Week of January 20, 2014

Analysts' Ideas of the Week – Top pick in the graphite space

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Top pick in the graphite space

This week, I would like to introduce you to an Ontario based company we cover, Focus Graphite Inc. (TSXV: FMS). Focus is not a typical junior exploration/development company, rather it is a graphite development and technology company focused on graphene research and development. **We have been covering FMS since June 2012, and currently have a BUY rating with a fair value estimate of $0.87 per share, and risk rating of 5 (Highly Speculative).**

Here is a quick background on the company: The company's core focus is on the 100% owned Lac Knife graphite project in Quebec. An updated Preliminary Economic Assessment, released in November 2013, showed a before-tax Net Present Value (@10%) of $250 million, with an IRR of 36%. With average grades of 15%+ Cgr, the Lac Knife deposit is one of the highest grade deposits owned by a Canadian public company.

In December 2013, the company announced an offtake agreement for future production from the Lac Knife property with an undisclosed third party in China. FMS has disclosed that the Chinese company, based out of Dalian City, is an industrial conglomerate with heavy industry, manufacturing and technology companies. The 10-year agreement is for up to 40 ktpa of graphite concentrate (large / medium / fine) and value added products. FMS's shares jumped from $0.27 to $0.64 on the news, and is currently trading at $0.49 per share. Although details of the offtake agreement were not disclosed, we believe this is a highly encouraging development, and believe it is the only company in the graphite development/exploration space in Canada with an offtake agreement.

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The company completed a 24 hole / 2,081m infill and exploration drilling program in July – August 2013, with the goal of upgrading the current indicated and inferred resources to the measured and indicated categories. An updated resource estimate is expected this month. FMS is also working on a feasibility study, which is expected later this year. An Environmental and Social Impact Assessment is also underway.

FMS also recently appointed Don Baxter as President and Chief Operating Officer. Mr. Baxter was the President of Northern Graphite Corporation (TSXV: NGC), and has a strong technical background.

With regard to its technology, FMS holds a stake in Grafoid Inc. ("Grafoid"), a private grapheme R&D company. Over the past year, Grafoid has developed a series of agreements with the goal of developing graphene applications and related technologies. Gary Economo is the CEO of both FMS and Grafoid.

As for financials, the company has a strong balance sheet, and we estimate they currently have approximately $10+ million in cash. Our fair value estimate on FMS is $0.87 per share. Note that due to the early stage nature of Grafoid's developments, our valuation does not take into account any upside from the company's stake in Grafoid.

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Input Capital increased exposure leading to big gains

Input Capital (TSX-V: INP) a company we cover, and have mentioned in previous articles, has been gaining a lot of attention recently. This increased attention has led to a considerable surge in the stock, rising to a high of $2.73 on Friday (January 16, 2014), from the $1.80 - $1.90 range it was trading at during the start the year. As we have mentioned before, Input has applied the metals streaming model to Canola. They provide upfront capital to farmers in return for a contract allowing them to purchase steeply discounted Canola from the farmer for 5-7 years. We feel the increased attention is due to revenues set to be reported in the next two quarters. Keep in mind that Q3 and Q4 are when canola is delivered and sold. The company recently announced that Input will release Q3 financials on February 6, 2014. The following highlights what we expect the company to report for the year.

The company, in its December update, announced that to date, they have received approximately 15.4% of the Canola due (2,634 tonnes) at an average price of $472 per tonne. Based on these figures, Input is on pace to report $6.8 million in revenue in its first year (based on a $75 average cost per tonne). We estimate that they

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deployed approximately $19.96 million in contracts at the start of the year. The return on deployed capital is approximately 34.17%, which we feel is very strong, and exceeds our original estimates of around 30%.

In our most recent estimates, we forecasted revenues of $7.3 million for the year, and net income of $0.64 million. We feel that due to the strong yield this year, canola prices have declined, however, this is slightly hedged by the bonus tonnage. We feel that strong canola yields will result in decreased pricing, but increase the bonus tonnage due to Input. We anticipate Input will report a good amount of bonus tonnage for the year, resulting in revenue closer to our estimates.

We feel investors should continue to watch Input in the next two quarters as we have a fair value of $3.30 on the stock. We feel the next two quarters will have continued news flow and publicity. There are a lot of eyes on the stock, as it is a new model in an agriculture industry that is gaining in popularity with investors. We believe that with revenues reported, and the business model proved, the market will show more confidence towards the agriculture streaming model. In addition, Input will be deploying their vast amounts of capital over the next few months, which should give a good indication for FY2015 revenues.

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Canadian Mortgage Bond Program

The Canada Mortgage Bond (CMB) program is a mortgage funding vehicle for investment in Canadian residential mortgages.

Under this program:

1. Canadian Mortgage and Housing Corporation (CMHC) approved lenders (such as banks, trust companies, and other types of lending institutions) originate mortgages.

2. The lenders bring together a pool of these mortgages, for the purpose of transforming them into securities which can be sold to investors.

3. Lenders sell these pools as mortgage backed securities (MBS) to a special purpose trust known as the Canada Housing Trust (CHT), a CMHC-run entity.

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4. CHT sells non-amortizing CMBs to investors and uses the proceeds to purchase MBSs.

5. CMB investors are paid semi-annual interest, over the term of the bond, and principal, on a specific maturity date of bond, from the proceeds of MBS cash flows collected by MBS sellers on behalf of the CHT. Payment of interest and principal are guaranteed by the CMHC.

CMBs can be issued for any term (but initial issues are typically for a five-year term) and can be issued in denominations as low as $1,000. These bonds are accessible to both institutional and individual investors, and can be bought through investment dealers/banks/trust companies/and other financial institutions.

In order to be eligible to for this program, the lender must be federally or provincially regulated, and must have a minimum net worth and credit rating as specified by the CMHC. Also, MBS pools should meet a certain eligibility criteria; for example, each pool must have a minimum portfolio value of $2 million, and contain mortgages that mature no sooner than six months prior to bond maturity.

The mechanism above lets investors make secure investments in Canadian residential mortgages by buying CMBs. Because CMBs are fully guaranteed by the government, investors demand less interest on CMBs. That lowers the cost of funds for lenders, which in turn lowers interest rates/cost of financing for homeowners.

One of the TSX listed companies who participates in the program as a seller is MCAN Mortgage Corporation (TSX: MKP). MCAN is a loan company under the Trust and Loan Companies Act, and it qualifies as a Mortgage Investment Corporation (MIC). As of September 30, 2013, the size of MKP’s corporate and securitized mortgage portfolio was $1.36 billion.

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