The Australian

Mine the sector's strengths: overseas ventures

- **Robin Bromby**
- From: **The Australian**
- July 07, 2010 12:00AM

IT'S hard to spread your risk, even balance your portfolio, in the resources sector.

So many resource companies (about 850 listed on the Australian Securities Exchange) and there are plenty more to come: there were 13 resource initial public offerings listed on the ASX website at time of writing, and they'll be followed by others that believe they have a great story and need to raise a quick $5 million or $10m.

So many commodities. Apart from the vanilla-flavoured staples (gold, iron ore, coal, the mainstream base metals as well as oil and natural gas), you can dabble in molybdenum, rare earths, underground coal gasification, coal-seam gas, vanadium, helium or feldspar.

And so many places. Take Australia out of the mix and you still have a smorgasbord of companies on the ASX and commodities scattered across the globe.

But there is one advantage for those choosing plays abroad over those plumping for the safety of Australia: you can get access to many more majors.

Many investors take the strategy of owning either BHP Billiton or Rio Tinto, or both. Plenty of commodity spread, plenty of geographic spread, from Liberia to Canada to Namibia to Mongolia.

Or you can follow the juniors and hope to win the lottery, as those who bought Paladin Energy did on the strength of its uranium deposit in Namibia, that stock going from 1c in 2004 to $10 when the uranium price soared.

There haven't been many rides quite like that. But if you had bought West Africa gold darling Perseus Mining at its 13c low, you would presumably be quite happy with the price above $2 today (not to mention the 7.7 million ounces of gold, and still drilling, at its Ghana and Ivory Coast properties).

But, gradually, there is the emerging and third (and quite complementary) strategy of buying into a resources fund. There is the listed Global Mining Investments, or unlisted funds such as Perpetual's newly launched Global Resources Fund and the older Colonial First Global Resources Fund.

In the case of the funds, they need deep pockets to do the necessary research. Global Mining Investments pays London-based BlackRock to do all the thinking. It has one of the biggest teams in the world following the resources sector.

GMI suffered along with every other resources investor in the aftermath of the global financial crisis.

But chairman John Robinson says, dividend aside, GMI is a capital growth play. During the past five years, GMI's portfolio has added an average 19 per cent in value each year, compared with 15.5 per cent for the HSBC Global Mining Index, or 8.2 per cent a year average for the ASX resources index.

"You can't ask for more than that," Robinson says.

The GMI portfolio includes all the usual suspects, as it were, from BHP to Xstrata, along with smaller holdings in companies such as Swiss-based Katanga Mining, which produces copper and cobalt in the Democratic Republic of Congo, and Australia's Iluka Resources, the world's biggest zircon producer.

Robinson says the vast majority of companies held by GMI are simply not accessible for the average Australian investor, even the ones that have large Australian operations here such as Xstrata and Anglo American (through Anglo Coal).

And a fund its size can do things few individuals can manage, such as hold a large convertible note in Swiss giant Glencore.

They can also take big positions in sectors BlackRock thinks are likely to move. Recently, GMI has been going overweight in platinum because the supply side could get tight and there are few large producers of the metal.

Robinson says the BlackRock team works like this: it adds up all the supply-demand factors for all the metal commodities, chooses which metals are likely to get tighter in supply terms, and then looks for the lowest-cost producers of those metals.

GMI never dabbles at the bottom end. "We don't invest in the pure speculation phase, only in the cash-generating stage or companies in transition to that," Robinson adds.

Perpetual's resources fund, by contrast, does its research in-house, with analysts travelling across the world, kicking tyres at projects and companies.

But, as with GMI, they're interested only in the big players. Of the 105 resource stocks in the ASX-S&P 300 index, only 34 meet Perpetual's criteria.

Also in sync with GMI, Perpetual can invest in Australian stories not listed on the ASX. And they can get an arbitrage edge, investing in BHP and Rio in London where those stocks trade at a significant discount to their Australian market price.

Portfolio manager James Bruce cites Xstrata, which has 40 per cent of its assets in this country (and meets his other criteria, the sound balance sheet and good management). These companies' projects must also meet four benchmarks: long-life production, low-cost production, export markets with a diversified customer base, and expandable assets.

He is not so much concerned about day-to-day commodity movements, but rather companies that can cope with the downs as well as the ups. "We want companies that are able to make money through the cycles," Bruce says.

He adds that by searching the world rather than just Australia, he has access to companies that have a collected worth of $4.5 trillion.

Perpetual is picky about parts of the world. It won't have a bar of Russia (expropriation is possible), China (lack of accounting transparency and potential for transfer pricing) or parts of Africa (the Democratic Republic of Congo springs to mind).

Nowhere is without risk (as the miners have hastened to point out in the wake of the super-profits tax proposed here), but some places are more risky than others.

Junior Luiri Gold received a jolt recently when the Zambian government alleged the company was in default of provisions of its mining licence for its key exploration project.

At the time of writing this looked like some sort of administrative stuff-up in Lusaka, but events such as this tend to unnerve investors.

Mine Life analyst Gavin Wendt says it pays to be cautious when investing in countries with no great history of mining, and he includes in that category one of the present investment favourites, Burkina Faso, along with neighbours Mali and Niger (also with Australian explorers active).

He likes jurisdictions where there has been a considerable history of mining. "You've got to be confident that the government won't change the rules," he says.

There are not all that many African countries that meet his standards: Ghana certainly, along with Botswana, Namibia and Tanzania.

Latin America is another place where Australian companies have begun flocking of late.

Wendt likes Peru, one of the top metal producers in the region (No 2 in the world in silver), but with not all that much exploration and with the long mining history he likes to see.

He sees regions as moving in cycles. Indonesia was popular until the Bre-X mine salting scandal; Papua New Guinea has come back into vogue; Mongolia is hot with North American and European investors; and Brazil is now seeing an inward stampede.

West African gold? "It's been done to death," Wendt says. That, incidentally, is the view of some other analysts who see many of the gold stocks involved as being near to fully priced.

But he says private investors have made the running in backing many of the juniors exploring throughout the world.

"Big investors tend to be lazy and plump for Rio and BHP to give themselves a commodity and geographic spread," Wendt says.

As far as the institutions are concerned, they rarely look at any company worth less than $250m or one with a single commodity, plus the resources research teams have been run down over the past 10 years.

"If they want iron ore, they go to BHP and Rio rather than something like Atlas Iron, which they would have to research. It's laziness. They don't want to spend the time and effort," he adds.

The institutions may not be making the effort, but the retail investors seem to be.

Andrew Muir at stockbroker Hartleys says two factors are at work.

First, there was the big gold price spike that made all those projects in Africa and elsewhere so much more attractive.

Then, more recently, came the threat of the resources super-profits tax that made investors wary of committing money in this country.

On top of that, some of the explorers (in Africa, particularly) followed in the large footsteps of Perseus and began producing impressive drilling results; for example, Gryphon Minerals and Ampella Mining in Burkina Faso and Azumah Resources in Ghana.

Muir says there are also some interesting stories coming out of South America and cites Beadell Resources, with its new gold and iron prospects in Brazil, and Troy Resources, which just last week reported a new gold discovery at its Casposo deposit in Argentina.

And people here realise that big discoveries are getting harder to make in well-explored Australia.

"There's a recognition among investors that, to find the bigger deposits, you've got to go offshore," Muir says.

Michael Evans at Foster Stockbroking says brownfields exploration in Australia is not all that appealing any more.

That includes working around now closed mines with the latest technology looking for mineralisation that was missed. "Some investors don't like old mines being rehashed," he says.

He also notes the new interest in South America and cites Andean Resources as an example; while still in the exploration stage in Argentina, its share price has now consolidated above the $3 level.

Evans has been amazed by the number of clients who have shown interest in foreign exploration stories, but cautions that the West African gold story has probably run too far. "It's hard to find value there now."

Disclosure: the writer owns shares in Rio Tinto and is a contributor to the Mine Life resources service