FundCalibre.

investing on the go

TRANSCRIPT: EPISODE 321

4 July 2024 (pre-recorded 24 June 2024)

Below is a transcript of the episode, modified for your reading pleasure. Please check the corresponding audio before quoting in print, as it may contain small errors. Please remember we've been discussing individual companies to bring investing to life for you. It's not a recommendation to buy or sell. The fund may or may not still hold these companies at your time of listening. For more information on the people and ideas in the episode, see the links at the bottom of the post.

[INTRODUCTION]

Staci West (SW): Welcome back to the Investing on the go podcast brought to you by FundCalibre. Today's episode gives a comprehensive overview on the strategic metal market, including both precious and industrial metals. Learn more about the need for these metals in our economy, but also the challenges and opportunities presented by increased demand.

Darius McDermott (DM): I'm Darius McDermott. Today I'm delighted to be joined by Georges Lequime, co-manager on the [WS] Amati Strategic Metals fund. Georges, good afternoon.

Georges Lequime (GL): Good afternoon Darius.

[INTERVIEW]

DM: So strategic metals is all sorts of different bits and pieces: precious metals, industrial metals, et cetera, but one everyone's talking about is gold. Gold price is doing very well. What do you feel on the sentiment for the gold market and where are gold equities in comparison to the gold spot?

GL: Yes Darius, for us, we are looking at this and we've seen a significant move in the gold price in recent years, and especially this year. From March this year up to now [gold's] up 12.7%, so that's quite a big move. This is obviously being driven by central bank buying, primarily of Chinese buying. In the West, investors seem to be suspicious of the move. Usually when rates are rising, we don't wanna be holding gold because it makes it more expensive to hold gold. [**DM:** Yep.] But China's kind of overridden this equation right now, and the stocks are still discounting a much lower gold price, primarily based on the suspicion that, how sustainable are they at these levels? We haven't seen the first rate cut, because that gives the market some kind of confidence that maybe gold prices on the move again. So I think we're in a bit of holding position right now, where prices have moved up significantly, that the companies are looking extremely cheap on all the metrics we are looking at.

DM: That's that discount between the gold spot and the implied gold price for the share price of the miners.

GL: Exactly. Exactly. So the miners and the companies themselves, when they're looking at M&A, I know we're gonna touch on M&A a little bit later on, but they're still working at $16,00/$1,700 an ounce. I've seen one company moving up to $1,800 an ounce gold price on considering M&A. So the market's still caught in the bearish…

DM: So that's one company buying another company at a valuation that would imply $1,800 for gold, whereas [**GL**: Correct] when we looked a few moments ago, it was around $2,320. So still quite a lot of potential value in the gold miners based on today's spot price.

GL: And we've seen it before, Darius, the market, it moves very quickly and we wait for a certain period of time. Sometimes it takes a couple of quarters, three quarters, before the market gets accustomed to a new price. And then they start looking and what we are getting behind it is the brokers keep upgrading their earnings and dividend forecast going forward and valuation metrics. And that sort of supports the gold equities.

DM: So we've seen in times before, not just necessarily with metals, but things can be cheap and stay cheap for quite a while. What do you think might reconnect that spot and the sort of implied price for the miners? What might be the next signal that you think everybody's gonna catch up and these cheap assets will be less cheap?

GL: It's and I think about this quite, quite deeply about it. But I think the key issue is that alternative investments have been there for investors. If you invested in the S&P 500 or technology sector, the Nasdaq, you've done incredibly well. [**DM:** Yeah.] So I show you a company that looks incredibly cheap and say, well, they've done nothing for quite a while. Meanwhile, I've made 25% return on Nvidia last month. So why should I even get my mind around a mining company?

So I think we need to probably see some of the capital that's in the rest of the market, start looking for maybe the Nasdaq and S&P to get overvalued. [**DM:** Yep.] And they start looking for value. But the companies themselves are sitting there and saying, we are seeing good value.

And the other factor that may get a turn of turnaround in this value trap that really what you're talking about is that we see a pickup in M&A activity and we started to see it on the fringes. And I think that'll probably be accelerated if these equities don't pick up pretty soon.

DM: Well, we always know that if the share prices don't go up, other companies will see the value in those shares. But we will come back to M&A. Let's talk a little about silver. Often seen as the sort of the poorer sibling to gold. Are you seeing the same sort of factors in silver and are you more or less excited about silver and gold miners today given that opportunity?

GL: I'm excited about the silver price as well as the silver miners.

DM: So the silver price, you think still got further to go and then…

GL: If you look at all commodity price and you go back to 1980, I was born then, not too many people listening are probably born then, but silver's still at a lower price than we saw in 1980. So it hasn't really moved dramatically.

Historically, silver tends to be more volatile than gold and moves in the same direction as gold. So when we are getting the the gold price moving aggressively in one direction, we normally get a catch up of the silver price, and then the equities usually trade at a premium because there's a scarcity of silver companies around the world.

Yes. The last 15, 20 years, silver companies have become silver/gold companies [**DM:** Yep.] because of the lack of silver projects. But we have an interesting situation now with the silver market where it's been in deficit for three years now. It'll definitely be in a bigger deficit in…

DM: And that's deficit with respect to supply and demand for the actual…

GL: Supply and demand, yeah. It's a primary supply, mine supply, is falling. 70% of supply comes as a byproduct. [**DM:** Yes.] So even if silver were to double tomorrow, we are not necessarily gonna see a pickup in silver supply to the market.

DM: So you are more excited generally then about silver than gold because the silver price has lagged the gold price. [**GL:** It has.] And the silver miners that normally trade at a premium are not.

GL: And you've got real industrial demand for silver. So you have 65% of the demand for silver comes from the industrial sector, which includes the solar panel industry, includes the EVs and electrification of cars. So that demand is growing at a rapid rate. And what's been keeping the market in check is that we've had the ETF selling the same as we've had in gold, we've had in silver. If this starts turning to buying [**DM:** To positive, yeah.] and that's where we think it could happen if we start getting rates coming down. But at the same time, we're more interested in what the equities are discounting, and the market is pretty bearish when you can buy the average large cap silver company trading about 0.6 times net asset value, looking at the silver price around $29 an ounce, where historically it was, they were always trading at 1.8 or two times.

DM: Yeah. So you've got…

GL: There's an apathy in the market.

DM: Yeah. But the opportunity set with the right catalyst, whether that's ETF buying or increased demand, so silver even more attractive than gold, but a bit more volatile that comes with it.

GL: A bit more volatile. But the valuations aren't at an extreme right now. And we get excited when they're the extreme, because nobody knows what the future's going to look like.

DM: So you have a broad metals fund and everybody always wants to talk about the shiny stuff, I get that, right. But we'll talk a little bit about some of your industrial metals. Everybody's heard of decarbonisation. We know that there is a move to remove carbon from the economy, EVs, electric vehicles, being one of the the main things.

So this should, I mean, at any basic principle should see, you know, continued demand for these metals for decarbonisation. Can we actually mine it quick enough? I heard you recently say that sometimes mines take 16 years to get on board from inception to actual production. That's quite a long lead time. I mean, how do we deal with that?

GL: Lead times are getting longer. There's no doubt. So we are in a situation where, as you mentioned, we are moving to another phase in the economy, not only decarbonisation, which is metals intensive. [**DM:** Yep.] But we have infrastructure spend. [**DM:** Yep.] We've heard the US talk about infrastructure spend. We know in Europe they've gotta improve their infrastructure, in this country as well. It's all metals intensive. And with these lead times, that's the latest figure that that's been brought out, around 16 years on average from discovery to production of these metals.

But the sector has been starved of capital where capital has gone to other sectors of the market. So we go through these big phases, Darius, of recapitalisation of the industry. And if you want to invest in the metal sector, you want be invested during a period where there's recapitalisation, which means bringing projects on stream, it unlocks a discount, but they also do near mine exploration and you have more money being put into exploration. That's where the real value creation comes from these companies. And at the same as 1980s parts of the 1990s and now I think for the next five to 10 years, we are definitely gonna go through a recapitalisation of the industry.

DM: Lithium. Another big part of the fund. Tell us, I mean, I think most of us think of batteries, lithium batteries, when we think about that particular metal, what other uses does lithium have or is it primarily in that sort of battery area? And do you see demand continuing to be strong? I mean, all I hear read about and hear about is the move to electric vehicles. That surely is a one-way demand supply for the foreseeable future.

GL: There different battery technologies that are prevalent around the world. The Chinese have definitely gone the lithium ion direction. And that makes up the bulk of the EV and the battery compositions. You've got predominantly lithium in the one half the battery and the graphite in the second half. Europe initially moved towards the nickel, cobalt, manganese batteries. But they started to move now more towards the lithium ion batteries, as well as we have a spending on solid-state batteries, which utilises lithium, we have containers, the size of containers for energy storage. [**DM:** Yep.] And that is becoming about, it's getting close to 13%, 14%, up to 15% of total demand for lithium is getting into the energy storage. We waste so much energy in the grid because…

DM: And that’s to try and capture solar and wind exactly. [**GL:** Exactly] When the sun shines and the demand from the grid isn't that high at that particular amount.

GL: So I think we in this is a nascent industry — clearly. [**DM:** Yeah.] We've gone from various industrial uses of lithium to the lithium use in EV swamping the entire market. [**DM:** Yeah.] And we've seen the prices rally and falling all the way back. So we had a euphoria now everybody's despondent, the shares on their backs right now but this industry's not going away, but it's starting to find a mature level moving forward, and it'll start bumping down where you're gonna get some producers, high cost producers, producing at a loss and then closing down. And that's gonna give the price some kind of support of moving forward.

DM: So let's, we've touched on MA& - mergers and acquisitions - and just as a reminder, this is a broad metals fund that does precious metals as well as industrial metals. Where is the M&A starting? We're seeing M&A, particularly in the United Kingdom, where globally people are thinking, all stocks are cheap, not just mining stocks. Which sectors, is it in the precious metals or is it in the industrial metals, or is it actually now starting to be more broader and M&A really picking up across the piece?

GL: I think it's usually right across the piece, Darius, when, we sat down and we thought to set up the strategic metals fund, we always found that the best values to be had in the smaller and the mid-caps, the guys developing the projects. [**DM:** Yeah.] And especially because the large mining companies have basically cut back on their expiration teams quite dramatically. So they're becoming mature producers with a declining production profile. [**DM:** Yep.] And they basically said, we can produce the metal very well, but we are no longer good at discovering the metal.

DM: Yeah. Somebody has to go and find it for them.

GL: And with this long lead time, especially through the permitting, we'll let you do the heavy lifting in the beginning, and we'll come pick you up at 10 cents of the dollar. It works pretty well when there's nobody interested in the sector and these stocks trade at lower cost then it costs you to discover the same kind of rock.

And I think this is where we are getting to the rubber hitting the road now with these big mining companies waiting for maybe some of these companies to run out of money and they can pick them up cheaply, but the market's starting to wake up. And we've seen quite a few M&A deals, unfortunately through the past three years while we've had this fund up and running, we've had 11 companies taken out. Out of a total portfolio of 37 companies that we typically hold. [**DM:** Right.]

So we're doing the right thing. Unfortunately, they're being taken out [**DM:** Too cheap!] too cheap because we mentioned a few companies that trading at 0.1/0.2 times net asset value, and they're getting taken out at 0.3. So you're not getting the full value uplift, but I think it's just a cycle that we are in. And I think as we move out of the cycle, which I'm really optimistic about over the next couple of years, we are gonna see much bigger valuations or bigger takeout premiums being attributed to the companies.

DM: What do precious metals add to a portfolio? Why should we, you know, we've talked you know, since you launched the fund, there's been pressure on the commodity prices and even more pressure on the miners of those commodities. And sometimes these cycles can last quite quite a long time. And these are equities we're buying, metal companies, mining companies, why should we bother at all? Is it worth it? What does it add to a portfolio?

GL: Well we've always said at the onset we would hold 15% or 20% in precious metals because they give you a good risk diversifier in the portfolio. [**DM:** Yep.] Usually when industrial metals do very well, gold tends lag vice versa. You'd now throw a spanner in the works with battery metals and lithium and nickel coming in. So you've got three big variables moving around. And last year we had the battery metal sector really come under a lot of pressure. [**DM:** Yeah.] And the precious metals came under a lot of pressure because rates were rising, which conventional wisdom. [**DM:**Yeah.] you coming out of school saying, well, rates are rising, I don't wanna be holding precious metals.

But we've got all time highs in gold and silver prices. We got undermining valuations across the sector. So, we are always gonna hold a certain percentage. We are holding more than usual, purely because this is where we're finding the best value right now. And we'll look to trim that back down to 20%. And also I think the other key factor is that if we look at where the expiration dollars are coming from or being put to work in the sector, about 70% is going into the precious metals. So that's where you're seeing the most growth coming through. And that's for us looking and saying, where can we get the best value, is getting to undervalued good companies that are bringing projects online.

DM: And we talked very briefly there about rates. Now here we sit almost spectacularly right in the middle of 2024. The rate cuts that every, well, all the economists anyway, anticipated through the first half of 2024 have not come. Apart from I think maybe one in Australia or Canada somewhere, but in the major markets [**GL:** In Switzerland.] Yeah. I think we can probably all agree unless there's a horrible spike in inflation, the next direction is down, even if it is not substantially down. How do these metals would you expect them to perform in a rate cutting environment?

GL: It was quite interesting, Darius, we ended the year last year thinking there's gonna be a rate cut. [**DM:** Yep.] Probably in the first quarter. We got into January and it didn't look like it's gonna happen anytime soon. The market went into free fall. The metals market, the equities especially everyone sit back, it was almost capitulation saying, okay, it's not gonna come through. Because usually, especially in the US, if US is cutting rates aggressively, it should put some pressure on the dollar, which makes the metals cheaper in other currencies, which stimulates demand. And you see currencies doing well. Right now, you've had some cuts in other regions, not in the US yet. And the market is waiting for that signal that the rate hike cycle has come to an end. And we're now cutting rates before moving in into metals.

DM: And that should particularly benefit the precious or the industrials, or both?

GL: Usually the precious do the first. And then there's usually, if we follow patterns of in the past, we get the industrial metals coming through, I think what's every cycle is slightly different. But certainly we see it from a valuation perspective, that if we are looking for value across the sector, we're seeing great value in the precious metals. We're seeing now great value in the lithium because everybody hates it now, from loving it two years ago. [**DM:** Two years ago. Yeah.] And nickel as well.

DM: So we've got about a minute left, so let's just, I always like to try and talk about the human side of our jobs. One of the things that you and your co-manager, Mark, do is actually go and visit some of these sites. To me that would sound as if I was going to a lot of very hot countries, potentially maybe politically unstable companies. What do you learn from the boots on the ground approach and you know, I know your background of 30 years is a metals, you're a metals man. You, this is what you know, get passionate about. What do you like about the company visits, actual site visits?

GL: Well, it's very difficult to build a mine, and it's very difficult to build a processing plant as well. A lot of things can go wrong.

DM: That's processing, you gotta get it out the ground, then you gotta decide what to do with it.

GL: You got to get it out of the ground, exactly. And especially today, we really focus at the market on ESG, we like to see what are they doing with the community? How does the community feel about these guys building an operation in their backyard? What are the challenges? What are the logistical challenges?

Mark went out to Guyana, to see G2 Goldfields and right next door Reunion mine, he had to cross a big river on this rickety ferry. It took him, I think half a day just to get out on site. But it was invaluable. You see the geologists, the guys working on the ground, you have a real appreciation for the challenges in the territory and looking at the core itself to make up your mind, is this gonna be a real project or not.

Now what's happened is a year later, both Reunion have been bid for by G Mining [Ventures] and G2 Goldfields, AngloGold [Ashanti] have just taken up to, they've built up to 12.7% waiting in G2 Goldfields.

DM: So that's a sign of a takeover, potentially.

GL: Exactly, and now we are hearing that there's a few other companies are raising money to come over the top and take the whole, it's gonna be the next big project around the world.

But until you've been out there to really recognise and understand that, and understand the people working at it. I went to G Mining building the operation in Brazil, and I was astounded by the quality of the personnel that were building the mine. I was lucky that I visited the same operation building a mine for London Gold in Ecuador. And they built that mine, under budget, on time, and it's one of the best mines in the world today producing at below $1,000 an ounce. So I kind of, these guys know what they're doing, but the market, until you get to a certain stage, they're not gonna give them any credit. And that G Mining is up 137% in the past 12 months. So that's the kind of insight we get from going on site.

DM: Georges, thank you very much. And, you know, in a period where lots of assets have gone up we've just had a nice chat about some genuine value and the fact that the miners are trading even cheaper than those spot prices means there's a potential for a really strong rerating in the coming years.

SW: The WS Amati Strategic Metals fund is an active, high-conviction portfolio whose investment process is driven both by bottom-up analysis and the prevailing macroeconomic environment. The strategy places great emphasis on the stage in which metals are in their cycle, and invests in metals that have strategic importance to the global economy. To learn more about the WS Amati Strategic Metals fund please visit fundcalibre.com