.