Largo – Out of the Woods in its Financing Needs

The last time I wrote on Largo I was looking forward to a recovery based upon Mark Smith joining as the new CEO from Niocorp, where he had managed to turn around the fortunes of what was a small Niobium developer. Largo is a totally different kettle of fish with an operating vanadium mine in Brazil, a country in which the new CEO has significant experience (and contacts), due to his time served with CBMM, the world's dominant Niobium producer.

However the market did not view the move as positively as we did and the stock price was brutalized.

The new appointment was clearly not to build the mine but to mend the financial situation and bring some magic to the stock price. In this cynical day and age the market is clearly waiting for the former before it will concede the latter. Therefore it is useful for me to shine some light on the recent moves to fix the finances of Largo.

The Latest Deal

Since the start of May, Largo has announced that it has put together what should be a financing of up to CAD$50 million. Mackie Research Capital is acting as lead agent and sole book-runner for a private placement of units (one common share and a half-warrant) at an issue price of CAD$0.80 per unit. The warrants will have an exercise price of CAD$1.50 per warrant for a period of 12 months following the closing. This will be on a "best efforts" private placement basis.

There was also a greenshoe facility permitting the agent to up the size of the financing by a further 15% if demand warrants it. The more the merrier we say if the offer receives a strong response. The offer is expected to close by May 15, 2015. However, we shall discuss anon a further twist on how this financing has played out.

A minimum equity raise of US$35 million is one of the conditions precedent to Largo's restructuring of its debt facilities for its Maracás Menchen Mine with its commercial consortium of lenders.

The Previous Financing

Just prior to the anointing of Mark Smith as CEO the previous management had negotiated a deal with the largest shareholder in the company which, while welcome in staving off worse alternatives, did smack of being taken advantage of. The new management team (and shareholders) have to live with the consequences of that arrangement.

It was back in early March that Largo announced a deal with certain funds managed by Arias Resource Capital Management LP. I had previously encountered them in my New York days with regard to Dia Bras, a company now known as Sierra Metals. The ARC deal with Largo involved a somewhat Shylockian CAD$12 million non-revolving, convertible term loan facility bearing an interest rate of 20% per annum (yes, you read correctly!). The proceeds of the loan were to be used solely to finance development costs and for general corporate purposes of the Maracás Menchen mine. It is worth noting that ARC has been acknowledged as a "Control" person with regards to Largo since June 2013.

The loan has a six-month term and was to be drawn down over a number of weeks on a bi-weekly basis. It was secured by a pledge of securities and guaranteed by a Largo subsidiary, Campo Alegre de Lourdes Ltda. Then we get to the convertible element under which all, or any portion, of the outstanding indebtedness will be convertible into common shares of Largo (at the option of the ARC Funds) at a conversion price of CAD$1.01 (the closing price on March 10, 2015). Obviously this conversion price is not attractive as the price of the stock has been below that level since the deal having been announced.

The Bridge Loan had certain death spiral elements to it which normally make us raise our eyebrows. The loan is subject to mandatory repayment if Largo raises any additional financing (in an amount equal to the net proceeds of such financing transaction), upon a change of control of Largo or if the loan is accelerated upon an event of default. In case of default, interest will increase to 23% per annum on the amount outstanding under the loan.

ARC Funds will also be granted a participation option to subscribe for up to an aggregate of CAD$40 million of securities under any proposed offering of common shares. This effectively means they can ward off any other interlopers.

In a recent update Largo announced that the last CAD$2 million of this facility had been fully drawn down by the company on May 8, 2015.

Deal in the Bag

And lo and behold! The most recent private placement has ended up caught in the gravitational pull of the March bridge loan. In the middle of this week it was announced that ARC funds were taking up to CAD$50.65mn of the most recent financing on a non-brokered basis. The total raise on a non-brokered basis will be CAD$68.6mn with the brokered portion by Mackie Research Capital Corporation being a mere CAD$1.4 million on a best efforts agency basis. In total the issuance of new shares shall be approximately 87.5 million Units.

Control

The ARC Funds current ownership is approximately 28.2% of

Largo. If the financing is fully sold, ARC Funds will own up to 47.8% of the issued and outstanding common shares (or approximately 56.3% if ARC exercises all of the convertible securities held by them excluding the CAD$12mn convertible note facility, which will be repaid from the proceeds of the offering). Whether anyone would want to convert a loan into equity at $1.01 per share, when the market price is 30% lower, remains doubtful.

In addition to the repayment of principal and interest under the convertible note facility, ARC Funds get to nominate two new directors to the board of directors taking them to three directors. Effectively ARC, through this series of financings, have taken control of Largo.

Conclusion

Well, it would appear that Largo Resources is out of the financial woods as a result of these transactions but at the same time they have effectively been “taken over” by ARC’s funds at market price with no premium offered at all. Such a development means that Largo is not in play and highly unlikely ever to be in play no matter what happens to the Vanadium price. That removes the attraction for those investors looking for a corporate action to trigger their exit strategy. That only leaves a dividend story if the company can get to profitability and earn enough to start throwing off excess cashflow to ARC and other portfolio holders of the name.

Production costs are coming down with $3.91 per pound being achieved in March. This cost improvement is also linked to the currently weak Brazilian Real against the USD.

Shareholders can breathe a sigh of relief that default has now disappeared as a threat…