

# Q&A



## ANSWERS

**JOANNE WARNER**

Manager, First State Global Resources fund

**DAVID MILLER, HEAD OF ALTERNATIVES, CHEVIOT: How does your fund access the global commodity markets?**

First State Global Resources takes a diversified approach when constructing its equities portfolio. We are invested across a broad range of commodity companies, including those working in precious metals, base metals, bulk commodities and energy.

Commodity prices are notoriously volatile and trying to time that market is a risky and thankless task. Instead, we employ a conservative approach better suited to long-term investors by focusing on world-class, low-cost global resources companies that, in our view, are well placed to benefit from positive long-term trends. Apart from financial expertise, this requires technical knowledge in disciplines related to resources, including geology, metallurgy, physics and chemistry. For example, when we analyse a mining company, we examine the geology of each site, as well as the likelihood of discovering new deposits there in the future.

**PHIL GENT, DIRECTOR, JUPITER PRIVATE CLIENTS: Everything seems to be making super-normal profits – what happens when things contract and they do not make these margins?**

Our favoured companies tend to have strong organic growth credentials and to be at the low end of the cost curve, which means they tend to make the largest margins. These low-cost producers are the ones best placed to withstand a fall in commodity prices. It is the high-cost producers that can experience negative margins and often go out of business.

Although commodities are at historically high prices, we believe there is a credible reason for this. The resources industry is facing significant cost inflation, from both the capital costs of new projects and the operating costs of existing projects, as labour, energy and raw materials costs have risen. At the same time, demand continues to grow, driven by industrialisation in emerging nations. To encourage the development of new production with acceptable internal rates of return, we need to see commodity prices higher than historical levels for a sustained period.

Since the launch of First State Global Resources in 1997, our team has made over 950 visits to mines and other sites in over 60 countries. These visits help to identify and assess specific risks associated with companies and decide whether a particular stock deserves either a premium or a discount to its valuation.

**PG: What is your outlook for the sector and what are the key trends currently generating opportunities for investors?**

The market continues to forecast a decline in commodity prices, which is weighing on the 2012 forecast earnings growth for

resources companies. However, earnings upgrades are likely if commodity prices stay at current levels and consensus prices are revised higher. Valuations are attractive in our view, especially among major diversified miners, and we continue to invest in quality companies at the low end of the cost curve.

A key trend we expect to play out this year is an increase in mergers and acquisitions. High commodity prices have resulted in very strong cashflow generation for mining companies and the market anticipates that some will look to deploy this through value-accretive transactions. Already this year, we have seen Rio Tinto bid for Riversdale, Equinox bid for Lundin and Minmetals bid for Equinox, trumped by a bid from Barrick Gold, while BHP Billiton is to buy Chesapeake's Fayetteville shale-gas assets.

The market is also anticipating further capital management programmes in the form of special dividends and buybacks during the year, particularly from large-cap diversified companies, some of which are expected to move into net cash positions this year.

**JAMES HUTSON, CHIEF INVESTMENT OFFICER, ARJEN: With China banking \$3tn of US dollar reserves, given its demand for commodities, how do you see its role in the resources sector?**

China continues to play a significant role. Over the short term, there are concerns that inflation in China will prompt the authorities to introduce further tightening measures, which could have negative implications for resource companies. On the other hand, longer-term trends indicate a shift in demand driven by the growth of China and other emerging economies.

China's insatiable appetite for commodities to urbanise has driven nearly every bulk commodity and base-metal price to an all-time high. We would argue that these prices have already changed how resources companies approach projects. Ten years ago, a copper project with a grade of 0.3% would have been considered uneconomic. Today, world-class mining companies are considering constructing mines to exploit copper ore bodies with 0.3% grades.

We expect that as Chinese demand continues to support commodity prices, mining companies will continue to assess previously uneconomic ore bodies, and the high prices, combined with continual improvement in productivity, will allow increasingly lower-grade projects to be brought on-stream.

We also have to consider that China is unlikely to sustain growth at 8% a year forever. The country is going through an urbanisation process, the likes of which it may never need to undertake again. We would compare China today with Japan in the 1950s and 1960s. Japan enjoyed extremely rapid growth during that period, but its growth rates today are near zero.



# We're leaders in our field (and under it).

First State Global Resources Fund.  
First State Global Agribusiness Fund.

To be a successful investor in both hard and soft commodities, you need the right team, with the right work ethic. The team members who manage the First State Global Resources and the First State Global Agribusiness Funds are respected not only for their ability to find long-term investment opportunities, but also for the approach they take.

Drawing from a wealth of combined investment experience, our Global Resources team includes mining and petroleum engineers, as well as experts in agriculture, physics and chemistry. We take a hands-on approach to analysis, having made over 950 mine and site visits across 60 countries in the last 13 years\*. This ability to accurately judge companies first-hand, combined with our bottom-up stock-picking process, has won us many awards, including Best Resources Fund 2011 at the Lipper UK Awards.

We believe this approach is an essential element in our success and makes the First State Global Resources and the First State Global Agribusiness Funds worthy of consideration in any portfolio.

## First State. Worth knowing.

For more information on the First State Global Resources Fund or the First State Global Agribusiness Fund:  
[www.firststateinvestments.com/resources](http://www.firststateinvestments.com/resources)  
0800 587 4141



\* First State, as at 31 December 2010.

**This is only directed at professional advisers and is not intended for, and should not be relied on by, private investors.**

Telephone calls may be recorded for your security. The First State Global Resources Fund and First State Global Agribusiness Fund are sub-funds of the First State Investments ICVC, an Open-ended Investment Company with variable capital. A copy of the Prospectus is available on request. Issued by First State Investments (UK) Limited, authorised and regulated by the Financial Services Authority (registration number 143359) and a member of IMA. Registered No. 2294743 England and Wales.