TUESDAY, MAY 2, 2023

Dear Friends and Investors,

The Massif Capital Real Assets strategy returned -2.69% net of fees in the first quarter of 2023.

## ATTRIBUTION

It was a challenging quarter for the portfolio, again driven primarily by the short book, which was down 5.6% vs. the long book's gain of 3.5%.

Digging deeper, our best-returning exposures were to diversified industrials, up 1.4%; gold miners, up 1.2%; and industrial/electrification metals, up 0.6%. Short exposure in the steel sector continued to lead the book on the downside, dragging 1.7%, followed by utility exposure on the long side, down 1.0%, and specialty chemicals, down 0.7%.

Our top 10 gainers YTD were up 7.8%, and our top 10 decliners YTD were down 8.4%. Of the top 10 decliners, three of the top five names are part of our basket of US industrial shorts, which have been painful to hold for much of the last two quarters and warrant particular attention over the next quarter, which we believe could be a make-or-break quarter for those shorts.

During the quarter, we exited four short positions for a realized loss of 0.8% and realized gains on cash management Treasury positions of 0.7%. Our tail risk hedge position was a drag of 0.1%. We did not exit any positions on the long side but did add two new positions to the long book.

As of the end of the first quarter, we had long exposure of 75% and short exposure of 28%, resulting in a gross exposure of 103% and a net exposure of 47%. We expect gross exposure will increase over the year and net exposure will remain stable at around 50%, implying additions will be made to both the long and short sides of the book.

### High-level Thoughts on Investing in Cyclicals and Current Trends in Metals Markets

We often talk about the importance of investing in businesses for company-specific reasons, even, to the surprise of many, within the cyclical real asset industries. This observation can sometimes be misconstrued as either attempting to invest in commodity producers without having thoughts about specific commodities or that the commodity somehow does not matter to the return. This is not the case. What we do believe is that commodity prices make for weak and undependable catalysts for investing in a business's operations.

This is not a suggestion that either commodity prices don't play a role in the price formation of commodity producers or that commodity prices can be ignored altogether, but rather that a rosy commodity price forecast is an insufficient basis upon which to invest in the equity of a business. Businesses are not the prices of their product; it does not matter if that business produces Coca-Cola or copper. A business's value (or its price in the market, as distinct and different from value and, in many regards, more complex) cannot be determined by focusing solely on factors outside the control of management. In fact, it is quite the opposite.

The strongest arguments for investing in a business are to be found in understanding what a management team does well within the bounds of what it is they control. Most companies, and indeed most of the businesses that Massif Capital focuses on, have low barriers to entry, but that is not the same thing as saying there are low barriers to success. We often find that the barrier to success in real asset businesses is disciplined execution of that which is within the control of management, and that is also where the most value is to be found.

Again, this is not a suggestion that the contextual environment in which a business operates is unimportant, only that there is more to it than the commodity price. The often-singular focus on that variable obscures important indicators of opportunity. The result is that investing in natural resources businesses is often seen as a game of cycle timing rather than a source of through-cycle investment opportunity.

This is an error. The wasting nature of the assets being monetized means opportunities occur continuously throughout market and economic cycles. Someone is always building a mine somewhere. This viewpoint also ignores that all businesses experience cycles and that all companies/industries have points when they are the "easiest" place to make money in markets. That does not mean those are the only times to look at such businesses, only that those are the easiest times.

For more than a decade, natural resources and real assets have been among the more challenging areas of the market to make money. Massif Capital has succeeded at it precisely because we have focused on company fundamentals and catalysts rather than commodity prices. Since our inception in 2016, roughly 40% of the portfolio has been exposed to metals and mining, so we have put our money where our mouth is. At the same time, we are becoming optimistic that the tide is turning. This is not a statement that company fundamentals should be abandoned; instead, it is an observation that we could soon get the wind at our back rather than always in our face

Admittedly, the first quarter results, and the choppy trading of metals during the first quarter, caught between a strengthening Chinese economy and rising US recession fears, do not appear to lend credence to our claim. Still, we think digging deeper reveals a more nuanced reality. For starters, the lack of returns reflects a balance between the aforementioned forces, a balance that exists despite obvious evidence of an aggregate deficit in physical metal stocks. The current market dynamics are strikingly different than the last commodity boom, driven, as it was, by strong demand-side growth, not supply-induced scarcity.

Western economies appear to be decelerating, and Chinese demand is slow to pick up, making investors rightly concerned with near-term demand weakness. Within China,

though, the changing industrial patterns of metals consumption mean the market is already tight globally, with more supply-induced upside in the short and medium term than most market participants appreciate.

This thesis contradicts the current narrative, which suggests that slowing developed economies and a weaker-than-expected Chinese economic rebound will stall commodity prices, especially those of such economically sensitive metals as aluminum and copper. However, this claim must be tested, especially given the record-tight metals inventory globally. Recent research by Goldman Sachs did just that, stress-testing their supply and demand models for aluminum and copper. They found it would take a severe "GFC-like" recession to change their 2023 deficit outlooks for both economically critical metals. A minor Organization for Economic Cooperation and Development (OECD) recession would still leave copper and aluminum in deficits at year's end.

The key to understanding these results is recognizing the changing nature of consumption. We have long stressed the structural character of our metal supply concerns, linked to chronic underinvestment on the commodity supply side. We have discussed the distinctive positive demand-side leverage to green transition technologies much less, as it remained a wait-and-see story. That wait-and-see story is quickly becoming an industrial policy-fueled reality, with China demonstrating the direction of travel. China's strong consumption growth drove last year's copper market deficit despite a severe property crisis due to offsetting green demand growth. Copper's green demand has grown from 1Mt in 2020 (~4% world demand) to 2.6Mt in 2023 (~8%) and could be as high 3Mt (~10% global demand) next year.

Goldman Sachs predicts 58 percent of copper demand growth and 65 percent of aluminum demand growth in China in 2023 will be green demand. But the story does not end with China; it only begins with China. Over the last 10 years, nearly 100% of copper demand growth has come from incremental Chinese demand, which is changing. Developed world policies, such as RePowerEU and the Inflation Reduction Act (IRA), are diversifying green demand drivers. This increases counter-cyclical demand channels while also increasing pressure on producers who have failed to invest heavily for more than a decade.

Even if we are wrong on the timing, the potential for strength, or at worst stagnation, in metals markets throughout the rest of the year appears strong. In the case of a recession, the tightness of supply, even in the presence of weak demand, could very well result in the dollar's strength playing the key role in determining the direction of travel. A strong dollar was one of the primary headwinds to metals in 2022. This year, especially in the case of a US recession, that seems likely to reverse itself.

The potentially rosy outlook does not mean we can afford to ignore company catalysts, but it would be a nice change of pace.

## POSITION REVIEW

**Lithium Americas (LAC) — Current Share Price: $20.20, Massif Cap Value: $40.0**

During the first quarter, LAC had several positive events, including a favorable record of decision ruling for Thacker Pass, paving the way for construction of the mine to start, a

revised Thacker resource/cost estimates, and GM's financing/offtake agreement. Even though LAC is non-producing and its stock is down 34% over the past year (compared to the larger lithium producer's 3%), the stock remains one of our favorites with multiple catalysts (and still up roughly 600% from our initial purchase price):

- Cauchari-Olaroz Stage I first production in sight and Stage II initiation by year-end,
- Substantial earthworks beginning 2H23 at Thacker,
- Growth potential with greater guidance on Pastos Grandes, and
- Formal separation of North American Assets and Argentine assets into separate publicly traded entities.

As Cauchari-Olaroz in Argentina and Thacker Pass come online, volumes will effectively be marked at leading-edge pricing. As such, it seems prudent to continue underwriting growth, especially given the firm's experienced management team with a visible pipeline to incremental supply before 2025. These qualities make one or both post-separation entities attractive buyout targets for numerous suitors.

In Argentina, Cauchari construction is nearly complete, and production is scheduled to ramp up in 2H23 to ~20ktpa by year-end and 40ktpa by 1Q24. Given the close working relationship management has developed with the assets JV partner Ganfeng, management expects a faster ramp to battery-grade carbonate than might have been expected had they gone it alone. During ramp-up this year, we expect LAC and Ganfeng to sell technical-grade carbonate to third parties. Once in full commercial production (sometime in 1H24), over 80% of LAC's Stage I volumes will be sold at market pricing via existing offtake agreements. Stage II construction should start in 2H23 to match Stage I production.

Thacker pass is largely on track as management awaits conditional loan commitment from the ATVM DOE. LAC completed its application earlier this year and can begin accruing development costs. Thus far, management is budgeting $125 million for construction this year and expects the loan program to cover up to 75% of the total capital costs for stage 1. Subsequently, after the ROD ruling, LAC began construction preparation with major earthworks starting from 2H23, and the first production guidance was reiterated for 2H26 at a total production capacity of 40ktpa lithium carbonate. Also, following the court ruling, LAC received the first $320MM tranche of funding from GM as the second $330MM tranche is anticipated to hit after the completion of formal separation between LAC's domestic and Argentine businesses.

Although announced in November last year, we have not discussed the impending separation of the business into Lithium Americas and Lithium International. Lithium Americas will house Thacker Pass, an investment in Green Technology Metals (5.2 percent), and Ascend Elements and will be helmed by current LAC CEO Jonathan Evans. Lithium International will house investments in Arena Minerals, Cauchari Olaroz, and Pastos Grande. When the separation is completed, shareholders will receive pro rata ownership holdings in both companies.

The final details of the division are still being worked out, but from a purely economic (and medium-term) perspective, we back the separation. The Argentine-focused company will be much better positioned to invest in and grow the highly prospective

Pastos Grande project without the complication, distraction, and financial costs of Thacker Pass. At the same time, separating the North American business accords with the political desires of prospective finance partners and battery OEMs that want to fund North American supply chains that don't touch China.

Purely economic analysis occurs in a political, narrative, and sentiment vacuum. The company's split appears to be as driven by political and geopolitical factors as it does business fundamentals—perhaps even more so. As such, ignoring those factors is not possible. How and where electrification resources will be extracted, transformed, and manufactured increasingly involves contested geopolitical interests reshaping the global energy map. Both future LAC entities will be subject to increased takeover risk as stand-alone publicly traded entities. We are particularly concerned that the South American entity will be subject to takeout risk that improperly values the assets.[1]

In the current US political environment, it would be far too easy to focus only on maximizing immediate shareholder value via a sale of the business to the obvious Chinese buyer (Gangfeng) and overlook the long-term strategic importance of LACs Pastos Grande land package (which is unencumbered geopolitically by a Chinese partner). The exact economic value of Pasto's Grande is unclear, it is too early stage with too many questions, but the best place to look for any metal is where you have already found economic deposits. The fact that LAC's Argentinian assets sit within the Lithium Triangle, a salt flats region of South America at the intersection of Bolivia, Chile, and Argentina, which accounts for roughly 56% of the world's lithium resources, 52% of its reserves, and nearly one-third of its 2021 production, only increases the odds of the land packages economic value.

The US and its developed world partners, who have been extracting lithium for more than 20 years in Argentina, are unfortunately already losing influence in the region due to the cold calculus of economics. Presently, 51% of all lithium produced in Argentina is exported to China, and 28% is exported to other Asian nations. Europe and the US receive just 21% of the total exports from Argentina. Furthermore, the decentralized governance structure around the management of lithium assets in Argentina has made it possible for Chinese companies to directly negotiate with provincial governments, a fact that few Western countries have taken advantage of. Ganfeng Lithium, LAC's partner in Argentina, has, for example, signed a memorandum of understanding with both the Ministry of Mines and the Jujuy provincial state to develop a Lithium-Ion Battery factory in the north of the country; the state of Jujuy is the location of LAC's Cauchari asset.

Admittedly a memorandum of understanding is not the same as a spade in the ground. Still, Latin American governments have long been concerned with dependency[2] , an economic theory arising from the continent's development struggles. As such, even the intention to support investment that moves the country up the value chain is meaningful. As previously noted, the Lithium Triangle is a geo-strategically important region, and Argentina represents just a portion. China has also pursued other inroads into securing the region's natural resources in Chile and Bolivia. In Chile in 2018, China's Tienqui Lithium Corp bought a 24% share in Chilean lithium company SQM. In Bolivia, China formed a joint venture with the government to develop resources in the salt flat Coipasa.

These efforts are just a tiny sample of inroads the Chinese have made to a region where they have become increasingly influential, to the detriment of longer-term relationships

with partners like the US. Despite rhetoric and memorandums of understanding to the contrary, it is hard to look at China as anything other than a revisionist power with neo-mercantilist aims when it comes to its resource partners. The loss of the future South American-focused Lithium International to a Chinese company would be not only a financial loss for shareholders, as the prospectivity of Pastos Grande is significant, but an economic and geopolitical blow for the US.

The Lithium Triangle and South America is not the only place China is attempting to corner the Lithium market. It is also rushing to secure lithium assets in Africa, but more than just the lithium supply is at risk. After Russia invaded Ukraine and amid growing tensions between the West and China, the EU and US are more concerned than ever before about the availability of vital minerals. Cobalt, lithium, and rare earth metals are essential for the energy transition, and China has amassed a strong position in several of these minerals in Africa. China has by no means done so to the exclusion of Western companies. Still, given their toehold, they are in a stronger negotiating position with most governments than Western companies. Short-sighted grabs for immediate shareholder returns, as we would propose a sale of Lithium International would be, risk a continuation of events in Africa on a continent much closer to home.

**Equinox Gold — Current Share Price: $5.17 USD, Massif Cap Value: $15 USD**

Equinox Gold was our best-performing investment during the first quarter, returning 57%, outperforming the broader gold sector as measured by the GDX and GDXJ by more than 40% and outperforming gold by roughly 50%. The outperformance was not driven by fundamental factors at the company but rather by a combination of sector sentiment and a beta to the gold price of 3.1. We believe that fundamental factors, specifically the conclusion of construction and eventual ramp-up of the Greenstone mine during the first half of next year, represent potent catalysts for EQX, but this quarter's appreciation was not fundamentally driven.

While we are pleased with the excellent performance during the first quarter, we would be remiss if we did not point out that the stock remains well below the high of roughly $13.50 achieved in 2020, a price at which we owned the stock. While we are in the black on the position despite a 62% fall from the stock peak, our failure to exit the position at that time remains a painful portfolio management misstep.

With the information available to us then, we believe it would have been possible to make a better decision. Still, that decision would have had to been made based on a better feel for the role of sentiment in the price formation of gold miners than we had at the time, not based on fundamental factors. While our enthusiasm for the company, its assets, and its management team likely warranted maintaining a partial position, trimming it would have been prudent.

What lessons can be learned from this experience? In a wonderful little book called *The Art of Execution* by Lee Freeman Shor, the author categorizes investors sitting on winning positions into two categories: Raiders and Connoisseurs. The Raiders perennially sell too early and the connoisseurs "enjoy every last drop" of their winners. Being a connoisseur is not without its dangers. Overstaying one's welcome is easy to do.

Although simplistic, it is an interesting breakdown of how investors deal with winning

portfolio positions. We tried to “enjoy every last drop” of our win in EQX, but we made the mistake of thinking the momentum would continue. At its peak, we had a roughly 125% gain in the position; Mr. Shor identifies most raiders as taking profits in the sub-50% return range, so we acted as the connoisseur. It seems the right question to ask is if gold equities are equities with which one should try and act the connoisseur.

Gold, unlike other metals, seems a beast primarily driven by sentiment. As such, the momentum can be illusory and end abruptly. Although we like to focus on the nuts and bolts of businesses when we invest, fundamentals do not always determine an investment outcome, despite best efforts to the contrary. As Mr. Shor notes: “The hidden forces that drive speculative money to buy into a winner is the same as that which causes us to choose to dine in a restaurant that has a queue coming out of the door. Success has an allure. But not all success will last forever.” Paul Tudor Jones famously noted that he learned from his mentor that “even though markets look their very best when they are setting new highs, that is often the best time to sell.” It is reasonable to assert that these statements apply to gold and gold equities. As such, we will likely take Mr. Shor’s advice in the future and sip some of our gold profits over time.

Turning to the bigger picture, gold miners appear to be tricky assets to invest in, similar to oil and natural gas companies at the end of last year’s first quarter. If we stick to the Senior Gold Producers[3], margins have been falling since 3Q2021, when EBIT margins peaked at 25.6% and are now down to 20%, while FCF yields peaked the same quarter at roughly 10.5% and closed out 2022 at just 5.6%. EBIT margins for the majors were last at this level in 4Q2019 when spot gold was in the $1,500 range. Inflationary pressures are evident, especially for critical production inputs such as diesel, labor, and explosives (explosives often have an ammonia base, and thus prices correlated with natural gas) which have severally crimped cash flow returns from higher gold prices.

With energy prices coming off last year’s highs, some inflationary pressure crimping margins might let up. At the same time, if we get a rate hike pause, gold might move quite a bit higher, and given the tight correlation between gold miners and gold prices, perhaps the tightest correlation between any commodity and the equity of its producers, miners might have a long way to go. At the same time, during the last run-up in gold prices (2011/2012), industry margins were quite a bit higher than they currently are. If we look at the NYSE Gold Bugs index, the index with the most extended time series of fundamental data that we could find, EBIT margins peaked at 33% in 2011 vs. last year’s 7.7%.

Despite the inflationary-induced margin compression, the senior producers have outperformed gold year to date, with the Bloomberg Senior Gold Miners index up 11.5% YTD vs. Spot Gold up 9.3% through April 14th. The outperformance of the juniors is even more pronounced. The MVIS Global Junior Gold Miners index, the index upon which the GDXJ is based, went up 15% vs. the 9.36% return on gold through April 14th. The outperformance makes sense given that the 20-year beta measured monthly between spot gold and the GDXJ is 2.1 and 1.7 for the senior producer’s index.

As has been the case for several years, the seniors are in a difficult position regarding non-gold price catalysts, as is demonstrated by Newmont’s pursuit of Newcrest and Barrick Gold’s decision to advance its Reko Diq project in Pakistan. Given the size of many seniors, figuring out how to grow is hard. Neither Barrick nor Newmont’s decision smacks of desperation. However, the $19.5 billion

merger between Newcrest and Newmont would rank as the 5th largest metals deal in history, a short four years after they completed the 10th largest metals deal in history when they merged with Goldcorp. As for building a mine in Pakistan, well, it is certainly possible to build a mine in Pakistan, but it is probably more interesting to watch someone else do it than actually undertake it yourself.

As is always the case, there are plenty of opportunities in the junior gold miner space, which is where we will continue to look. In a departure from our usual targets, developers, we find the most exciting opportunities in more speculative pre-development miners. These are necessarily more speculative and sentiment-driven, but there is a logic to going earlier in the present market. Seniors and producers suffer from a margin crimp; developers suffer from a combination of inflationary pressures and a tough financing market. However, pre-development miners suffer neither margin crimp nor inflationary pressures. Although financing is challenging for pre-development miners, avoiding two out of three industry challenges is pretty good. If gold continues to run, pre-development miners offer the most torque to the upside. Should gold stall or fall, we still have plenty of potential exploration and future development catalysts, although the timelines will be significantly extended. The combination of torque to the gold price (which cuts both ways) and the potential for an extended timeline means the management team is more important than ever, and the entry price is more important than ever.

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As always, we appreciate the trust and confidence you have shown in Massif Capital by investing with us. We hope that you and your families stay healthy over the coming months. Should you have any questions or concerns, please do not hesitate to reach out.

Best Regards,

WILL THOMSON

CHIP RUSSELL

## ENDNOTES

1 Our concern increases as we look to which entity the current LAC CEO will be heading and propose that his choice indicates some thoughts on his part about the future of the entity he has chosen NOT to helm. Given that most senior managers want to build ever bigger, better businesses, we would suggest that the long-term growth optionality of the future Lithium International (with the potential of Pastos Grand green field project vs. primarily just Thacker Pass brown field expansion optionality post 2026) is richer than that of Lithium Americas. If that is the case the choice of current LAC CEO to led Lithium Americas over Lithium International could be suggestive of his opinion that the company's independent life will be short lived after separation.

2 Dependecy Theory is an economic theory that attempts to explain the lack of development in certain countries on the nature of the terms of trade between those countries (periphery countries) and their richer trading partners (core countries).

3 Evaluated through the Bloomberg Senior Gold Miners Index, which includes: Gold Fields, Newcrest, Zijin, Anglogold, Kinross, Harmony, Polyus, Barrick, Agnico Eagle, Newmont, and Sibanye Stillwater.

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