

**MJG Capital  
891 Parma Way  
Los Altos, CA 94024  
(650) 814-6105**

**To: MJG Capital Limited Partners**  
**From: Matthew J. Geiger**  
**Date: July 26, 2013**  
**Subject: 2013 First Half Review**

Below is set forth The MJG Capital Fund, LP's performance since inception.

---

**Performance Since Inception (9/1/11):**

The MJG Capital Fund, LP (net of all fees and expenses)	(64.80)%
S&P 500	31.78 %
S&P/TSX Venture Composite Index	(51.33)%



**Note:** All returns for MJG Capital partners are estimated and subject to the completion of an audit at a future date. In addition, the returns for each limited partner may vary depending upon the timing of their individual contributions and withdrawals.

## ***Introduction & Partnership Update***

This is MJG Capital's fourth semi-annual review. The limited partnership was formed twenty-two months ago and the results are detailed on the previous page. (Remember that the S&P 500 is being used as a gauge for the "alternative investment of choice", while the S&P/TSX Venture Composite Index is the closest proxy for the universe of junior resource companies.) The partnership added another limited partner in the past period, bringing the total to eleven.

While I remain steadfastly confident about this partnership's long-term investment returns, I understand the disappointment with recent performance from both my partners and other participants in the resource sphere. We are witnessing an epic resource down cycle with a duration and scale not seen for nearly fifteen years. All participants in this market (the majors, the juniors, fund managers, investors) are feeling this unprecedented pain more acutely every month that this bear market drags on. Additionally, the decline has only accelerated in the most extreme capitulation we have seen thus far (in the last three weeks of H1 the partnership's holdings lost 25% of their value). In situations of both extreme "money-making" and extreme "money-losing", it is highly difficult to keep emotions from taking control. In this case the emotion is pure panic, and it can be seen across the resource sphere with steeply declining share prices and billions of dollars of redemptions.

While the partnership's performance has not impressed thus far, I am sure that times like these are the worst possible times to forsake a long-term investment thesis. In fact, I will try to demonstrate with my Featured Investment that the most scary and seemingly risky times often produce incredibly un-risky opportunities (with plenty of upside as well). The ten year lock-up was implemented for a reason (patience is crucial as resource cycles historically last around five years), and we will continue to press on.

To reiterate, current investors: please hold your commitment as I will do mine – 35%+ compounded annual returns when the lock-up expires in 8+ years. To prospective investors: please try to view the partnership as an individual company with a number of extremely undervalued assets (23 in fact). While what happens in the next three months is anybody's guess, the next three years will result in spectacular gains – both for current and new partners. While cynics may view this as either naïveté or bravado, the reason I remain so confident about the partnership's outlook is my steadfast belief in the efficacy of a long-term contrarian mindset.

In the words of Rick Rule, who applies Ben Graham value investing principles to the junior resource space:

*"I can tell you this, through all recorded economic history, going back to the time of the Rothschild's, money has been made by buying when there is 'blood in the streets'. All of the aphorisms are still true. 'You buy straw hats in winter.' You make money by buying low and selling high.' As Buffet says famously, he made his fortune by 'being brave when others were afraid, and afraid when others were brave.' Timing? If that's the question – a mea culpa. I have proven I am always early, I will always be early."*

In order to prosper in this mold, an investor must have *conviction* in the value investing mentality, *courage* to defy the market's moody judgments, and the *patience* to leverage time until they are vindicated. I will give my abridged definition of value investing which personally provides me with conviction, share the story of Silver Wheaton to demonstrate courage, and discuss Warren Buffet's eternally long (yet surprisingly rocky) investment career to illustrate patience.

*Conviction* - If you observe the partnerships 23 holdings, today's share price is not the ultimate value per share of today's holdings. It is instead the market's perception of the value per share of today's holdings. This is in fact a huge difference, particularly true in the unthinkably bi-polar junior resource market. In this market, at any given time, the share prices are likely to be far more eschewed from "fair value" than almost any market out there. This is because the market is nearly always either (a) irrationally exuberant or (b) unthinkably depressed – as it is now. To truly know today's "fair value" of a random partnership holding, one would have to travel into the future to the exact year where the company stops making money, look back in time, and discount the cash flows from today until that date. While the market thinks it knows the correct price of today, it is nothing but a guess (at least until time travel becomes possible)– sometimes rational, oftentimes not.

A simple conceptualization is to look at one mining company with one project with a 10 year mine life (for simplicity's sake assume that they will start producing tomorrow and this will be the only mine the company pursues). Discounting at a rate you can reasonably expect to achieve with alternative investment choices, you must look at streams of cash for the next 10 years to know the true "fair value" for this company. These streams of cash will fluctuate depending on the price of the produced metal/material and the company's operating cost – none of which are easy to predict in a given time span. In other words, without a crystal ball, you would have to wait 10 years to know exactly what TODAY'S "fair value" per share truly is/was! This amazing concept provides conviction to those who believe their long-term projections to be more realistic than what the market tells them.

*Courage* - Equally important is the courage to hold your ground (or more appropriately, double down) when the market moves against you. This is because contrarian investments (where you try to "buy low") will very often initially move against you – in the short term, low prices beget lower prices. This is why over his multi-decade resource career Rule has concluded: "Timing? If that's the question – a mea culpa. I have proven I am always early, I will always be early." In the same vein,

Ben Graham believes that a proper value investor should be both prepared and thrilled for new purchases to drop 20% within two weeks of buying. The reason - so that the investor can buy more shares at an even greater bargain.

While it would be much preferred for the partnership's returns to be closer to this -20% number, in the junior resource market there are numerous contrarian investments that have produced excellent gains after similarly disappointing beginnings. Let's look at an anecdote involving Silver Wheaton - a household name in the junior resource sphere, which became the world's largest precious metal streaming company in less than ten years. Established in 2004 at around \$3 a share, Silver Wheaton's share price surged alongside silver up to \$19 a share in March 2008. However, due to the financial crisis of that year, the price dropped violently to \$12 per share within six months of that March 2008 high - even as the company's fundamentals remained extraordinarily strong. At this point, contrarian investors large and small began accumulating shares and for good reason - a premier silver company had sold off 40% because of a financial crisis thoroughly unrelated to the company (in fact, an argument could be made that the monetary uncertainty caused by the financial crisis should be a further reason to own the stock). Especially looking at Silver Wheaton's standing five years later, this contrarian buy thesis was dead on right and spectacularly profitable. But in the short term (four months to be exact), Silver Wheaton's share price fell from \$12 to \$4 - a 67% loss in four months!

So the question is: was buying Silver Wheaton at \$12 a bad investment? If you had sold during that four-month period, it certainly would have been (up to a 67% loss). But if I told you SLW reached \$45 per share within three years of the \$4 low, that would seriously change things. In fact, even if you had ignored Ben Graham's time tested advice and thrown all your money in at \$12 per share (without dollar cost averaging lower and lower as he advises), you would have still made a very handsome return within three years, assuming you remained courageous when others told you that you were wrong.

*Patience* - Another classic Ben Graham aphorism is that "in the short run the market is a voting machine, while in the long-run it's a weighing machine". Warren Buffet, the most famous of Graham's disciples, has built his entire career off of leveraging time to his advantage. Surprisingly, he too has endured serious Silver Wheaton-esque declines of up to 50% - in the time periods of 1973-1974, 1987, 2000-2002, and 2007-2008. But these did not faze him - Buffett believes that timing the market is folly and would rather identify extremely undervalued assets and then use an extraordinarily long-time to vindicate his picks. Over the years, most anybody with the patience to hold long-term Warren Buffet has made a killing - regardless of when they were bought.

Additionally, from an investor perspective, Berkshire Hathaway's greatest returns were shortly after the four major declines - the very best times to invest in Warren Buffet were the four times the market most disagreed with him. Nonetheless, his

earliest, multi-decade investors made very handsome returns (regardless of entry point) due to their patience.

## ***Site Visits***

Six site visits were made over the past period to the flagship projects of the following companies – Virginia Energy Resources, Tasman Metals Ltd, Flinders Resources Ltd, Cadiz Inc, Limoneira Company, and Alterra Power Corp. Interestingly, the first three of these companies are developing projects of a different “energy metal”: uranium, rare earth elements, and graphite, respectively. Cadiz and Limoneira are both water-focused agriculture plays that have jointly announced an Agricultural Development Agreement in the past month, while Alterra presents interesting opportunities regarding alternative power. Pictures from the site visits can be viewed at: <http://www.mjgcapital.com/mjg-on-location/>. Of the different companies visited, the partnership currently owns Tasman and Flinders.

### *Virginia Energy Resources*

Virginia Energy Resources is not yet a partnership holding, but I expect that to change over the next half year. VUI is an interesting story, as it falls into a basket of risk that is different from most all of the holdings – legislative risk (versus commodity, geopolitical, technical, technological, etc). VUI’s flagship Coles Hill project was discovered in 1982 by Union Carbide and is one of the largest undeveloped uranium deposits in the United States – with 130+ lbs of the green metal. Coles Hill would already be a uranium mine if Virginia wasn’t one of six states nationwide to ban uranium mining. This ban is illogical for two reasons: (a) Virginia is the nation’s seventh most reliant state on nuclear energy (at 40%+ of total electricity generated) and (b) properly operating uranium mines are no more dangerous or environmentally harmful than other mining operations. Considering the illogic of the uranium mining ban, Virginia’s need for steady jobs, and uranium’s likely double in price over the next 3 years, it is my belief that the Virginia legislature will overturn this ban over the next 12 months. With \$3M in the bank, Virginia Energy has a low IPV of \$10M. Even with a 33% chance of legislative success and a conservative upside valuation of \$300M, this 10x difference between the IPV and VUI’s \$100M expected value should be taken advantage of at these prices.

### *Tasman Metals Ltd*

Tasman is Europe’s most advanced Rare Earth Element development company featuring the Norra Karr in southern Sweden. I’ve had the pleasure of meeting Tasman management in NYC over the past two springs and have followed this story

for some time. TSM has the top quality management necessary to negotiate long-term REE supply agreements as well as a very favorable distribution of “heavy rare earths” (the most valuable of the 17 REE’s) compared to all producing and development projects globally. These metals are highly important both now and into the foreseeable future (regardless of what opportunities say about REE recycling or increased China supply) as they form the high-powered magnets necessary in both current and future innovations.

From a fundamental perspective, Tasman has a similarly desirable expected value to VUI when viewed through the “Development Checklist” (desirable attributes for a development project) championed by Rick Rule. This checklist allows you to look at these prospects through the lens of a major mining company considering an acquisition or partnership with the company in question. In general, a smart senior mining company will look for three things when considering deals: low cost to initial production relative to the value of the asset ( $NPV \text{ of Project} > EV + \text{Initial CapEx}$ ), a high IRR compared to other possible assets ( $IRR > 30\%$ ), and a quick payback of invested money (3 years or less). Applying this to Tasman, which used impressively conservative REE basket prices in their PEA, TSM passes each of the criteria with flying colors – indicating that it represents good value to a potential partner or acquirer: pre-tax NPV of \$1.4B  $>$  \$290M (initial CapEx) + \$35M (EV), IRR of 49.6%, and a before tax payback of 2.6 years. Ironically, Rule would not endorse this pick as he is decidedly negative on the rare earth sector – nonetheless, I’ve followed this space closely for three years and have confidence in TSM’s ability to develop profitable end-user agreements with German and/or Chinese parties during 2014.

### *Flinders Resources*

Flinders Resources, located in Central Sweden, is a brownfield graphite project that is planning to restart production in 2014. I believe there is a high likelihood of this occurring, as the company needs at most \$7M in additional funding to fully restore the plant. Flinders is different from Tasman, Virginia Energy, and the majority of the partnership’s development holdings in that the best case upside isn’t a home run – Flinders doesn’t have enough scale to cover all of Europe, let alone the world. (Tasman’s Norra Karr, in comparison, has enough REE’s to cover Europe’s demand for 40+ years.) Therefore, while the likelihood of success (reaching production) is high, the reward is relatively modest – barring dramatically higher graphite prices. Nonetheless, Flinders is a partnership holding because (a) its downside is limited as the company is valued at only 20% above cash, (b) it provides a hedge to the partnership’s Northern Graphite position as a second position levered towards the upcoming graphite boom, and (c) the Woxna brand name as a past producer gives the company a large competitive advantage over other graphite development plays. I’m looking forward to Flinders being the next graphite mine to commence production outside of China.

### *Cadiz Inc*

Cadiz is a medium-risk, high-reward company focused on its Mohave Desert Project in Southern California. Most recently demonstrated by the expensive and energy-consuming Poseidon desalinization project near San Diego, water is at a premium in this highly populated, highly agricultural, and highly arid part of the state. Cadiz has been focused on water investments for decades; in fact, the company prudently purchased the Mohave Desert Property in the mid 1980's due to an intricate understanding of the rainfall, geography, and geology of the region. It turns out that this property is located at the base of a major watershed that is annually replenished. Cadiz believes that it can produce 50,000 acre feet of water a year to sell to the thirsty metropolises along the CA coast. Considering that an acre foot of water has been valued as high as \$5000 in this part of California, Cadiz is sitting on a water source that could generate hundreds of millions of dollars a year (and for a long time too – the company expects at least 50 years of water production). The company also gained unanimous approval from the Board of Directors of the local water authority to certify the final EIR (Environmental Impact Report) and approve the project.

There is still significant risk that this property may not reach production due to environmental concerns (there are currently two outstanding litigations expected to be resolved by the end of this year); nonetheless, the company's current value of \$70M offers solid speculative value with its massive upside if the project makes it into production. The company also recently signed an agreement of Limoneira (North America's largest lemon producer) that leases land and water to Limoneira to grow lemons at the Mohave Desert Project. This agreement (and the fact that CEO Scott Slater just joined Limoneira's board) offers downside protection – if the water project ultimately doesn't pan out, larger farming operations (such as Limoneira) will either lease land or purchase Cadiz outright for access to the water.

### *Limoneira Company*

Limoneira is one of the largest producer of lemons in North America that also owns large quantities of water to support its operations. The visit was to the company's headquarters, processing/passing facilities, and original fields in Santa Paula, California. The company also has 6400 Photovoltaic solar panels which fully power the company's facilities from 11am to 4pm on sunny days (around 310 per year!). The company is in global-expansion mode (it already exports 30% of its lemon production) and plans to increase its acreage from 8200 to 30,000 in the next ten years – with possible expansions to Chile, Mexico, and South Africa. The company has strong brand equity with their "Santa" and "Paula" varieties and counts Chipotle and Walmart as major buyers.

In terms of the Cadiz relationship, the company seems to be in a no lose situation with decent upside. If the water project begins supplying families in the near future,

then Limoneira will continue to lease a reasonable amount of farmland close to their processing/packing facilities in Santa Paula, CA for an indefinite time period. This would be a welcome long-term relationship for Limoneira as the Cadiz partnership allows year round lemon production (the growing seasons are months apart). If, however, the water project gets derailed by environmental concerns, it could be a boon to Limoneira. With the recent Agricultural Development Agreement and Slater's seat on the Limoneira board, the company has the inside track to acquire the project outright and plant as many acres of lemons as possible. This could potentially be a big win for Limoneira but, regardless of the Mohave Desert Project's outcome, the company provides long-term value with minimal risk (the company has been in operation for 126 years) at \$21 per share.

### *Alterra Power Corp*

Alterra is a leading producer of alternative energy world-wide, producing 1,400 GWh annually. They develop and operate a variety of alternative energy sources, including geothermal plants, a hydroelectric generator, and the largest wind operation in British Columbia. I was interested in the company from a geothermal perspective – but learned from the visit that the company is currently favoring wind and hydro investments. That said, the company still has existing long-term geothermal operations (most notably Iceland), along with high-risk, high-reward geothermal projects in Chile and Peru.

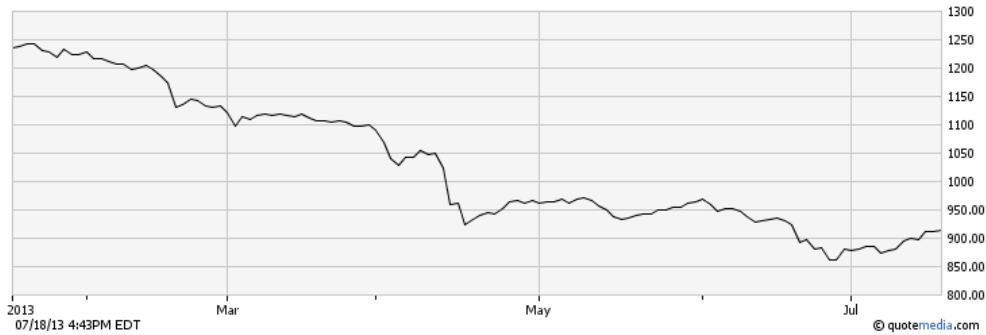
The visit was to the company's Soda Lake Geothermal Site near Reno, which has been contributing as much as 100 megawatt hours per year of energy since 1987. This operation (there are actually two distinct plants on the property) is relatively insignificant to Alterra from an absolute perspective – nonetheless it was fascinating to see a geothermal plant in operation, as well as management's diligent work to cut costs and increase efficiency through prudent purchases of new technologies. While management does a great job of controlling what it can (particularly safety – there have only been 13 incidents of any kind since 1997), any upside or possible expansion at Soda Springs is much more dependent politics and utilities.

### ***Junior Resource Market Outlook***

In the past period, nearly all junior resource companies traded in lockstep – with the direction being steeply down. The junior resource market (the past six months represented by the S&P/TSX Venture Composite Index chart below) is in very bad shape – having fallen approximately 70% since this 2+ year bear market began in Feb. 2011.



#### Charting for S&P/TSX Venture Composite Index



While this type of highly correlated downward behavior (aka capitulation), is generally indicative of a strong time to be buying and holding the winners, it is an admittedly terrible time to be in the market if the intention is immediate outperformance. When everything is moving in the same direction, why even try to pick the winners? This continued downturn has been as equally painful to the share prices of well-capitalized companies continuing to progress their projects as prices of the “walking dead” (companies with less than \$200k in remaining working capital).

Resource specialist John Kaiser reckons that approximately 45% of the junior resource market qualifies as these “walking dead” companies. Besides having less than the minimum amount of cash needed to be publicly listed (meaning that money has to be raised before the next audited financial), these “walking dead” are likely lacking anything close to an economic resource, likely do not have a larger joint partner for support, and are largely waiting for a miracle before they bleed out of existence. The partnership does not own any of this 45% of the junior resource market (the riskiest of our exploration plays has least \$1M in the bank and a strategic joint partner) – which makes the partnership’s subpar performance especially frustrating, as companies that I’ve identified to have exciting future prospects are shedding equal amounts of value to companies with no goal but to pay management for another year.

The silver lining to this situation is that the best cure for a weak market is an extremely weak market. Judgment day is rapidly approaching for the majority of these “walking dead” – Kaiser expects 500 of these companies to shut down by this time next year. Paradoxically, this scenario playing out over the next year would be fantastic news for both the partnership and the junior market at large – we would be looking at the leanest and most undervalued market since at least 2002. Markets made lean by excessive selling are the exact place to put long-term investment money to work. At this point, the key from both a company and investor standpoint is survival – those that are able to stick around until the next up-cycle will be richly rewarded.

## ***Nuclear Power & Uranium***

As you'll see in the "Overview of Partnership Holdings", the partnership has shifted a significant amount of resources to uranium explorers and developers. Although this has so far worked against the partnership's performance, this is a long-term investment thesis that will provide tremendous upside over the following years and decades.

With the Fukushima disaster in 2011, the longevity of nuclear energy is again in question. The reluctance to buy into nuclear power may seem legitimate upon a quick glance; however once a few macroeconomic factors are taken into consideration, its future existence can be solidified.

Most people want to save the environment, but do not want to sacrifice the quality of their individual lifestyles. For this reason, people constantly scramble to increase efficiency rather than downsize. The bottom line is that people want power (the rate in which work gets done), not energy (the ability to do work). This everlasting search for power has been prominent from day one of human existence. Originally, wood was the primary source for people to generate energy. This lasted for many decades, until a more power dense energy supply existed- coal. This energy source now allowed trains and various other forms of transportation to be created. Next, came the generation of oil. This energy source had an even higher power density and allowed for diesel engines and jet turbines. The reoccurring theme from these energy transitions is the search for power.

Due to global warming and various other environmental issues, people in developed countries are becoming more and more environmentally conscious. Global warming is obviously a legitimate concern for us; however we must understand this issue is not at the forefront of the minds for most of the global population. Statistics show that approximately 1.5 billion people worldwide don't even have any access to electricity. As technological innovations inevitably continue, wind, solar, hydroelectric, and other alternative energy sources will continue to increase their respective power densities. With this being said, none of these previously mentioned energy sources will ever be able to harness the current power of oil and gas. The key for meeting future energy expectations (without emitting CO<sub>2</sub>) lies on the most power dense energy source of them all- nuclear power.

This brings up the inevitable question. Are nuclear power plants safe enough to become a reliable source of energy? When you look at the statistics, nuclear energy is actually relatively safe. At this current time, there are 436 nuclear reactors operable power plants worldwide. Almost every one of these reactors has provided stable, safe energy without any major issues. For example, 75% of the electricity in France comes from nuclear power and there has yet to be a major accident in this country. In the scare of Fukushima, the Japanese decided to halt all production from nuclear reactors. With resulting pollution and rise in energy rates, the Japanese

have now realized the importance of this energy source and will be restarting their nuclear reactors in the upcoming few years. Over time, more regulations on the safety of nuclear energy will be put into place and the overall safety will continue to rise in this already safety-conscious industry.

Nuclear power plants are extremely expensive to build. These plants do have an enormous amount of upfront costs; however, once the initial CapEx is invested, it is the cheapest source of energy in the world. To emphasize this point, envision a theoretical country with nine fully-constructed power plants that produce equal amounts of power: 3 natural gas, 3 coal, and 3 nuclear. The country then enters a deep depression and is forced to close down six of these plants. In this case, even ignoring the environmental benefits, it is far more economic to close down the gas/coal plants and continue to run nuclear – as nuclear operating costs are significantly lower than the other two options. This concept illustrates that once a nuclear plant is built, it will be run for multiple decades. And with the large fleet of reactors currently operating and the hundreds in the planning/construction phases, nuclear is firmly in our energy mix.

A key component for the existence of nuclear energy is uranium, which is used as the feedstock for nuclear reactors. This is one of only few elements that has the atomic instability necessary to produce nuclear power. This green metal is known to be quite plentiful worldwide; however these deposits can take years to exploit. Since the Fukushima incident occurred uranium prices have fallen through the floor. The Japanese halted the generation of electricity from Nuclear Power Plants; yet still held 20% of global uranium supply. This oversupply of Japanese uranium helped flood the global market – greatly diminishing the price of this metal. Uranium prices dropped from almost \$85/pound to \$40/pound over this time period. At the current time, it does not make economical sense to excavate additional uranium due to the extremely low price for this metal. Many sources indicate that the market equilibrium is around \$80/pound for the currently producing mines to be economical. This provides an opportunity for development projects with production costs of less than \$80/pound (less than the current price of \$40 is even better) to make it to market over the coming 3-4 years.

Uranium has proved to be an extremely volatile material. From a short-term perspective, this is a high risk investment; however, the long-term macroeconomic trend shows otherwise. Even if more nuclear reactors accidents do occur in the future, they will simply be small potholes in this long term upward macroeconomic trend. At this current point in time, this green metal is undervalued and will revert back to the market equilibrium – at a price almost 2x higher than it is now.

When many people hear “uranium,” immediately Hiroshima, Nagasaki, or 3 Mile Island come to mind. Nuclear power is a scary idea due to the potential misuse of its immense power. Although this fact is not debatable, even developed “anti-nuclear” countries are still continuing to increase their amounts of nuclear power. The United States claims to be “anti-nuclear”, yet have 13 new nuclear power plants and

plan to build at least six more plants in the next decade. At this point in time, any country that is anti-carbon and anti-nuclear is essentially Pro- Blackout (in the words of nuclear advocate Robert Bryce). Whether the reality has set in or not, the anti-carbon and anti-nuclear nations are simply not going to provide enough energy to meet their energy demand. Nuclear power (and its feedstock uranium) is essential both now and for many years to come.

### ***Overview of Partnership Holdings***

The partnership is exposed to different commodities, different jurisdictions, and different stages of the development cycle. Unfortunately, the holdings have been extremely correlated since the partnership's inception; however, this won't always be the case – especially as each limited partner's 10 year lock-up progresses. Below is an approximate breakdown of the partnership's holdings as of July 15.

<b>Holding Allocation By Primary Commodity</b>	
<b><i>Food</i></b>	
Potash	8%
Phosphate	6%
<b><i>Energy</i></b>	
Uranium	31%
Silver	18%
Heavy Rare Earth Elements	5%
Graphite	3%
Scandium	3%
Lithium	2%
<b><i>Infrastructure</i></b>	
Iron Ore	6%
Copper	4%
Nickel	1%
<b><i>Cash</i></b>	<b>10%</b>

<b>Holding Allocation By Country (Flagship Project)</b>	
Canada	35%
Russia	16%
Mexico	5%
Sweden	5%
Eritrea	5%
Turkey	4%
Australia	4%
Cameroon	3%
Botswana	3%
Chile	2%
United States	2%
Ethiopia	2%
Argentina	2%
Mali	1%
Brazil	1%
<b>Cash</b>	10%

<b>Holding Allocation By Stage of Development</b>	
Exploration	36%
Development	50%
Production	4%
<b>Cash</b>	10%

## **Featured Investment: Phoscan Chemical Corp (TSE: FOS)**

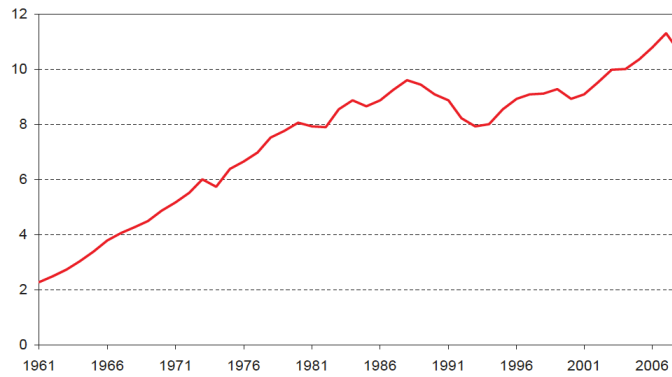
Phoscan Chemical Corp is a phosphate development company with its flagship Martison project located in Ontario, Canada. Besides considerable upside due to (a) an experienced and dedicated management team led by CEO Stephen Case, (b) a committed shareholder base led by agri-bull Eric Sprott, (c) a prime location near existing fertilizer plants in need of phosphate rock supply, and (d) the possibility of significant niobium byproduct credits (in addition to phosphate rock revenue), Phoscan is a virtually riskless opportunity as it is trading 20% below its cash breakup value. Riskless and high-reward opportunities are usually only found in the bleakest of markets (now certainly qualifies); the irony is that these are often the hardest opportunities to take full advantage of due to the difficulty of putting money to work when things are ugly.

The partnership has owned FOS since inception with an average cost of \$0.29 per share; as of July 15, Phoscan was trading at \$0.27 with a ~\$44M market capitalization (and \$55M in cash!). As more capital becomes available to the partnership through additional contributions and cash payments from acquisitions, the partnership will attempt to triple its holding in FOS over the next 12 months. Besides being extremely undervalued and providing large upside with minimal risk, Phoscan has taught me a valuable lesson regarding the power of cash during severe bear markets – if this position had been one of my largest from the beginning, the numbers would certainly have been less ugly.

### ***Investment Thesis for Phosphate***

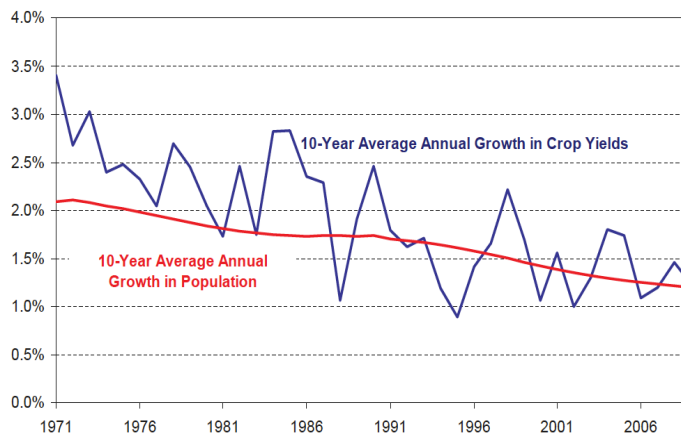
Phosphate is a mined material that is one of the three major inputs (the other two being potash and nitrogen) into inorganic fertilizer. Phosphate is a material that will gain in value as the world continues to grow both in population and in food consumption per person. Producers of this commodity will be some of the few winners as the Global Food Shortage continues to progress. Even today, we are utterly dependent on inorganic fertilizers (in which potash is an irreplaceable component) to provide enough food for our overpopulated planet. The below graphs illustrate this concept: even with greater and greater amounts of fertilizer are being used, crop yield growth is suffering from diminishing marginal returns.

Tons of Fertilizer Used Annually (per sq km of cropland)



Source: Food and Agriculture Organization of the United Nations As of 12/31/08

10-Year Average Annual Growth in Crop Yields



Source: Food and Agriculture Organization of the United Nations As of 12/31/09

A key difference between phosphate and potash/nitrogen is that phosphate is the only component of inorganic fertilizer in which the United States is not self-sufficient. Considering the massive amount of food that North America exports to the world and our continent's obsession with self-reliance when it comes to other resources (for example oil), this is a surprising fact. In terms of near-term phosphate supply, North America's production will only decrease with the imminent closure of Agrium's Kapuskasing Mine (also in Ontario, the Kapuskasing Mine is a stone's throw away from Phoscan's Martison deposit).

This leaves the United States reliant on imported phosphate from North Africa, more specifically Morocco. Morocco's reserves are so large that in theory the company has 4x more sway in the phosphate market than Saudi Arabia does the oil market. Jeremy Grantham, who is a long-term bull of "stuff in the ground" and agriculture, recently wrote in an investor letter:

*"On the topic of phosphate reserves, last year I mentioned another snag in long-term availability – the extreme concentration of resources in Morocco. Follow-up research confirms that given currently known reserves, as much as 70% of high quality, low cost reserves are in their hands, a number far in excess of the whole of OPEC collectively for*

*oil. (The best dream of the Saudi oil minister is that they would be in that position rather than having so many obstreperous colleagues to deal with.) So, yes, we may have up to 200 years of phosphate reserves even if we continue in our present ultra-wasteful ways. But if we do so, Morocco, already increasingly considered to be the price setter, will have in a relatively few decades the most important quasi-monopoly in the history of man! We should at least be very prepared, I believe, for a steady rise in the price of phosphates..."*

Whether Morocco attempts global domination remains to be seen, but nonetheless, the outlook is very bright for potential producers of phosphate in North America. Phosphate is an industrial mineral (unlike gold or uranium a bucketful isn't valuable) and with that comes high transportation costs – especially from North Africa into the heartland of North America. This delta between the market price and the market price plus transportation costs (a) provides an opportunity for fertilizer makers to reduce costs and (b) provides a golden opportunity for multiple North American development phosphate operations to make it online in the following three to four years.

### ***Investment Thesis for Phoscan Chemical Corp***

I will now address in detail the five points stated earlier that make Phoscan a convincing long-term holding: (a) an experienced and dedicated management team led by CEO Stephen Case, (b) a committed shareholder base led by agri-bull Eric Sprott, (c) a prime location near existing fertilizer plants in need of phosphate rock supply, (d) the possibility of significant niobium byproduct credits (in addition to phosphate rock revenue), and (e) Phoscan is trading 20% below its cash breakup value. At these share prices, the combination of the above attributes gives Phoscan exciting upside with very little risk. Additionally, the market is currently saying that there is a 0% chance that Martison will make it to production by assigning it an IPV of \$0. My conviction is that Martison will make it to production due to both company fundamentals and phosphate market dynamics.

Phoscan management is more low-key (bordering on secretive) than the vast majority of “news release happy” junior mining companies – nonetheless, they are experienced, smart, and thoroughly committed to the project with a 25% insider stake. CEO Steven Case has over twenty years experience in the financing and development of mineral assets. He co-founded RFC Resource Finance Corporation (now a wholly owned subsidiary of Teck – a big name in the resource space) and has been working on this story since 1997. Case, along with Vice President and CFO James Pringle, has been very judicious with the company's cash reserves – after raising \$55M in 2008 to bring their cash balance to \$68M, the company has only used \$13M in the past five years (mainly to fund ongoing niobium metallurgical studies). This discipline has resulted in the company having more working capital than 95% of similarly priced resource companies in a time where cash is at a serious premium.



Phoscan is also endowed with prominent, long-term shareholders – particularly Eric Sprott, who has been involved since 2001 through Sprott Asset Management. Steve Yuzpe, a partner of Sprott’s, nicely summarizes their long-term commitment to the agriculture space (and presumably Phoscan): “In agriculture, you have to take a long-term view. We believe that the global macro-economic picture is on our side in this area. Global populations will continue to grow; the amount of cultivatable farmland per person is being squeezed down. We believe that this create opportunities for our investment portfolio over the long term.” With a 21% ownership stake, a 10 year holding period and counting, and a bullish long-term view on agriculture, Sprott is here to stay. While this committed involvement doesn’t much help with Phoscan’s current metallurgical studies, Sprott will ultimately play a pivotal role in bringing this project into production (with or without a niobium byproduct).

The Martison project is ideally located near both a Cargill fertilizer production facility and Canada’s only producing phosphate mine (140km to the south of Martison). This operation (called the Kapuskasing Mine) was brought to production by Agrium in 1999. Despite the quality and significant resource provided within the Kapuskasing geology, the mine’s economic reserves are set to run out by the second half of 2013. In anticipation of both the mine’s closure and increased phosphate demand at their Redwater fertilizer production facility, Agrium recently signed a long-term phosrock agreement through 2020 with Office Cherifien des Phosphate, S.A. – the national Moroccan phosphate company and world’s biggest exporter. The table below shows the excessive transportation premium that Agrium has to pay the Moroccan government as a means to secure phosphate supply -providing a golden opportunity for Phoscan and other North American phosphate development plays.

## Transportation & Logistics Competitive Advantage

Comparing the landed cost of delivering phosrock from various sources to Agrium’s Redwater phosacid plant (Beamer, AB)<sup>1</sup>

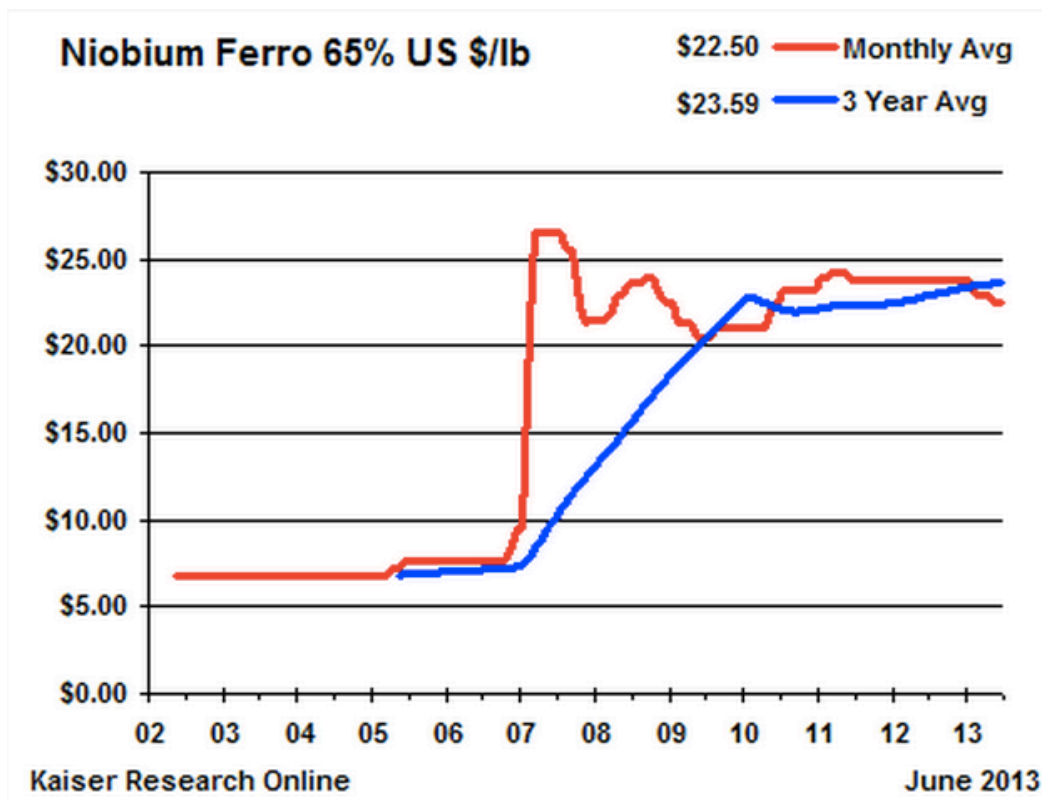
Freight Ranking	US\$/MT	Difference
Martison – Hearst, Ontario	\$35.05	
Bayovar – Lima, Peru via Vancouver <sup>2</sup>	\$52.84	\$17.79
OCP – Safi, Morocco via Vancouver	\$67.07	\$32.02
OCP – Safi, Morocco via Montreal	\$75.81	\$40.76
Bayovar – Lima, Peru via New Orleans <sup>2</sup>	\$81.13	\$46.08
OCP – Safi, Morocco via New Orleans	\$82.22	\$47.17

<sup>1</sup> PhosCan estimates

<sup>2</sup> Bayovar no longer viewed as a source of phosrock for the merchant market due to the Mosaic, Mitsui, Vale transaction



Due to Martison’s elevated 20-25% phosphate grade, the project is large/rich enough to become a big moneymaker by just selling its phosphate to Agrium and calling it a day. However, there is a potential sweetener that provides addition upside - the deposit also hosts a large amount of the material niobium. Niobium has been gaining more and more attention since the Rare Earth debate began in 2009 (while not a rare earth metal, niobium is often grouped with these “specialty metals”). Niobium is used as an alloying agent to produce specialty steels that are known for their strength and play an important role in diverse fields such as gas pipelines, jet engines, MRI machines, and nuclear power. Brazil is globally the leading producer of niobium and, with IAMGOLD operating the only North American niobium mine, the market can handle Martison’s additional niobium supply.



The company has been doing extensive niobium byproduct metallurgic studies since 2010, when IAMGOLD themselves investigated taking niobium from Martison mine tailings. While a deal didn’t emerge between those two parties, the niobium possibility has excited company insiders for quite some time. In early March, Phoscan reported that they had reached 21% recovery from phosphate flotation tailings (in a normal phosphate mine, these tailings would be waste) and concluded that “Even at the modest niobium recovery obtained so far, preliminary internal add-on capital and operating cost analyses are sufficiently encouraging to justify more work to validate niobium as a viable by-product.” I am looking for the company to wrap up these studies by the end of 2013 and shortly thereafter let shareholders know whether niobium extraction is economic. If so, this would

reduce Phoscan's phosphate production cost dramatically and be a boon to long-term shareholders.

The final and most convincing argument for buying Phoscan is that its shares are trading below cash value. Around seventy years ago, Ben Graham (the father of value investing) made a career by purchasing baskets of companies valued below book value - with a particular emphasis on companies trading below cash value. Graham felt so strongly that buying below cash was an effective strategy that he rarely evaluated his purchases beyond that. Needless to say, he was immensely successful and provided a foundation for value investors of today. Many people today believe that it is no longer possible to find company's that fall into this category because Graham's advice is now considered ubiquitous - yet these values can be occasionally found in the starkest of junior resource bear markets and have to be taken advantage of. Buying riskless opportunities in a risky industry is a definite recipe for success.

To further emphasize this point, let's imagine a hypothetical scenario where in the next month Phoscan (a) loses its entire management team in tragic a plane crash, (b) gets the Martison project expropriated by the Canadian government, and (c) finds out that their past 3 years of niobium extraction research is entirely worthless. Even in this excessive worst-case scenario, with Phoscan trading 20% below cash value, an investor at these prices would still make a 25% gain by the end of the year (assuming the board shuts down the company and distributes Phoscan's cash balance to its shareholders by Jan 1). This demonstrates both the irrationality of the market's current valuation of FOS and the opportunity presented to buyers at these prices. When a worst-case scenario can potentially result in a small gain, and a best-case scenario results in pure upside in a mine valued in the hundreds of millions, then a fantastic opportunity is being presented.

## **Update on Past Featured Investments**

### **Soltoro Ltd (CVE:SOL)**

Featured In: **January 2013**

Partnership Average Cost per Share: **\$0.47**

Current Market Price (July 15, 2013): **\$0.17**

Soltoro has shed close to 70% of its value in the past six months, a violent response to the temporarily low silver prices we have been seeing. The partnership is looking to add significantly to its position at these prices. Over the past six months the company has been making significant progress on both the El Rayo project (with two of its best drill holes to date of 91.3M of 129 GPT silver equivalent and 64M of 106 GPT silver equivalent) along with exciting gold grades at its Tecolote project. Soltoro also added Ernesto Echavarria, a Mexican mining magnet with a 14.4% stake, as a shareholder at ~\$0.22, so SOL's downside is limited.

Soltoro is in the market's doghouse due to a low cash position of ~\$1.5M. They will need to raise money in the next six months from the market/strategic investor or stop making progress on their properties. The company will likely be caught in the grey area between not raising enough money and risking excessive dilution. The good news is that Soltoro management has a very strong history of putting capital to work (80%+ "into the ground") and also has silver major Coeur d' Alene mines as a major shareholder – so funding should be available at these terms and better. The partnership will look to participate directly with the company if they come to market for funding at below \$0.40.

### **South Boulder Mines (ASX:STB)**

Featured In: **July 2012**

Partnership Average Cost per Share: **\$0.58**

Current Market Price (July 15, 2013): **\$0.25**

South Boulder Mines continues to be a long-term partnership holding, despite the painful slide in share price. Geologically and logistically, the Colluli Resource in Eritrea continues to be #1 major undeveloped potash deposit in the world; the only major risk to the company is Eritrea's stability. With potash prices around \$400 and anticipated operating costs of \$260 conservatively (and possibly ~\$150 if sylvinites, carnalite, and Kainite are considered), STB will become a cash cow when it reaches production in 2016. In the past half year, the company reached a definitive agreement with the Eritrean government on revenue sharing and spun off assets in Australia to focus solely on the Colluli Project. Before the end of this year, I'm looking forward to seeing robust numbers in STB's Definitive Feasibility Study (the final technical study needed before construction can theoretically begin, financing

pending).

With STB's market capitalization at ~\$31M and with ~\$14M in cash, Colluli has a tantalizingly low IPV of \$17M which does not match the world-class location and geology of the project. In addition, STB's relative value looks very enticing when compared to a close neighbor of a similar scale – Allana's Dallol project in neighboring Ethiopia with an IPV of \$130M (in which the fund holds a position as well). A quick back of the envelope estimate clearly shows that there is not a 6x difference in value between the two projects – implying either major upside for STB or limited downside. However, my strong belief is that both of these projects will be online by 2018 at the latest as India, China, and even Ethiopia will continue to need increasing amounts of potash-rich fertilizer to feed their progressively more affluent populaces.

### **Northern Graphite Company (CVE:NGC)**

Featured In: **January 2012**

Partnership Average Cost per Share: **\$1.10**

Current Market Price (July 15, 2013): **\$0.78**

Northern Graphite Company (with its Bissett Creek property) continues to be a partnership holding. The company's share price has continued to fluctuate wildly and is currently at a YTD low. Over the past half year, NGC has made disappointing progress after the signing of an "Equipment Financing Deal" with Caterpillar in January. I was hopeful of a successful financing and for construction to begin by July but that has not occurred, with CEO Gregory Bowes blaming Ontario regulators with a six-month delay for a Mine Closure Plan (the final necessary permit before construction can begin).

While it is unfortunate that this delay is out of the company's control, time is of the essence in the fast moving graphite supply market – there are numerous competitors trying to beat the company to first production to secure more generous supply agreements (extremely important in energy metal markets such as graphite as these metals cannot be sold anywhere like, say, gold). If NGC is not able to raise full construction financing by the end of the year, the fund will liquidate its position and put the majority of money to work in Flinders Resources, with the Woxna mine needing only \$7M more to reach full production in 2014.