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## Today's Market View - Bushveld Minerals Limited, Gem Diamonds, Wolf Minerals

**Bushveld Minerals (LON:BMN) Target price 14p (raised from 11.6p) - Vanadium prices drive profits higher as management target expansion**

**Gem Diamonds (LON:GEMD) - Interim results for H1 2017**

**Wolf Minerals (LON:WLFE) - Progress report on operational turnaround plan**

### **Copper, zinc and nickel lead metals complex as traders and manufacturers stock up on China ahead of anti-pollution closures**

- China has been getting tough with pollution and has informed steel producers in key provinces that they will be expected to shut down or reduce production during certain winter months.
- One aim is to improve air quality through the winter when smog is particularly bad.
- Inspectors are also focussing on miners, smelters and other furnaces in a drive to force companies to pollute less and clean up historic waste.
- While many producers will clean up and restart production some may not afford the additional cost of environmental compliance.
- The disruption is serving to cause manufacturers to restock metal inventory as metals prices are expected to rise due to the higher costs going forward.

### **Vanadium prices holding at new high levels**

- Ferro-Vanadium prices are holding at \$42.6/kg (MB Bloomberg) having risen from around \$26/kg in mid-July and \$24/kg in January
- The market has jumped due to the closure of a number of vanadium process plants in Sichuan province, China where environmental inspectors have been focussed (see Metal Bulletin news)
- China's environmental inspectors may move next to Hubei which may tighten the supply of ferro-vanadium further.
- The Metal Bulletin report prices of \$55-60/kg for 78% ferro-vanadium fob China vs \$40.40-42.60/kg in Western Europe.

**Dow Jones Industrials +0.12% at 22,025**

**Nikkei 225 -0.14% at 19,703**

**HK Hang Seng -0.24% at 27,344**

**Shanghai Composite +0.68% at 3,268**

**FTSE 350 Mining +0.79% at 16,792**

**AIM Basic Resources +0.22% at 2,470**

## Economic News

Gold prices are up nearly \$14/oz trading around \$1,290/oz levels as FOMC meeting minutes highlighted weakening inflation pressures; although, the committee continued to believe consumer prices growth slowdown is attributed to temporary "idiosyncratic factors".

- The US\$ index is level today after losing 0.7% yesterday as markets revised chances of another rate rise this year down.
- Additionally, following a number of high profile business leaders leaving Trump councils, President disbanded both manufacturing and jobs councils adding to concerns over prospects of enacting pro-growth policies.
- Steel making commodities including iron ore and coking coal posted strong gains in China on Thursday one day ahead of the Chinese house price data.
- Coking coal contracts hit new high of \$78.7/t for 2017 today while iron ore January futures jumped 3.7% to CNY 545/t (\$81.6/t) undoing this week's losses.

## Economics

**US - Describing the state of the economy FOMC meeting minutes highlighted that "the labour market had continued to strengthen and that economic activity had been rising moderately this year... job gains had been solid... household spending and business fixed investment had continued to expand".**

- "Members saw near-term risks to the economic outlook as roughly balanced, but, in light of their concern about the recent slowing in inflation, they agreed to continue to monitor inflation developments closely," minutes read.
- On the balance sheet normalisation subject, "several" FOMC members were ready to announce the start of the programme at the July meeting but "most" preferred to wait assessing both economic conditions and "development potentially affecting financial markets" including such things as debt-ceiling negotiations and geopolitical concerns.
- There was little reaction in the bonds market to the announcement with government debt yields on 2y notes trading flat at 1.33% and 10y notes posting a drop of 1bp to 2.22%.
- Market estimates of the next rate hike during the December meeting have come down from 43.8% to 40.6%.

**France - Labour market continued to improve with unemployment contracting for a third consecutive quarter in Q2/17.**

- The jobless rate inched down hitting the lowest level since early 2012.
- With business sentiment running high and latest Markit PMIs pointing to robust economic growth rates expectations are for the labour market to continue improving.
- Unemployment Rate: 9.5% v 9.6% in Q1/17 and 9.5% forecast.
- Unemployment Change (qoq): -20k v -115k in Q1/17.

## Currencies

US\$1.1740/eur vs 1.1735/eur yesterday. Yen 109.96/\$ vs 110.93/\$. SAR 13.169/\$ vs 13.244/\$. \$1.290/gbp vs \$1.290/gbp.

0.795/aud vs 0.786/aud. CNY 6.673/\$ vs 6.694/\$.

## Commodity News

### Precious metals:

Gold US\$1,288/oz vs US\$1,270/oz yesterday

Gold ETFs 66.8moz vs US\$66.6moz yesterday

Platinum US\$976/oz vs US\$965/oz yesterday

Palladium US\$924/oz vs US\$896/oz yesterday

Silver US\$17.10/oz vs US\$16.68/oz yesterday

### Base metals:

Copper US\$ 6,505/t vs US\$6,442/t yesterday - Peruvian government enact 30-day state of emergency around the Las Bambas copper mine area

- Local protesters have blocked the only route connecting the operation to Matarani port.
- Police are reported to have yet to clear road ahead of a meeting between government, MMG (operator and owner of the mine) and residents today.
- The Chinese do not have a good track record of public relations in Peru from our experience.

Aluminium US\$ 2,081/t vs US\$2,067/t yesterday

Nickel US\$ 10,805/t vs US\$10,545/t yesterday

Zinc US\$ 3,106/t vs US\$3,009/t yesterday - China accounting for roughly half of the world's zinc supply recorded the weakest monthly output in three years

- The weakness is on the back of environmental closures due to ongoing inspector checks and a shortage of ores.

Lead US\$ 2,497/t vs US\$2,419/t yesterday

Tin US\$ 20,255/t vs US\$20,080/t yesterday

### Energy:

Oil US\$50.3/bbl vs US\$51.2/bbl yesterday

Natural Gas US\$2.884/mmbtu vs US\$2.901/mmbtu yesterday

Uranium US\$20.85/lb vs US\$20.75/lb yesterday

### Bulk:

Iron ore 62% Fe spot (cfr Tianjin) US\$74.6/t vs US\$70.5/t

Chinese steel rebar 25mm US\$634.1/t vs US\$635.4/t

Thermal coal (1st year forward cif ARA) US\$78.4/t vs US\$77.3/t yesterday

Premium hard coking coal Aus fob US\$195.9/t vs US\$196.9/t

### Other:

Tungsten APT European US\$248-256/mtu vs US\$230-235/mtu

## Company News

**Bushveld Minerals (LON:BMN) 9.5p, mkt cap £77m - Vanadium prices drive profits higher as management target expansion**

### Target price 14p (raised from 11.6p)

- Bushveld Minerals report impressive results from the acquisition of Vametco, the South African vanadium producer. Bushveld currently holds 45% of Bushveld Vanadium which owns 78.8% of SMC which owns 75% of Vametco Alloys with the other 25% owned by the BEE consortium. Bushveld Minerals is equity accounting for 26.6% of Vametco Alloys in its accounts and may move to consolidate its holding further in time.
- This, well timed, deal has paid off its acquisition cost and associated debt within an impressive four months of its acquisition.
- The team are looking to expand market share to >10% of global vanadium supply over the next 3-5 years in a move which could add significantly to production expanding nameplate capacity to 5,000tpa of FeV from 3,000 tpa currently.

- Vametco increased production by 16% last year to 2,804t of ferrovanadium which is mainly sold under the 'Nitrovan' product name representing a 3.7% share of global production and is looking to raise its market share of global vanadium supply to >10% in the next 3-5 years.
- The business produced some 1,441t of vanadium in the first six months to end June indicating that production is continuing at this rate.
- Vanadium Prices: have soared in recent weeks nearly doubling since June and more than doubling since last March.
- We have assumed vanadium prices remain at elevated levels of around \$42/kg for some months to give an average of \$30.80/kg for the year up from \$25.25/kg previously but that prices will normalise in the last quarter.
- We are using \$25.25/kg as our as our longer term assumption for ferro-vanadium.
- These may well prove to be very conservative assumptions if China continues to enforce environmental restrictions causing the long term closure of a number of vanadium plants.

Vametco plant assuming 100% 2017 2018 2019 2020 2021

Price V2O5 \$/lb 6.40 5.46 5.46 5.46 5.46

Vanadium flake price US\$/kg 30.80 25.25 25.25 25.25 25.25

Vanadium sales kg 2,757 2,757 3,342 4,984 4,984

Sales US\$m 80.67 66.13 80.17 119.55 119.55

Operating costs US\$m 52.36 53.91 61.57 89.47 89.47

Operating costs US\$/kg 18.99 19.55 18.42 17.95 17.95

Operating profit US\$m 28.31 12.22 18.60 30.08 30.08

Pre-tax profit US\$m 28.07 11.76 17.22 27.84 27.94

tax inc royalty US\$m 9.06 4.35 7.45 12.96 12.96

Post-tax profit US\$m 19.01 7.42 9.77 14.87 14.97

EPS US\$/s 2.36 0.92 1.21 1.85 1.86

PE x 5.2 13.4 10.2 6.7 6.6

EV/EBITDA x 3.5 8.1 5.3 3.3 3.3

Figures based on 100% of Vametco plant. Bushveld currently equity account for 26.6% of the Vametco plant

- Costs: While costs fell 16% to \$14.50/kg of vanadium last year vs \$17.23/kg in 2015 costs rose slightly to \$15.58/kg in the first six months of the year, though these costs remain at the bottom of the vanadium cost curve due to the higher grades mined by Vametco vs much of the rest of the industry.

- If Chinese vanadium producers are able to modify their plants to meet the new environmental regulations then we would expect prices to pull back from today's very high levels but for prices to potentially rest at higher levels than previously seen to pay for higher processing and capital costs. We suspect that some Chinese vanadium production may not come back onstream due to the cost of environmental compliance at related mines and process plants.
- Vanadium deficit: Bushveld see the current market deficit as very real as evidenced by the Chinese releasing stock of older ferro-vanadium into the market. Better enforcement of Chinese regulations on the quality of steel being used in construction combined with ongoing strong demand for steel is likely to increase demand for vanadium yet further at a time when European steel producers are also looking to increase capacity utilisation and raise production.
- Barrier to entry: Bushveld's previous feasibility study indicates that prices of over \$33/kg are required to stimulate new vanadium production to meet a pre-tax IRR of 24%. While some new incremental vanadium production may come in at lesser price increases it seems unlikely that any new mines and process plants would be built at this price level in our view. Most vanadium plants in China process grades of 1-1.1% material exacerbating their environmental issues and requiring yet higher price levels for new investment.
- FOREX: A stronger South African rand has served to dampen the impact of higher ferro vanadium prices. Strengthening the Rand by around 7% eg from \$14/US\$ to \$13/US\$ knocks around 2p/s off our Bushveld valuation. We assume a stable rand of SAR14/US\$ over the life of the project. We could assume this will weaken but we prefer to use stable price and currency rates in our modelling.
- Profit: Bushveld Minerals reported a profit of £1.167m for the year ended 28 February 2017. The acquisition of Bushveld's effective 26.6% stake in Vametco will radically change the company's income outlook going forward as indicated in the company's recent operational update. Further structuring of the group is likely to continue to change and develop the profit outlook for Bushveld from here.
- Bushveld Energy (vanadium rexox batteries) are reported to be on plan to vindicate the IDC's choice of vanadium for large-scale energy storage as one of the significant new industries to support in South Africa. This could mark a major milestone in the use of vanadium for large scale utility battery storage.
- Greenhills Resources (49.5% interest in Dawnmin, which owns an 85% interest in the Uis Tin Project in Namibia): Bushveld are looking to consolidate a critical mass of tin resource inventory and are implementing a pilot production programme and are exploring options for a potential listing of Greenhills Resources.
- Lemur (coal and power generation in Madagascar): for Lemur this entails securing a power purchase agreement for a 60MW thermal coal power project as well as tying up partnerships with financial and EPC project involves securing an Independent Power Producer licence and a Power Purchase Agreement for a thermal coal fired power station next to the coal mine, thereby providing a captive market for the Imaloto project run-of-mine coal.
- Lemur have signed a MoU with PowerChina for the development of a 60MW thermal coal power plant in Madagascar. The development of the Imaloto project, including the mine and the power plant could generate ~US\$300m of new investment in Madagascar and increase the country's power supply by 15%.
- Valuation: We have carefully considered the impact of the rise in vanadium prices, the strength of the South African rand and the increase in FerroVanadium production in our modelling. We see significant potential for upside with higher prices over the longer term and if the South African rand weakens from here as it is likely to do. We have not assumed any reduction in unit costs to come from the increase in production though it would be reasonable to assume so.

Conclusion: We are excited to see vanadium prices take off but cautious in our revised valuation in case prices pull back for the fourth quarter. We see Bushveld as offering unusually good value for investors. Our revised earnings table is for 100% of the Vametco vanadium operations in which Bushveld currently hold just 26.6% though we expect this stake to change. The dramatic rise in vanadium prices should have a substantial impact on Vametco's profit through the second half as indicated in our revised numbers.

\*An SP Angel mining analyst and nomad have visited the Vametco vanadium mine and processing facilities in South Africa. This note is MiFID II compliant.

### **Gem Diamonds (LON:GEMD) 78p, Mkt Cap £108m - Interim results for H1 2017**

- Gem Diamonds reports an after tax profit for the six months to 30th June 2017 of US\$578,000 (H1 2016 US\$ loss US\$15.9m). The 2016 result, however, reflected a US\$40m impairment charge against the value of the Ghaghoo mine while the 2017 result includes a smaller, US\$3m, exceptional charge for care and maintenance of the suspended Ghaghoo operation.
- A combination of lower ore tonnages treated due to reduced plant availability and reduced recovered grades, which at 1.59cpht was lower than both the 1.79cpht achieved in H1 2016 and the targeted 1.63 cpht for H1 2017, led to a 12% decline in the overall production to 50,478 carats (H1 2016 57,380 carats).
- Production of larger, higher value diamonds has, however, improved with the 70% owned Letseng mine yielding 4 stones larger than 100 carats in size and a total of 96 diamonds larger than 20 carats during H1 2017. These included "two exceptional D-colour Type IIa diamonds of 98.42 and 80.58 carats".
- A further positive trend has seen the prices achieved for the high value diamond production from Letseng which showed a 20% increase to average US\$1779/carats in H1 2017 (H2 2016 - US\$1480/carats), although still below the US\$1899/carats recorded in H1 2016.
- Despite the positive impact of the large, high quality diamonds, revenues declined by approximately 15% to US\$92.9m (H1 2016 - US\$109.1m) and EBITDA fell to US\$13m (H1 2016 - US\$43.5m).
- The company comments that "Capital and cash management discipline remains a high priority in the short term and the Company remains committed to generating cash and strengthening its balance sheet." We estimate that at 30th June, Gem Diamonds held net debt of approximately US\$14.2m compared to net cash of US\$3.0m at the beginning of 2017.
- As part of the effort to improve its balance sheet and improve cash generation, Gem Diamonds is implementing "a Group-wide efficiency and cost reduction review has commenced and has already identified opportunities that are being actively pursued."
- In a review of the wider state of the diamond market, the company remarked that "The global market for both rough and polished diamonds remained cautious. Financing challenges persist and the volatile macro-economic environment continues to create challenges for the middle diamond market. In the medium to long term, rough diamond prices are expected to be supported by favourable demand/supply fundamentals, which are underpinned by a continued growth in demand from emerging markets coupled with a limited growth in supply. ... The cautious approach adopted by rough and polished diamantaires and manufacturers is expected to continue into the second half of the year".

Conclusion: Gem Diamonds has weathered a tough half year helped by the improved production of large, high value diamonds from Letseng. Lower earnings and increased debt remain a challenge as the company is taking a cautious outlook on the short term market for rough diamonds. We look forward to further details on the efficiency and cost reduction strategy and other measures to strengthen the balance sheet in due course.

### **Wolf Minerals (LON:WLFE) 3.6p, Mkt Cap £39.4m - Progress report on operational turnaround plan**

- Wolf Minerals reports that it is making progress with its operational turnaround plan at the Drakelands tin tungsten mine in Devon. The plan is focussing on three main areas:

- o "improving processing plant reliability in the crushing circuit;
- o improving performance of the refinery to enhance production levels; and
- o reducing noise emissions from the processing plant including low frequency noise ("LFN")."

o Implementation of remedial measures involving shut-downs of the screening circuit at weekends has involved Wolf Minerals and its lead contractor, GR Engineering Services, identifying a need to expedite control of LFN emissions which, understandably, are a potential source of friction with the mine's host communities. "The Company has assessed the costs of ongoing LFN rectifications and has decided to notify GRES of its intention to recover these costs from the £7.5 million Performance Bond under the construction contract. The Company is confident that the Performance Bond will be sufficient to cover the costs of implementing the technical solutions required to deliver a successful LFN outcome."

o At this stage, the company has not elaborated on the progress of measures to improve the crushing circuit or the moves to enhance production levels.

o Commenting on the decision to trigger the Performance Bond, Acting Managing Director, Richard Lucas, emphasised the community relations aspects of LFN; "Managing our operations successfully ... requires us to maintain strong relationships with our local communities, which includes further reductions in low frequency noise emissions. Therefore, after extended discussions with our lead construction contractor, GRES, we have decided to notify them of our intention to call upon the Performance Bond to ensure an LFN solution is achieved as quickly as possible."

o Mr. Lucas went on to comment that "We are ... encouraged by an improving tungsten price which supports the opportunity for Drakelands to be an important part of the global supply chain for such a critical industrial metal." We note that the price of the benchmark ammonium paratungstate (APT) currently stands at US\$248/256 per metric tonne unit compared with a price of US\$187/198 per mtu at the beginning of 2017.

**Conclusion:** The decision to call upon the Performance Bond will not have been taken lightly however the funds it releases should speed up the rectification of the LFN issue and demonstrate to the local communities the company's resolve to maintain a positive working relationship. In the wider context, the remedial work to improve plant performance is entering a critical phase with the company having commented at the release of their quarterly results in July that "The next six months is a pivotal time for Wolf to realise its' objective of becoming a reliable steady-state producer." and that it "aims to achieve a sustainable production platform during the December quarter ..."

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