Mining Journal

Valence goals go beyond miner league

Bringing an old graphite mine back to life – indeed the lure of being a miner – is not what drew Chris Darby to Uley in South Australia. That was always just the starting point for Valence Industries' CEO, whose bigger vision for the project should come more sharply into focus for investors this month.

- Richard Roberts
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Loading Uley graphite samples for shipment

Having last month marked the initial phase of Uley's rebirth with the first substantial graphite shipment in more than 20 years, Valence is expected to announce financing arrangements in the next few weeks for an expansion that will really put it on the graphite industry's new world chart. It's a different looking map to the one Uley figured in up to the early 1990s.

While strategic thinking on adding value to Australia's mined resources through advanced manufacturing hasn't progressed much in the past two decades, Darby is determined not to bypass opportunities presented by today's rapidly evolving graphite market. For him, embedding Uley Graphite in international material supply chains, simultaneously slashing its dependency on basic mine-gate product prices, and cementing Valence as a producer of 'industrial' earnings and dividends, will be the key markers of success over the next five years.

"We've got plenty of dirt," Darby told *Mining Journal*.

"Our … magnetics [surveys] indicate an almost endless supply of graphite – like I'm going to be well and truly dead by the time we're going to get anywhere near running out of graphite. So that's not the challenge.

"The challenge is making sure we mine that in a sophisticated manner which matches the sophistication of our operations … so that we have a consistency of product yield coming through the plant and can then be predictive about what we're then going to be supplying to customers over any given period, whether it be one month, three months, six months; so that we can be supplying exactly what those market segments are going to be requiring and selling to meet that expectation, and that is where it becomes key to know exactly what our resource is.

"It's not got to do with I've got more tonnes and I'm going to shove them out the door as rapidly as possible.

"Our rationale right across the executive team and driving down through the company is, how can I sell this one tonne for much, much more than we're originally selling it for? How can we add value to this tonne – not shift more tonnes – and sell each tonne for much, much more?

"Because that not only leads to more loyal customers and much longer term contracts, but also greater stability in your ability to predict long term revenue streams for the company."

Firming up resource and reserve levels, and an exploration target of up to 12 million tonnes at 9-12% carbon, to support long-term production planning and contract negotiations, and a higher enterprise value (one calculation has each new 1 million tonnes of ore reserve adding A$32 million to Valence's NPV), is the focus of current drilling at Uley which will run into the second half of the year. Darby remains confident the work won't hold up long-term supply deals with potential customers.

Valence has been using stockpiled ore from previous mining at Uley during recommissioning of a 14,000 tonnes-per-annum processing plant at Port Lincoln on the Eyre Peninsula, and provide samples for customer assessment. It recently shipped about 20t of flake graphite via its logistics handling facility at Port Adelaide.

A 2014 feasibility study on expanding the concentrator by 25,000tpa and adding a new openpit mine, and putting in advanced product handling and manufacturing facilities, indicated A$50 million (US$38 million) capex could deliver handsome EBIT margins (circa 50%) on revenues of about $100 million a year or more, obviously dependent on current memoranda of understanding (MOU) covering 80,000t of future output converting into sales at about the US$1400/t mark for traditional flake graphite production, and some advanced product sales at prices perhaps 2.5-times that rate.

Valence is factoring in less than 5% of output being 'advanced' flake graphite, with Darby noting that was about as much as bankable feasibility study guidelines would allow at this stage.

"You do have to very clearly establish the economics of each element of what you're going to produce [in the feasibility study]," he said. "We're able to clearly do that – not simply, but clearly do that – for the traditional product lines, which are opaque enough on their own [in terms of benchmark pricing].

"But when we talk about these higher purity, or micronised, or advanced products we're going to be producing, there's no benchmark basis for people to measure that against. So to release a bankable feasibility study you have to say, okay, let's say it's going to be less than 5% of what we do.

"In reality the business plan is of course you want to do as many tonnes as you can possibly do through your advanced manufacturing plant, because for every tonne you do instead of getting paid $1400/t you get paid $3800/t. And that is simple mathematics, and it's pretty obvious what you should be doing if you can do it."

For a range of reasons, including cost of finance, Valence will have been pushing for as much debt funding as possible with the spread of domestic and international financiers in its data room in recent weeks. The final mix of offtake, equity and debt project finance should become clear soon.

"It is a very low capex exercise in the scheme of things, when you look at other potential operations," Darby said.

"We don't see any challenges around putting that [expansion funding] away despite the global market being a little challenging.

"As well as expanding the existing mining and processing, we're building the advanced product handling and high purification plant at the same time, which significantly moves forward some projects that we had on our 3-5-year planning horizon. It becomes a very attractive model because it's very much de-risked from a financier's point of view already, and each month that goes by it becomes further and further de-risked."

The reference to normal plant and logistics-system rebooting, and the more significant renewal of customer links, have been keynotes of Darby's promotional refrain for the past 12 months. The former is a clear point of difference in the Valence story, relative to most of its junior graphite peers, and Darby also accentuates Australia's low-risk status. A fast operational restart since Valence's ASX listing early in 2014 has been accompanied by a steady regrowth of sales channels.

Darby says this part of the story needs to be about numbers rather than names for the foreseeable future. He maintains there are sensitivities around identifying sources of supply for end-users (different issue, evidently, to the one around transparency in supply of diamonds and other minerals) and it also no doubt suits Valence to keep its customers' names to itself at this stage. This is contrary to some other would-be producers who are flagging offtake partners as a differentiator.

"It's a very deliberate thing on our part," Darby said.

"Our customers are particularly sensitive about their competitors knowing who they've qualified with and where they're sourcing raw material. And the other aspect to it is there is no need for me to educate everybody about everything we're doing in the market space.

"We are being tested: there are a number of audiences to every announcement we make, and those audiences include the local communities, and our investors. But there is a separate audience which is the customer, who is looking very hard at exactly what we say and how we say it.

“The bottom line is we are getting those contracts signed up with the customers. That of itself, particularly with an industrial mineral, should be a very clearly demonstrative of the success of what we’re doing. None of the customers would be signing up with us, or accepting product, if we hadn’t proved our technical capability or our ability to service their requirements. So these contracts are very illustrative of what we’re doing now.

“The importance of us maintaining secrecy has also got to do with the manner in which we do contracts. We’re hitting the easy runs at the moment – with refractory foundries and the like. But we have customers who are qualifying, and who have been qualified, [who include] everything from the refractory foundries, to conductors, paints and polymers, to engineering products, through to energy storage and batteries, and all the way through to biomedical applications. Those customers logically are the ones who are going to be there to purchase the material as we do the advanced purification and the advanced blending of that product. They are the people who in 10 years’ time, or even 5 years’ time, as we move into graphene, are going to be the customers who are going to be participating in the … research and production, and acquisition at the time.

“A lot of this has got to do with having trusted, strong, long-term suppliers who are integrated into your supply chain as a global manufacturer. That’s the sort of partner these companies are looking for.

“All of these factors mean it’s a more sensible approach to say, look, I’m selling this many tonnes, I’m hitting this average price and please do test me, but test me against what profit margin are we achieving. So, is the team working efficiently and producing a product that is saleable in the market, and is that market providing a price that is meeting the margins and the levels of profit that we’re anticipating to achieve? This is why we’ve put out the forecasts we have around profits and particularly with a focus on earnings before interest and tax over the next five years of our program.”

A lawyer who for 20 years has worked with and advised resources and construction companies financing and building projects in Africa, North America and Australia, Darby is part of a Valence board that includes former head of Mitsubishi Australia, Graham Spurling; experienced company director Glenister Lamont; and veteran Australian mining industry figure, Ian Schache.

Darby said lessons learned in the delivery of projects in more difficult operating environments were now being applied at Valence.

“This asset [Uley] was sitting there 23km outside a major regional centre in a very well established western country with good road networks, electricity and water, and a light industrial centre 12 minutes down the road. There was a long history of acceptance of its production in the market,” he said.

“So it ticked a lot of boxes for me when I first looked at it.”

Growing production, and potentially earnings, will position Valence to be acquisitive in a sector – outside the dominant source of production, China – Darby sees as moving toward consolidation, particularly if capital for developing projects remains scarce.

“I think there will be a substantial consolidation in the industry and the key thing we’ve been saying since the day we listed in January last year is there are three core pillars that uphold a good graphite company. One of them is an easy and accessible mineral resource with low impurities. The second thing is you have to know how to process flake graphite, which is not an easy task unto itself – there aren’t that many people who know how to do it outside of China – and do it in a way that satisfies very sophisticated manufacturing principles.

“And the third key pillar is you actually have to have a good understanding of who is actually going to buy your graphite. And it’s not by signing a single offtake contract with a single offtake partner who will dump you the next day. It’s by signing, and allocating production to customers right across your spectrum and managing and diversifying your risk so that you’re not overly exposed to a particular industry. That’s exactly what our company has got and that’s where we think we’re differentiated.

“If customers have shifted their production focus and qualification process to you, and they’ve got the good, solid stable supply, it makes it ever harder for everybody else to come in through the door after you. When they [customers] order it they’ve already qualified it, and spent anywhere from $100,000 to

$1 million qualifying your graphite and changing their production processes to match it, and having done that they need to know that it's actually going to turn up on their doorstep where they're manufacturing.

"So I see that [being among the consolidators] complementing our very rapid and aggressive organic growth program."

Valence had a market capitalisation this week of about A$51 million (US$39 million), down by more than a third since the start of the year. Darby will obviously be looking to improve the current rating as the company kicks more goals and takes on more of the look of a sector leader.

Delivery of the planned expansion, and larger offtake deals, along with promised shareholder returns (including 25% of EBIT as dividends), would certainly aid the cause.

"We put that [proposed dividend yield) out based on a conservative analysis of where we think the business will be … in four years' time," Darby said.

"We think we can do better than that but let's see if we can knock that out of the ball park first."

Tags: Chris Darby, Graphene, Port Lincoln, Uley

Commodity: Graphite

Country: Australia