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Does the Berkshire Hathaway Model Work in Energy Metals?

If anything has become clear in the resource space in recent years, sustained value creation is hard to come by. The reasons for this are manifold. Last week I discussed the likelihood of M&A in the Energy Metals space but didn't allude to how this is likely to happen. There are a multitude of ways for these arrangements to occur, but one in particular seems absent from the discussion. Given oversupply and the great engine of commodity demand (China) slowing, perhaps the time is right for a Berkshire Hathaway-style model in the Energy Metals space.

Given that demand for various Energy Metals continues to grow and the metals sector remains out of favor, one wonders why a model such as this hasn't been undertaken. If you believe, as I do, that we could see lithium carbonate or cobalt prices perhaps up to 20% higher in three or four years, mergers combining separate assets or metals make the most strategic sense currently. For one, you spread the risk across multiple metals or assets. Second, you open yourself up to access multiple end user markets.

On the surface, a Berkshire Hathaway model in Energy Metals makes perfect sense. Given the fragmented nature of the battery markets (multiple raw materials coming from various sources), a one-stop-shop for metals such as lithium and cobalt or graphite would enhance security of supply for an end user and also offer the producer of the metals additional margin capture.

The model for the company would look something like this:

Berkshire Hathaway (BRK.A:NYSE), in its current iteration, is a conglomerate and we would aim to mimic that. A single CEO and Board of Directors oversees multiple Energy Metals producers each with their own CEO and Board of Directors. A key distinction would be that any of the companies comprising the conglomerate would be *privately held* with our conglomerate a majority owner. This is one of the issues currently plaguing the junior mining space – the substantial cost just to remain publicly listed outweighs many of the perceived benefits. It currently makes little sense to send shareholder money to an exchange when it could be better spent developing the business plan. We mitigate this risk by ensuring no public ownership. The companies involved here would either be in production or near-term producers, an idea in place to minimize the risks inherent in exploration. The length of time it could take to make a discovery and the substantial cash drain would hurt the

profitability of the conglomerate. A key feature of BRK.A today is that it is self sustaining through cash flow generation. This is what we're aiming for. In the interest of additional revenue streams, a centralized trading/marketing operation could be incorporated to make markets in the raw materials produced by each of the companies (lithium, etc) under the company umbrella. This would resemble the current Glencore (GLEN:LON) business model. Owning royalty streams on producing assets would be another potential revenue source.

Another way to leverage returns and ensure low cost production would be through utilizing technology to drive down production costs. Regular readers will know of my predilection to focus on those mining technologies that allow for lowest-cost production. Whether we utilize the technologies in house or license them to those outside our company, this lower operating cost will allow us to compete with the oligopolistic structure of Energy Metals markets.

As an aside, with the rate of technology advancing at an ever faster pace, there is obviously no guarantee that the optimal battery chemistry today will remain in place in the coming years. This raises the possibility of a separate arm of the conglomerate focusing on R&D into technology focused on batteries and mobility so as to ensure the "pieces" of our conglomerate are positioned to take advantage of future demand for specific metals/materials.

The goal here is to compete with the relatively few companies that control much of the production of Energy Metals. Given the bleak prospects for many emerging mining plays, this model appears feasible. Admittedly, some of this is "pie in the sky" thinking, but this is how new business models are born. Many detractors are right to point out that building this model is light on detail (I'm still working through it), is too specialized, too cap ex intensive, and question the size of the ultimate prize. There is some validity to these concerns. The bottom line is that the potential upside of a company leveraging strengths in high quality battery raw materials, technology development, and market making in these metals is worth exploring.

This model is precisely what the Energy Metals space (not to mention the mining space overall) really needs. It grants investors access to multiple billion dollar markets all at once while allowing for exposure to these cyclical but emerging areas. It can also help to consolidate multiple fragmented industries which many, either willingly or unwillingly, overlook.

I'm more interested in creating longer term sustainable value through innovative ideas than anything else. We have been hearing about a "technological revolution" led by batteries being right around the corner yet, the promises have failed to meet expectations. It would appear that with the numerous roadblocks standing in the way of the commodity space, this is one way to finally create lasting value and pull the mining space out of its funk.