The graphite party looks to be over (for now) — here's what analysts prefer instead

Many investors have been jockeying for position in recent years ahead of the pending boom in electric vehicles.

Compounds such as graphite and lithium have been in vogue, given their standing as a key input for lithium-ion batteries used in EV production.

In August 2018, experts were predicting graphite prices would rise steadily into the 2020's in response to strong demand — both for EV's and the production of fire-retardant building cladding.

However, a year has proven to be a long time for graphite prices (and other battery minerals).

The tide has turned from a bullish demand outlook to concerns about oversupply. And based on the price action this week, it's now filtering through to a re-rating of ASX-listed stocks with sector exposure.

Nowhere is that more evident than for embattled graphite producer **Syrah Resources (ASX:SYR)**, which turned heads in the market yesterday with another production downgrade.

Last August, analysts were predicting the market would need another 4.5 projects the size of Syrah's flagship Balama operation in Mozambique to meet demand.

Fast forward 13 months and the company has flagged another round of headwinds — some familiar, but others less so.

Market struggles

On the familiar side, Syrah pointed to a significant buildup of inventory in the Chinese market, which is now affecting price negotiations and contract renewals.

Prior to the end of 2017 China imported less than 1000 tonnes per annum, but by May this year that figure exceeded 22,000 tonnes.

More surprising was the recent sharp depreciation of the Chinese yuan against the US dollar, as another round of trade war tensions heightened in August.

“Concern over further potential decline is placing downward pressure on $USD-denominated pricing negotiations with Chinese customers,” Syrah said.

The net result was a “sudden and material decrease” in the weighted average price for natural flake graphite, to $US400/t ($583/t) from $US457/t in the June quarter.

In response, Syrah announced it would be cutting production to reduce costs. The share price slumped by around 30 per cent, leading a wave of selling across ASX-listed graphite stocks yesterday:

Ticker Name Price Tuesday % change Market Cap Volume

Ticker	Name	Price	Tuesday % change	Market Cap	Volume
AXE	Archer Exploration Ltd	0.13	-3.70%	$26.6M	52.4k
BAT	Battery Minerals Ltd	0.01	-10.00%	$22.5M	1.1M
BEM	Blackearth Minerals NL	0.05	-3.51%	$13.2M	60.0k
BKT	Black Rock Mining Ltd	0.07	-2.74%	$45.5M	821.8k
BSM	Bass Metals Ltd	0.01	+0.00%	$6.5M	10.3M
CGN	Crater Gold Mining Ltd	0.01	+0.00%	$18.4M	480k
GPX	Graphex Mining Ltd	0.19	-2.56%	$19.6M	45.1k
HXG	Hexagon Resources Ltd	0.07	+0.00%	$21.6M	176.4k
KNL	Kibaran Resources Ltd	0.1	-4.76%	$30.7M	150.0k
LML	Lincoln Minerals Ltd	0.005	+0.00%	$2.9M	50.0k
MLS	Metals Australia Ltd	0.002	+0.00%	$100.8M	1.6M
MNS	Magnis Energy Technologies Ltd	0.16	-3.03%	$5.9M	416.9k
OAR	Oakdale Resources Ltd	0.01	+0.00%	$2.4M	3.6M
PSM	Peninsula Mines Ltd	0.002	-33.33%	$3.0M	2.7M
QGL	Quantum Graphite Ltd	0.002	+0.00%	$15.3M	3.5M

Ticker	Name	Price	Tuesday % change	Market Cap	Volume
RNU	Renascor Resources Ltd	0.01	+0.00%	$17.3M	3.8M
SRK	Strike Resources Ltd/Australia	0.05	+0.00%	$35.9M	307.0k
SVM	Sovereign Metals Ltd	0.1	+0.00%	$7.9M	290.0k
SYR	Syrah Resources Ltd	0.5	-29.79%	$291.4M	21.0M
TLG	Talga Resources Ltd	0.4	+0.00%	$87.8M	71.0k
TON	Triton Minerals Ltd	0.04	+0.00%	$37.1M	451.3k
VRC	Volt Resources Ltd	0.01	-7.69%	$20.8M	6.3M
WKT	Walkabout Resources Ltd	0.22	-4.44%	$71.3M	660.0k

While external factors have weighed on demand, Niv Dagan — executive director at Peak Asset Management — also pointed to a more complicated picture around supply as the market works to strike a balance.

While graphite prices have come off their recent highs, Dagan noted that prices actually peaked in 2012.

Since then it's been a broad decline, "largely due to a weaker Chinese economy and an over-fragmented market", he said.

More recently, "incremental supply — largely coming from Africa and Syrah's mine in particular — has hampered prices," he told *Stockhead*.

"Especially given that global markets are looking for a far more sustainable supplement to drive the electrical car boom."

Syrah's problems weighing on others

Dagan also said that Syrah's push to lead the market with the world's first large-scale graphite operation had also had some unintended consequences in the form of a negative feedback loop.

"Syrah's mine has been in operation for only two years and operates at 50-60 per cent of design capacity," he said.

However, the mine has been "cash-flow negative from the start", which has put "growing concerns on the sustainability of other graphite producers going forward".

As a result, he warned that investors with a short-term investment horizon would be well-served to steer clear of graphite for the time-being.

In addition to the buildup of Chinese inventory, Dagan said that with a "depleted lithium market and environmental concerns around large-flake production, there remains great concerns in the near term".

Looking a bit further out though, other market participants remain optimistic.

Speaking with *Stockhead* in July, the boss of Aussie graphite player **Renascor Resources (ASX:RNU)**, David Christensen, said he still expects markets to be in "slight undersupply" by 2021 — and that's for both synthetic and natural flake graphite (along with a functioning Syrah mine).

Christensen said by 2023 that undersupply would become "quite acute". For now though, Dagan recommended that investors should focus their attention on the more traditional base and precious metals.

"Nickel and gold have been the shining light in the second half of 2019, and we believe that investors are much better positioned to be in this sector relative to the graphite market, as we head into 2020," he told *Stockhead*.