

SMART MONEY

YOUR GUIDE TO MINING STOCKS

The sharemarket is now so dominated by resource stocks you can't afford to ignore them. Here's what you need to know about those spectacular gains, and sudden busts, before putting your money down, writes Tony Featherstone.

Mining shares are like a drug for some investors. They know the sector has lots of junk that poisons portfolios, but the lure of tenfold returns is irresistible. Not even catastrophic share price falls during the 2008 bear market or warnings about the dangers of speculative resource stocks can cure their habit. No sector unleashes greed like mining.

And if the 2003-07 mining boom was a dress rehearsal for a stronger mining cycle this decade, even conservative investors may struggle to resist its temptations.

Recent comments by Reserve Bank governor Glenn Stevens – that the resource-sector export boom may revisit 50-year highs this year – show mining's fundamental strength.

Other red capes for mining bulls are breathtaking commodity price rises, double-digit Chinese growth, and signs the US is rising out of recession. Locally, most economic momentum is from mining and

analysts' earnings upgrades favour resources. However most are yet to factor in the impact of a resource rent tax being considered by the Federal Government and see it as a long-term consideration.

In the shorter-term International Monetary Fund forecasts for buoyant growth in emerging economies and muted growth in most developed nations suggest resources' gains are far from over.

For all the top-down forecasts, nothing whets appetites like rampant share-price gains. Analysis by the *Weekend AFR* shows the 100 best-performed materials shares over the past five years had a median annual gain of 33 per cent – after a two-year bear market. Median annual gains in the top 20 stocks were a stunning 74 per cent. A new generation of mid-cap miners, such as Atlas Iron, Perseus Mining and Sandfire Resources, are the sector's poster boys. Long-term investors may resist the next big thing and stick to the 10 largest resource companies. Why buy speculative

One in every two listed companies – of almost 2000 – is resource-related.

miners when BHP Billiton offers diversified commodity exposure and higher-quality projects, returning 24 per cent a year over the past five years? What about 21 per cent annual returns from Rio Tinto and Newcrest Mining?

Like them or not, resource stocks are playing a bigger role in everyone's portfolio. The mining boom is propelling more resource companies into the S&P/ASX 200 Index. Superannuation funds that base equity weightings on indices are holding more speculative miners – which often have billion-dollar market capitalisations – by default. Fund managers are showing more interest in capital raisings for second-line miners, even those in exotic locations such as West Africa. Their participation in Perseus's recent capital raising is an example.

Our reliance on China, a two-speed economy led by resources, and a "long tail" of listed mining companies means the market has become even more of a commodity play for foreign investors. The

Australian Securities Exchange has 691 materials companies, 237 energy companies and at least another 100 mining services or engineering companies that rely on the resource sector. One in every two listed companies (of almost 2000) is resource-related.

The figure could swell if a stronger equity market and more resources hype encourages hundreds of small explorers to list. Most floats this year have been for miners. In a big year, more than 100 mining floats are possible.

All this means investors must improve their mining-stock knowledge. That is not to suggest investors should chase small miners. A smarter approach is to consider asset allocation strategies for resources shares.

Getting good information is hard. A generation of resources analysts were lost earlier last decade as many brokers scaled back their coverage just before the mining boom. There is less independent information on small and mid-cap

Continued next page
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Illustration Suzanne White

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Real gems

The best-performed materials companies by total shareholder return

Company	Market cap (\$m)	Average return over 5 years (%)	Company	Market cap (\$m)	Average return over 5 years (%)
Victory West Moly	20	118	FerrAus	181	52
Aneka Tambang	2,480	107	Cape Lambert Resources	285	50
Andean Resources	1,564	105	Platinum Australia	321	50
Brockman Resources	532	89	South Boulder Mines	47	50
Sandfire Resources	454	86	TMA Group of Companies	35	47
Strike Resources	111	83	Summit Resources	451	47
Alterra Resources	12	76	Avoca Resources	645	47
White Energy Company	836	76	Golden Rim Resources	32	47
Nucoal Resources	120	76	Medusa Mining	845	46
CuDeCo	678	74	Nullarbor Holdings	45	45
Coalspur Mines	260	74	Coventry Resources	21	44
Fortescue Metals Group	15,565	74	Citadel Resource Group	527	43
Gindalbie Metals	902	70	Bannerman Resources	94	43
Berkeley Resources	184	69	Flinders Mines	237	42
Atlas Iron	1,204	67	Mirabela Nickel	1,010	41
Perseus Mining	655	66	Incitec Pivot	5,249	40
Dominion Mining	319	66	Mindax	65	39
Pacific Niugini	34	64	OceanaGold Corporation	604	39
Giralda Resources	412	63	Imdex	156	38
Alliance Resources	155	60	Gullewa	12	37
Equinox Minerals	3,233	60	OM Holdings	1,010	36
Coal Of Africa	1,201	58	Reward Minerals	31	35
Murchison Metals	1,162	58	Resource Star	5	35
Sundance Resources	447	58			

SOURCE: AFR.COM

Rock stars

The fastest growing material companies by annual earnings per share growth over the past three years*

Company	Average EPS growth (%)	Company	Average EPS growth (%)
Victory West Moly	306	Vital Metals	98
Alterra Resources	240	Heron Resources	97
Vietnam Industrial Investments	227	White Energy Company	94
Australian Mines	192	Talisman Mining	92
Orion Gold	178	Golden Cross Resources	90
Planet Metals	175	View Resources	82
Mineral Deposits	164	A-Cap Resources	80
TNG	160	Jabiru Metals	80
Dragon Mountain Gold	155	Western Areas	80
Compass Resources	152	Blackthorn Resources	76
Alliance Resources	143	Coalspur Mines	74
Moly Mines	140	Summit Resources	71
Regis Resources	136	AngloGold Ashanti	71
Alcyone Resources	133	Maximus Resources	70
Ram Resources	127	Padbury Mining	69
Strike Resources	125	Michelago	67
Matilda Minerals	124	WCP Resources	66
Galaxy Resources	119	Monaro Mining	65
Apex Minerals	118	CGA Mining	64
Grange Resources	113	Marenica Energy	64
Platsearch	111	Mintails	64
Adamus Resources	108	Crescent Gold	62
Territory Resources	102	Magma Metals	62
Australasia Gold	100		

* EPS is adjusted for abnormal items and minority interests

SOURCE: MORNINGSTAR

Your guide to the top mining stocks

From previous page

resources shares relative to other sectors. Smaller mining shares by their nature sit uncomfortably with many financial advisers and fund managers. Financial innovation for investment in mining shares has been lacking; more index and structured products are only now being launched.

Arguably, the biggest reason investors need more education about resources shares is to avoid the hype. The most important question is: are you investing or speculating? Risks are great. Morningstar research showed only 154 materials companies out of the almost 500 it surveyed had average earnings per share growth greater than 10 per cent a year over three years. Many more make losses and are always needing to raise capital to survive.

Long-term investors face important decisions. The first is determining resource-sector portfolio weightings. For example, a growth investor may allocate 40 per cent, or \$800,000, of a \$2 million portfolio, to Australian shares. Resources shares may account for 30 per cent of this, or \$240,000. Clear asset allocation is especially important with resource-sector investing because sharp price gains can dramatically alter sector weightings. Investors who do not rebalance their portfolio, at least annually, by selling resources stocks to get back to target weightings unwittingly take on more risk.

The second decision is buying shares directly or through a managed fund or listed investment company. The main benefits of a fund or LIC are expertise, diversification and, sometimes, access to global shares. Some key mining companies with significant Australian operations cannot be bought via the ASX. Xstrata, a global mining group with large coal assets in Queensland, is an

example. Investors can use resources funds to gain exposure to leading global miners, such as Vale, Codelco or Anglo American (prominent here in coking coal), that are listed overseas.

"Investors who want exposure to several of the largest resource companies must look beyond Australia," says John Robinson, the chairman of well-performed LIC Global Mining Investments.

"The smart approach is having a portfolio of resource companies offering diversified geographic and commodity exposure. BHP and Rio Tinto are the usual choices for Australian investors, but other major miners active in Australia are not available via ASX. And while BHP and Rio offer exposure to a diversified spread of commodities, they are not a preferred choice for investors looking for (large-cap) exposure to nickel, zinc, gold and platinum."

GMI and LinQ Resources, are trading at sizeable discounts to their net tangible assets per share. Global Resource Masters Fund, another LIC, was at a slight premium at the end of March.

The third decision is whether to de-risk investments by removing company-specific risk. Exchange-traded commodities provide exposure to underlying commodities such as gold or silver. Gold bulls who believe it will keep rising as inflation fears build, can buy an ETC over gold rather than a gold stock. Potential upside is not as high, but risks of bad management or operational problems are eliminated.

Another option is an exchange-traded fund over key resources indices, three of which have been launched this year over mining and energy indices. As with all ETFs, investors get low-cost index exposure and diversification – but not the potential for above-average gains of direct investment in shares or active managed funds.