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A Strategic Shift in an Increasingly Tight Lithium Space

\$80 Million Deal Between Western Lithium and Lithium Americas Redefines the Junior End of the Lithium Market

On an otherwise quiet holiday week in North America for mining, the news of the [effective merger](#) between Western Lithium (WLC:TSX, WLCDF:OTCBB) and Lithium Americas (LAC:TSX, LHMAF:OTCBB) is an exciting and positive catalyst in the lithium space. I have maintained for some time that, despite the rosy demand growth projections for lithium, the market needs fewer players. The lithium market (at approximately 160,000 tpy of lithium carbonate equivalent) just isn't big enough for numerous players to generate adequate cash flows (and hence returns). Further, the resulting players will need to demonstrate costs or competitive advantages that allow them to exist alongside the oligopoly in the space.

The WLC-LAC deal accomplishes this as it provides investors with something incredibly valuable at this stage of the cycle: optionality.

Investors in the merged entity will have:

1. Exposure to a fully permitted brine asset in Argentina at bankable feasibility study (BFS) stage,
2. A lithium clay asset in Nevada at prefeasibility stage, and
3. An emerging drilling additive (mud) business with a 10,000 tpy nameplate processing plant in Nevada with expected near-term revenue as the distribution sales network is built out.

Added benefits obviously include the fact that lithium demand is growing by 10% per annum and the major producers appear to be having various technical or legal challenges to expanding their business. This indicates the need for a diversity of supply.

On a pro forma basis, the new company will have a market cap of approximately \$150 million. This will place it far and away as the largest lithium development story in the world, though a long ways from the ranks of lithium producers. Orocobre (ORL:TSX, ORE:ASX) has a current market cap of \$291 million AUD and the existing producers are all multibillion dollar market cap enterprises (though to be fair, lithium remains a small relative portion of their respective businesses).

The new company will also have approximately \$11 million CAD in cash, cash being generated by the drilling additive business, and will be able to lower SG&A - typically the single biggest destroyer of value in the junior mining sector.

LAC's relationship with POSCO (PKX:NYSE, 005490: KRX) should not be affected here and I would assume it will cast the negotiations in a somewhat different light. Similarly, WLC's research relationship with Tenova Bateman focusing on low cost solvent extraction should not be affected. Both relationships add overall value to this merger.

The terms of the deal, \$80 million and all in stock, value LAC at roughly \$0.51 CAD per share, a 38% premium to its recent closing price. While this is appealing and management and shareholders ought to be congratulated, this is not what is important and misses the much larger strategic significance of the deal.

The new company, Western Lithium, will emerge as a potent and legitimate contender to eventually join the ranks of lithium producers in several years. A stronger balance sheet, multiple assets in varied jurisdictions, a near-term cash generator to cover SG&A, and various partners focused on leveraging technology to lower costs are all benefits that the new company's competitors do not possess. End users of lithium should look upon this new entity favorably given its potential to defray a litany of risks.

WLC's drilling additive business for oil and gas began production earlier this year and should begin to generate a revenue stream shortly. At a full capacity of 10,000 tpy and market prices anywhere from \$1,000 to \$4,000 per tonne according to industry sources, this is a real differentiator. While this won't directly help the new company's lithium ambitions, it strengthens the overall balance sheet and should make the company appealing to a new class of investors.

The dust has yet to settle on the deal and there are many questions yet to be answered. Where will the new company focus? Argentina or Nevada? Or both? How will the POSCO relationship evolve? These questions will be addressed in due time. In the interim, the deal announced on Tuesday places the merged entity in an enviable position relative to its peers just as the inflection point for lithium demand looms over the horizon.

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