

Long term investors in resource companies look to reap rewards

Media release

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The long-term outlook for the resources sector remains compelling despite recent volatility in financial markets and short-term concerns over the durability of the global economic recovery.

The demand for commodities is increasingly driven by emerging economies such as China, Brazil, India, Indonesia and Russia as they develop into economic powerhouses, driven by demographic trends and rising income levels.

In recent times raw materials volumes have remained relatively robust despite short term cooling in demand from the developed world, with China gaining the most market share. When the global economic outlook becomes clearer and growth finally re-emerges elsewhere the stage is set for strong demand fundamentals in the sector according to Dr Joanne Warner, Head of Global Resources, at Colonial First State Global Asset Management (CFSGAM).

“At current valuations merger and acquisition activity in the sector remains healthy, and completion is emerging for the mining houses. Once of the most active groups in recent times has been semi-government bodies keen to secure long term access resources.

“In the second half of 2009 more than US\$8bn of investments was made in the form of either debt or equity by Chinese companies and investment groups seeking to facilitate new supply or to secure off-take agreements.

“Resource companies are concerned about long-term cost pressures and the limited availability of debt. The process of permitting and building Greenfield development is becoming increasingly lengthy and complex. In many cases there is also a higher political risk profile for the growth projects in many of the companies,” said Dr Warner.

The shift in demographic trends and rising income levels in emerging economies, combined with rapid population growth in these areas, is also driving demand for agricultural products.

Dr Warner believes the soft commodities sector is showing signs of a long term, demand-driven trend that is similar to the one experienced by the hard commodities and energy sectors during the past decade.

“As populations in emerging economies become more affluent, their consumption patterns change.

“Populations in more wealthy areas typically increase their consumption of food and broaden their diet towards higher-protein foods, such as meat and dairy products. This in-turn, leads to an increased demand for grains and oilseeds, as protein production is grain-intensive. For example, seven kilograms of grain are required to produce one kilo of beef,” said Dr Warner.

In many emerging markets economies as individuals with a very low income leave the farm for the better economic prospects of the city we see their consumption of raw materials increases. Demand for aluminium, copper and steel making materials like iron-ore and cooking coking coal, tends to rise with income levels as we see purchasing power increase and personal ownership progresses from a bicycle, to a motor bike and finally to a car. Energy consumption grows dramatically as wealth increases, with increased use of air conditioning, heating and electronics.

“In China alone over the next 40 years a UN report estimates that more than 10 million people each year will move from the rural regions to the cities, driven by the desire for higher incomes. This will require infrastructure to be built to accommodate that migration. To date, 300 million people have been urbanised, which is the equivalent of moving the entire population of the United States,” said Dr Warner.

These opportunities are not without risk however and the sector can be volatile. The high risk/return nature of the global resources sector means that it is more suitable for investors with longer-term horizons.

“The CFSGAM Global Resources team take a conservative investment approach by focusing on investing in world class, low cost companies with production growth and proven management. Importantly, this approach does not require taking short-term directional views on commodity prices, which are highly unpredictable,” said Dr Warner.

Recent market volatility has provided some investment opportunities, as valuations become attractive, margins are generally good and company balance sheets are in a sound position. Given the long term growth of the sector, the recent price weakness and economic uncertainty could eventually be seen as a good opportunity for the longer term investor.

Market sentiment has turned particularly sharply against many of BP’s peers following the oil spill in the Gulf of Mexico, especially those with operational exposure to that area.

Cameron International, a manufacturer of oil field blow-out preventers, was a recent addition to the CFSGAM Global Resources Fund’s portfolio which was made on share price weakness following the BP accident.

Longer term Cameron should benefit from the tougher regulations that will require many companies to upgrade these vital pieces of equipment. The fund has also increased its exposure to North American on-shore oil producers such as Concho Resources and Crescent Point Energy where the operational risks are lower but we still find attractive growth profiles and robust margins.

“The Global Resources Fund remains heavily invested in best of class, large companies with strong balance sheets and cash generating abilities, with the top 10 making up around 50% by weight. We have a total of 75 stocks and have built positions in some higher growth, smaller companies where they have world class asset potential and have addressed balance sheet risk.

Typically there is a long tail of these companies in the portfolio, which enhance the overall growth characteristics,” said Dr Warner.

The CFSGAM Global Resources Fund, has been awarded an A[#] rating from van Eyk, a Four Star rating from Standard & Poor’s⁺, and a Highly Recommended from Zenith. In the UK it was named the Best Resources Fund in the Investment Week Fund Manager of the Year Awards 2010.¹

About Colonial First State Global Asset Management

Colonial First State Global Asset Management is the consolidated asset management division of the Commonwealth Bank of Australia Group, one of the largest financial institutions in Australia. Colonial First State Global Asset Management is Australia's largest manager of Australian sourced funds, employing more than 200 investment professionals.

At 31 March 2010, Colonial First State Global Asset Management managed more than A\$145 billion across a diverse range of asset classes including Australian and global shares, short term investments, fixed interest and credit, property securities, direct property, global resources, unlisted infrastructure and listed infrastructure securities.

Colonial First State Global Asset Management has been a signatory to the principles of the United Nations of Responsible Investment since March 2007.

The principles are an initiative developed by institutional investors in conjunction with the UN Environment Programme Finance Initiative and the UN Global Compact.

The UN PRI provide a framework for including environmental, social and governance (ESG) issues in investment decisions. Colonial First State Global Asset Management undertakes to utilise the framework provided by the UN PRI in aligning our investment processes with the objectives of our investors.

By embracing the Principles, Colonial First State Global Asset Management believes it can achieve better long term investment returns for our clients.

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