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BlackRock stakes claim on resources

Although mining stocks have rallied, fund manager Evy Hambro still sees plenty of value, writes Paul Garvey.

The last time BlackRock fund manager Evy Hambro was in Australia for his annual meet and greet, the world was a very different place.

It was, as he describes it, a "wrist-slashing" year – with equity and commodity prices slumping and confidence evaporating. His visit to Australia last November also happened to coincide with the about-face by BHP Billiton, which abandoned its takeover of Rio Tinto.

A year on, Hambro, one of the world's most influential resources investors, is back in Australia and his world is happier.

Commodity prices have rallied dramatically. The balance sheets of the world's miners are by and large off life support. And BHP is on the verge of securing a large portion of the enticing synergies that lured it into its original offer for Rio Tinto, courtesy of the joint venture which – pending regulatory approval – will see the two combine their massive iron ore operations in the Pilbara region of Western Australia.

With BlackRock, which manages $US31.9 billion ($34.2 billion) in natural resources assets with significant stakes in BHP and Rio, the compromise on iron ore is tantalising.

But it is, according to Hambro, the compromise that could kill off what has long been considered the Holy Grail of mining mergers – a union between BHP and Rio Tinto.

"What's left to go for post the iron ore joint venture?" Hambro said in an interview yesterday. "There's bits and bobs, sure . . . but the cream of the synergies would have already been captured by both companies. The deal would be compelling, but would you pay a premium for it?"

Beyond BHP and Rio, Hambro and fellow portfolio manager Catherine Raw are unsurprisingly bullish on the prospects for resources.

Evy Hambro is bullish on resources.

China's growth, now fed by substantial stimulus spending, is still strong. Other emerging economies such as India and Brazil also continue to grow.

There are even signs, Hambro and Raw say, that the United States and European economies are poised for growth. On top of that, the swift and aggressive cuts to capital spending by the world's miners in the early days of the crisis have slowed the introduction of extra mining capacity. And the discovery of major new mineral fields remains elusive.

While many mining shares have rallied substantially off their lows, both Hambro and Raw still see plenty of value.

"You're aiming again more for the long-term stories rather than short-term rebound in valuation – but the shares are not expensive even on what we would argue are overly conservative commodity price forecasts going forward," Raw said.

Of course, not all metals are equal. Copper, iron ore and coal remain the preferred investments for BlackRock. There's also a preference for platinum: on one level a curious one, given the metal's prime usage is in automobiles, but on closer inspection understandable given the paper-thin stocks of the metal among car makers and the multitude of operational problems in South Africa, where most of the world's platinum is mined.

Hambro has even raised the prospect of the world's central banks ending their years' old habit of selling gold reserves, forecasting that the banks would become net buyers this year as they diversify away from the US dollar.

On the flipside, BlackRock is cold on aluminium, ambivalent on zinc and cautious on nickel.

With confidence returning to the markets, the prospect of a renewed round of mining mergers and acquisitions has been revived. Hambro says some companies are finding it easier to secure bank support to acquire producing assets, rather than financing for organic growth.

That said, raw wounds from the financial crisis could make mergers between mining companies less likely. "The executives are keener to do M&A, but the boards are more cautious," Hambro says. "The boards are the ones bearing the scars more deeply."

Miners face oversupply risk

Resource demand, especially from China, is rapidly growing

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Evy Hambro and Catherine Raw say they are surprised there have not been more acquisitions

COMMODITIES demand is looking rosy, according to the managers of the world's biggest commodities fund, the BlackRock World Mining Fund.

In fact, if there is a risk facing the big miners of the world such as BHP Billiton and Rio Tinto, it is now oversupply, including from Chinese investment into the sector, rather than any return to the stilted buying of the global financial crisis.

BlackRock fund manager Evy Hambro said the global recovery was expected to continue, led by China, which accounted for 40 per cent of commodities demand in the second quarter.

"When you have an economy with such a role and such a market share of commodities demand growing at such a rapid rate, its no surprise to see that prices have recovered from the low points of last year," Mr Hambro said in Melbourne yesterday.

"The most recent data is probably a little flattened by the low level of activity in the Western world economies, but the trend is undeniable and I think we're going to see this trend exacerbated further over the next few years."

The risks to prices no longer lie on the demand side. Instead, there was the possibility of investors giving too much capital to miners, who then invest in new production. Increased Chinese production could also pressure prices, Mr Hambro said.

Chinese investment in resources has a double edge for miners. While it pushes up asset values, China's long-term view of its production needs means it could bring on more production than a listed miner would, pulling down prices.

BlackRock is a top 20 shareholder in BHP and Rio and has $US31.9 billion ($34.1bn) invested in its natural resources funds.

Mr Hambro, who through BlackRock also manages listed Australian fund Global Mining Investment, said banks were again starting to offer loan facilities to miners for acquisitions.

"I think we might start to see a more significant pick-up in merger and acquisition activity, as assets in general are trading at attractive levels," he said.

Catherine Raw, another BlackRock fund manager, said one of the more surprising things about the past six months was that miners with strong balance sheets had not made more acquisitions during the downturn.

"If you were a believer in the super cycle and you had an opportunity in what was a hiccup in that long-term view you would have thought there would be more activity than perhaps we've seen," she said. Ms Raw did not name any companies, but the miner that has left most people scratching their heads over its lack of acquisitions is BHP which, while talking up the possibility through the downturn, has so far failed to make a move