

Jonathan Lee: Companies Positioned to Grow With Exploding

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Lithium continues to be in high demand as battery application growth outpaces the economy. In this exclusive interview with The Energy Report, Jonathan Lee of Byron Capital calls on his engineering and manufacturing background to explain the factors shaping the evolution of this growing market. He also brings us up to date on several promising companies blazing trails in the lithium industry.

The Energy Report: Thank you for joining us this afternoon, Jonathan. You have a technical background in engineering and manufacturing in addition to your experience as an analyst. This gives you a unique perspective in evaluating investment opportunities. What do you look for specifically in a lithium company?

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Jonathan Lee: Numerous factors. Our strategy is to find low-cost producers within a sector. Then from a capital cost side, it's always more beneficial to have a lower capital cost to get a better return on equity and make the project more feasible. We like to have low capital expenditures and operating expenditures. Beyond that, it really comes down to valuing the company and trying to make sure that the equity is purchased at the right price. The two major factors that contribute to a better return on equity are good assets and low costs.

TER: Are you looking across the broad spectrum of levels of development, from prospectors to companies that are already producers? Or do you narrow it down to more advanced companies?

JL: We look at everything from exploration to producing companies. When we look at producing companies, a lot of times there is less technological risk or execution risk involved. At the earlier stage, there's a lot more risk entailed in proving out the deposit, proving up a resource and gathering more metallurgical information, etc. Earlier-stage companies usually are valued less and have the potential of higher returns but also entail more risk.

TER: Lithium has been a hot topic in the past several years. For those readers who are not all that familiar with it, can you give us a little background on the metal, its uses and what people should be looking at when considering lithium investments?

JL: Lithium is a metal that's used in a slew of different products. Batteries are a big percentage of it, roughly 25%-30% of production. Glass and ceramics are also a big usage because it lowers the heating temperature, which saves energy. It's also used in lubricants and castings. A variety of products utilize the element, but these end users make up the majority.

TER: Is battery usage growing faster than other applications?

JL: Yes. Although penetration into automobiles is not great as of yet, there is significant growth in consumer applications for lithium-ion batteries, and you're seeing that growth year over year. We think that's going to continue to grow as things get switched over from, say, nickel-metal hydride rechargeable batteries to lithium-ion

batteries in consumer electronics.

TER: With all the market turmoil that we've had here since you last spoke with us [back in April](#), can you bring us up to date on what's been happening in the battery materials industry in the past six months? Have there been any major changes?

JL: There are only four major lithium producers. Chemetall and [FMC Lithium Corporation \(FMC:NYSE\)](#) publicly stated in July that they were raising their prices, partly because of increased demand. That definitely helped out along with rising raw materials prices. Soda ash (sodium carbonate) has increased dramatically, thereby increasing the cost to produce lithium carbonate. Because demand is still strong, they've been able to raise prices and pass on those extra costs to customers. If you look at companies like [Talisson Lithium Ltd. \(TLH:TSX\)](#), which we currently cover and have a Buy recommendation on—it is also selling at capacity. You're likely to see FMC increase its capacity by 30% next year. So the overall strength of the market is definitely there in the short term. We believe producing companies, such as Talison, will be able to take advantage of that market demand.

TER: Has anything happened recently on the technical front to affect the lithium market in either a positive or negative way?

JL: As kind of a leading indicator of where the market is going, you can look at the amount of money that a company is going to spend on new lithium-ion plants. [GS Yuasa Corp. \(TYO:6674\)](#) is increasing the capacity of its plant. It's spending roughly \$300M on that plant. When it's up and running in 2014, that will be a significant buyer of lithium for batteries. Panasonic, although it's scrapping its plant in Japan, is also expanding in China. More and more battery producers are increasing capacity, and that's a clear signal of where we think the market is going.

TER: A number of companies are mining lithium deposits, mainly in South America, but also in Canada. Do you foresee a supply glut in the market?

JL: Most of the mining companies could come into production within the next year. Demand should increase in step with supply. Talison is increasing its production as is FMC. The markets have a pretty good way of clearing out producers that aren't able to compete. That is why locating potential low-cost producers is part of our investment strategy. Just like any other market or mining sector, not all exploration juniors make it to production. We try to find those companies that will be in the lower quartile of relative production costs.

TER: You mentioned that a couple of the major producers raised prices. Is lithium mainly a negotiated or supplier price-based market rather than one driven by investment demand?

JL: Yes, it's mainly supplier-price based. It's sold over the counter, and we doubt there is going to be any type of LME (London Metal Exchange). It's not going to be an exchange-traded material because customers have specific criteria for batteries on the chemical side as well as the physical side. A lot of the juniors that we cover are working with trading or industrial companies or even an end user like the Argonne National Laboratory, which has an agreement with [Western Lithium USA Corp. \(WLC:TSX; WLCDF:OTCQX\)](#). Determining the physical and chemical characteristics of lithium products will be based on customers' needs. Because each customer has different needs, we think that it will remain a negotiated market, and people will pay different prices for different chemical and physical characteristics.

TER: Back in April, you told us about the four major companies that dominate the market, which are [Sociedad Química y Minera de Chile S.A. \(SQM:NYSE; SQM-B:SSX; SQM-A\)](#) a Chilean company; FMC Lithium Corp.; Chemetall, a unit of [Rockwood Holdings, Inc. \(ROC:NYSE\)](#); and Talison. What are the prospects for

smaller companies now entering the market?

JL: Recently, demand has been strong and the majors are expanding. But we believe there will be space for companies to enter the market because the four majors will, at some point, max out on capacity. We think there is space for some of the juniors. In the short or medium term, you may see companies that have strategic investors who may pay up for the security of having that supply in an offtake agreement. If one of those strategic investors makes a more substantial equity investment in the near future, we think that shows that the customers are more worried about the security of supply rather than price. And that could bode well for some of these juniors.

TER: You've done some research reports recently on Talison Lithium, [Lithium One Inc. \(LI:TSX.V\)](#) and also Western Lithium. Of course, Talison is one of the majors. What can you tell us about Lithium One and Western Lithium, which are not in that category?

JL: Lithium One is a junior brine exploration company in Argentina. It just released its preliminary economic assessment (PEA), which showed positive economics. It showed it could be a low-cost producer of lithium as well as potash. Its estimated production includes a substantial amount of potash, which, on the byproduct credit basis, significantly reduces the cost of lithium production. It's similar to the model that SQM uses in Chile, where it has potassium and lithium co-products that make for positive economics. We think it's definitely tangible given that its salar looks very much like FMC's salar.

On Western Lithium's front, it signed up with the Argonne National Laboratory to collaborate and work on creating better lithium products. Because lithium is a non-commodity with respect to its chemical and physical characteristics, having that knowledge of what its customers want is a significant turn of events.

TER: How close are these companies to production?

JL: Most of them are at least a few years away from production. I guess the closest one out of the brine projects would potentially be [Orocobre Ltd. \(ORL:TSX; ORE:ASX\)](#). It's in negotiations with [Toyota Tsusho Group \(TYHOF:OTCPK\)](#) to finalize its offtake and strategic investment. Even after that is done, you still have to construct the mine, pump brine into the ponds and evaporate it for at least a year. So you are looking at a timeframe of at least two to three years to production. I think it would be one of the earliest companies to come to production. Most of them are fairly far off.

TER: What kind of capital costs are associated with putting these operations into production?

JL: It really depends on the size, but a lot of their economic assessments have come in roughly between \$200-\$360M, ranging in size from 15,000-25,000 tons. And those estimates seem fairly reasonable. Financing is going to be one of the risks for companies getting projects up and running. Mining is a capital-intensive business.

TER: Are there any other lithium development names that you think are worth considering at this point?

JL: The other two names that we cover are [Lithium Americas Corp. \(LAC:TSX; LHMAF:OTCQX\)](#) and [Rodinia Lithium Inc. \(RM:TSX.V; RDNAF:OTCQX\)](#). Lithium Americas has a strong management team with a property adjacent to Orocobre with very similar brine chemistry, and it already has strategic partners in Magna International Inc. and the Mitsubishi Corporation. Rodinia has a brine project in Argentina, which is highly prospective. It should have its PEA released within this quarter. That should bode well for it and prove up its economics as well.

TER: How would you summarize your reading on the lithium business at this point?

JL: I think the lithium business is strong. I'm seeing strong growth in the near term. With the consumption of lithium in consumer batteries, you'll see substantial growth, especially with the implementation of transportation vehicles. Companies are committing hundreds of millions of dollars in capital to build these plants. We think that's a leading indicator of where demand is heading.

TER: As far as you are aware, is anyone developing any competing technology?

JL: No. When you look at where lithium is on the periodic table, it's on the top left, so it's the cathode of choice because of its energy density.

TER: It looks like lithium is here to stay for the foreseeable future.

JL: We believe so as well.

TER: Very good. We appreciate the update and your current thoughts. Thanks for talking with us today.

JL: Thank you.

Jonathan Lee is a battery materials and technologies analyst with Byron Capital Markets in Toronto. As a member of Byron's research department, Lee's primary focus is on the battery materials sectors, which includes lithium, vanadium and cobalt.

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