NB: Welcome to the Contrarian Investor Podcast, where we give voice to those challenging a prevailing view in financial markets. I'm your host, Nathaniel E. Baker. On this podcast we discuss the metals and mining sector of the equities market. Now this is a sector that has not been very interesting at all lately. In fact, it's been one big disappointment going back about ten years or more. But therein lies, the opportunity, or so says our guest, Matt Zabloski of Delbrook Capital in Vancouver, British Columbia. Matt manages a long short equity fund focused on this very sector, and he has some very interesting things to say about the supply demand imbalance, in particular as it affects certain industrials metals. Before I roll the tape, a disclaimer that nothing we say should be taken as investment advice. This podcast is for entertainment purposes only. Lastly, what you're about to hear is a recorded phone conversation from Friday May 3 and while Matt comes through loud and clear. I am once again a bit muffled and maybe even a little bit difficult to understand at certain points. But luckily it's Matt speaking more than me. Like I said, He has a lot of interesting things to say, So let's get to it. Here you go. Enjoy.

NB: You know, if I look at the chart here of one of the ETFs which tracks the, um, metals and mining sector, XME is I believe the oldest one. And this goes back to, um I think that it launched in 2006. So if you look at the chart, like there it peaked in early. It looks like, you know, second quarter of 2008, and then fell off of a cliff along with everything else later that year and then had a brief recovery into what looks like early 2011 and then kind of started a long downdraft. That probably coincided with the whole commodities sell off, but the point is that, if took your money and put it in Call it 2009, Um, I wouldn't say your returns matched the S&P. Much less the tech sector or anything like that. So the question there is, you know why now, Um, what do you like about this? Where the opportunity. So, yeah, maybe can probably through that, though.

MZ: Sure, you know. So for us, the very important thing to realize is we're obviously an equity long short fund. So when you look at something like the XME and you commented, it's not been a great place to be on the long side. We we concur. However, it's important, you know, from our strategy standpoint, that we are actually long/short. We see opportunities in both directions.But for us, really, if you wanted to effect what's happened to the sector in the last decade and it's important to realize that the crash of 2008, 2009 coincided with with obviously a commodities meltdown, everything the entire asset class meltdown. But, you know, that was after five or six years of very strong commodities markets on the back of the Chinese sort of super cycle, if you will, Um what what happened prior to 2008 and the commodities face through that supercycle was, you know, massive expansion across the board for most metals. Which involved allocation of capital in a, you know, very inefficient manner. I'm talking about, you know, projects that were built by major mining companies globally, Basically, with the belief the commodities would continue to go higher. Ah, they obviously did not. So we ended up with massive excess capacity, uh, and projects that had subpar return on invested capital. Um, the result of which was was a complete, uh, meltdown of the equity evaluation of most major mining companies. And the resulting, um, halting of all development and capital expenditures in the space. So you know that that's really what we've actually been eating through in the last ten to twelve years is that access? What that means, though, is in the near term, as we get through, um, the depletion of those resources that were built a decade or two ago. We spend no money, uh, no capital exploration for additional pounds of copper around gold, um, building new mines. You know, the reason we're bullish on select areas within the space right now is the

[inaudible] has occurred, and this money companies have not reinvested in greenfield exploration. and quite honestly, what's happening is we're getting a squeeze in certain commodity prices where supply has dried up. You have demand that for certain thematic reasons is beginning to accelerate and I'll discuss that in a second. But really what we're really looking at right now is the perfect storm of ten plus years of underinvestment. As you know, a mine is a depleting resource with when you pull copper out of the ground, it doesn't regenerate itself. It's gone. So, yes, we we've had an atrocious time on the long side in the space in the last ten years. But certain events, including underinvestment in the space are going to lead to, in our belief, the perfect storm for certain commodities. You know, one thing that really gets us excited at the moment is the acceleration of the electric vehicle or the electrification thesis. Electric vehicles require four to five times more base metals in the car, in terms of not only storage of energy but the transmission of energy, than the typical combustion engine. So we could really paint a picture here of supply shortages and certain commodities like copper. And if you sort of apply the electrification, this is not only to the vehicle itself, but also to the infrastructure that's out there for distribution of power. Not just in the U.S. but globally. You know, certain commodities we think are primed for much higher prices. And as you and I both know, when certain commodities move, they don't just do so at a slow pace, you know, five or six percent a year, these things go parabolic. So I mean, for us that, you know, in essence, demand is much stronger than the market is. More importantly, we've depleted a lot of the supply. And any additional supply that may be able to come online requires much higher prices to make an economic impact.

NB: Okay, I'm curious about the demand picture, especially for copper. And you mentioned electronic cars. Do you know how that breaks down as far as electric car demand for copper versus good old traditional construction? And where most of that's coming from?

MZ: Yeah. So if you look at the demand for copper right now, electric vehicles are still very much a low single digit demand component for that to be honest. The majority of copper demand right now still does come from Asia. However, I think what's important to realize it's a second derivative, which is the accelerating pace of electric vehicle consumption of copper within thi. So, you know, if we look at five years ago, it wasn't even on the radar screen. Now we can point to ten to fifteen percent, um, sort of electrification demand for copper. But that's accelerating, right? In terms of market share for electric vehicles is very small right now, but growing in a very, very quick pace. So, by 2025, 2030, it's going to be a significant, um, component of copper demand. Now you say, Well, 2030 that's a long time from now. The average within the money space from discovery of a resource, through permitting development in commercial production just now takes seventeen plus years. You know, we're at a critical time for the space. Resources that we found are much lower grade and in areas of the world that you typically don't necessarily want to deploy a lot of capital for geopolitical reasons. So this is critical phase where copper, we’ll begin to be seeing prices that should reflect that. We can paint a picture in the short term of, you know, 350 copper without much difficulty. And I'm talking about 350 copper into the end of this year.

NB: We're talking about them upside of about, uh, 25 percent, right?

MZ: Right. So for us, you got to realize the nature of where we play as a long/short fund. We're playing in the equities. The underlying companies with exposure to [inaudible]. So how we generate our returns here, um, both long short. But you know, is is within the equity spectrum where we're also picking up the financial leverage of that company and the operating leverage of that company. So when comparable, it's twenty five percent. That could be, you know, a hundred percent in in an equity valuations. In terms of supply. There's very little a very limited number of new greenfield project coming online within the next. Call it five to seven years, you know, will point to the Cobra Panama project that is being developed right now in Panama. That's sort of the biggest one that's out there. We are seeing a lot of green field exploration into areas like central Africa. Specifically the Congo. We also have, uh, situations in Zambia where, you know, phenomenal resource belt, um, and great potential. So when I make the comment that you know what is being found now is much lower grade and or they carry an entirely different geopolitical risk. Which is fine. You know, we can get comfortable with that. However, what it requires for us, it's just a different, you know, risk metric within the matrix of judging long positions for us. [Inaudible] Well, basically saying we got to get paid for that additional risk through the upside and evaluation.

NB: Very interesting. Okay, are there any other areas, other metals that you're particularly bullish on or do you think this is more about copper?

MZ: Our overriding approach is to take each and every metal in the universe. Develop a demand supply analysis, Come up with the thesis. Bullish, bearish, neutral and then implement allocation of capital based on, you know, high level use of the commodity. But then, based on fundamental analysis of the under lying equities, um, places that we’re bullish at the moment, You know, we find a lot of value right now in trading pairs. So relative value trading within the industrial metals complex. We are, you know, for most high level. We're pretty neutral on gold. We're not gold bugs. Um, gold does make up about forty percent of the gross exposure within our funds. But the net exposure is very low. So you know, we're we're bullish on the prospects for some of the relative value trade within the space, you know, And that's something where we're running very low net. But just given, you know, the inefficiency in the market at the moment, you know, generating some very significant alpha on the relative value book.

NB: Interesting.

MZ: And we've begun to see certain other themes play out that we've been writing about for, you know, twelve to eighteen months, things that consolidation, right, we turn an acceleration of consolidation within the space. Something we believe is driven by one of my previous points, which was depleting resources, needing to be back in the field, uh, not being able to do it with exploration. So the majors are now going to have to go and acquire resources. That is the most efficient, both in terms of time, but also in terms of risk. The most efficient way to backfill a declining reserve base in declining production in the future. So that we've been on for call it, you know, twelve to eighteen months. Our fund has had six take outs in the last six months. So we've been very good at identifying those opportunities that's generated significant offer for our LPs.

NB: You mentioned the short side and that you have an active short book. Where? Where are some of those opportunities? How do you how you trade that?

MZ: Yeah. So we we basically divide the short book, if you will, into two categories. One is the short leg of relative value pairs trade. What we're looking for there is based on valuation, or we're very active shorting some of the ETFs, basically to generate also based purely on security selection. So we'll sort of basket gold ETFs for a certain equities, for example, and then go long a small basket of higher quality companies. And the trade there for us is simply security selection. Any other side of the short trade for us is what we call alpha generating shorts.

NB: Yeah.

MZ: You know, where we've identified one of two things. Either a fatal flaw in the project. We have a very strong technical team internally here. Geologists, engineers, etcetera. So we've identified a fatal flaw in a project that we think the market has not come around to yet. It's a great place to go hunting. The market is inefficient but it's very much so, um, even more inefficient. On the short side, we've been running [inaudible] at twelve months. Plus net net long and that for us, has been anywhere from sort of twenty five to sixty percent net long. The opportunities that we see there is, You know, the high over arching thesis has been that squeeze within certain commodities we talked about previously. And also the fact that equity evaluations in the space, even at spot pricing, are at, you know, generational lows. This space has been ignored by institutions in the last decade. But we all know, you know, the [inaudible] very cyclical, and it's our belief that that cycle is turning.

NB: Yeah, I think that's a good place to, uh, pause and take a short break. We're going to come back and I want to drill down a little bit, if you'll pardon the pun, and ask you about some very some specific ideas that you have on the long side, I think that'll be really interesting. So more on that when we come back. You are listening to contrarian investor podcast. We are on itunes, and anywhere else you can find podcasts pretty much: Sticher, Spotify um what are the other ones Google play now? So yeah, check it out. We’re on the social media as well. Um, Twitter's the most active: podcontrarian is the handle there. Matt, what about you where we can we find you?

MZ: If folks are interested in learning more about Delbrook, you can look for us DelbrookCapital.com And you can just do go out or you can email us at invest@delbrookcapital.com

NB: Right on. So, yes, how about a little more about you and your background?

MZ: Yeah, sure. So, you know, starting with I I suppose my background ah launched Delbrook in 2011. Prior to that, I was based in Boston. I was a portfolio manager for Fidelity Management Research Company. For a good chunk of the 2000s. Then came out to Vancouver, originally Canadian. My background, Um, Vancouver is the mecca, if you will, of the metals and mining world, Very much probably is for for technology. So I saw an opportunity in a specific sector that we thought was, um, mispriced at the time. But also, sitting in Vancouver, you know, the ability to have a first mover advantage in the ability to have sort of unfettered access to the large caps that are in the city. You know, we are the only [inaudible] hedge fund, um, in in the city, probably one of the only ones in North America. Uh, that's truly a hedge fund, not private equity. So for us, the competitive advantage being in Vancouver. Not only the corporates, but also to the banking teams and everything else that goes on. And they’re in the city. So, you know, it's a great place for us to run the middle of the money. Not a lot of guys in the

space and go back to what I've been saying. It's completely inefficient. We're making, you know, some some good money in the space at the moment. We think over time, market given the cyclicality. Capital will come back, but we definitely have a great first mover advantage in this. Most of our process very much starts with a top down Look at the quantity. Um, in in particular, we keep the man supply models. I'm probably two thousand different metals globally. Um, from that it sort of points in the direction of what we think of the commodity I am. We get to work on the underlying fundamentals Ah, of of, of businesses, of of operating companies within the space. And, you know, we're not a c t a. So we we don't trade the actual commodity. But what we enjoy doing and what we think we're good at is identify opportunities and the underlying equity or credit rating companies in the space. And by doing so, we pick up, you know, not only a movement in the commodity price. But we pick up the operating leverage in the financial leverage of the company. So for us, we think it's, you know, the best place to the point capital in the space. Um, and as mentioned, where one of the only friends doing it at the moment.

NB: Interesting. Okay. Give us one important lesson. Maybe that you could identify that you've learned in your investing career.

MZ: The most important one. If you had to pick one. Sure. I mean, and it applies to this basically managing right now. We never get emotional. Never, you know, gets fixated on any of these ideas. As I try to practice and I preach to all of our investment teams and analysts, it's, you know, be flexible with your views and I realize that that circumstances change and if you're good at your job, you'Ll change with them. You'LL adapt your, um, your outlook accordingly. Those who don't do that are the guys who who, you know get run over by these markets, especially when we're managing equities in a thirty or forty vol universe.

NB: Okay, favorite long idea. Before we go there, I just want to play Devil's Advocate for a minute here on the whole commodity thing, especially when it relates to copper. And a lot of this is so cyclical. I mean, okay, you mentioned the secular trends specifically the electronification of cars and how that's causing more demand for copper. But by your own admission it is still a relatively small, though growing part of the demand picture. And with all this boils down to demand still coming from, you know, people building stuff specifically China and with that part of the world economy, kind of, uh, you know, slowing down a little bit. And with the US probably closer to a recession than anything else with all that going on on the demand side doesn't that really the one driver of demand for copper. And isn't it? Couldn't it be a little bit, uh, you know, naive to pick stocks within that area when with the demand picture is so uncertain for the near and medium term.

MZ: Yeah, So I touch two points there, first of all, I mean, yes, we're sort of mid long term bullish on copper, but you know, the opportunities that we have in the space right now, it's both long and short, you know? That is, you know, an equity pair where we go long a quality copper company and short another one.

NB: Right.

MZ: [Inaudible] From the higher level standpoint. I mean, the current status quo in the world economy. Right now we're in deficit for copper. So we're in a copper deficit going to 2020. [Inaudible] Now, if we overlay prices needed

to bring new production online they must that be much higher. Combined with that is the fact that certain macro sorry certain demand things are beginning to accelerate just beginning right now. You know, things like New Mexico [inaudible] replacement in first big infrastructure bill, which we think the Trump administration will try to play out in the next call it, uh, six to twelve months in anticipation of election. So these are all big demand drivers for copper, which really aren't priced in right now. On the supply side, we have mines depleting and mines coming off line. But we also have large things like labor unrest in South America that pops its head up every once in a while and shuts down large mines. So, you know, for us, we've you copper. We're bullish on copper in simply in the context of current macro environment. In addition to that we are finding now ridiculously lower grades than it used to be even ten years ago. So you still got to move the same tunnel rock. But if you're getting how the copper out of that rock that you, you know versus ten years ago, you're wondering where the margins are going. And the fact of the matter is these companies are now very much focused on generating cash flow, not just building for the sake of building. [inaudible] You probably have some of the higher cost mines come off line. And that's that's just going to help on the supply side. So, you know. Yes, we're pushing copper for the right reason. Also bullish on certain other, uh, metals, you know, things like nickel class one nickel. But it's always sort of very hard for us to model and analyze demand, right? I mean, you agree on the supply side modeling and understanding cash costs occurs. We always sort of look and say, Look, within the context of the current global demand where are we at and can we identify black swan events that would seriously inhibit that demand?

NB: Yeah, absolutely.

MZ: Can we you know, risk those accordingly. However, within the context of the world economy right now, which is relatively healthy. We see there being a shortage of copper. That's only going to accelerate.

NB: Okay, good. Excellent lead in to the next question. Stock picks.

MZ: Within the large gas space, you know, we like names like teck, teck resources. That's a company where we see probably fifty percent upside from current levels. It's a mining company focused on unmet call, uh, copper and zinc with a little bit of oil and gas exposure. And there is a diversified minor which, you know we believe is generate significant free cash flow and is in a position to, uh, buy back in material amount of their float in the next year. A great balance sheet, cash building. And that's what we like to see any space.

NB: Um, cool. Sorry to interrupt. Stock picker T-E-C-K.

MZ: Yeah, so that's, you know, one of the larger cap ones that we like. Ah, we we managed across, you know, the gamut in terms of market caps, you know, from the fifty billion dollar companies down to the five hundred million dollar companies. On a liquidity risk basis, we think TECK is a great investment right now. We think the real focus, we had some acquisitions in the last call it twelve months. [inaudible] We believe that the next wave of consolidation is going to be within sort of the mid cap space in the mining sector. We position our fund to take advantage of on the long side of sort of our top top five ideas within that space.

NB: Okay. Wonderful Matt Zabloski. Thank you so much for joining us. That's all for this week's program. Thank you for listening. And we look forward to speaking with you again next week.