



## **Evy Hambro**

Managing Director of Merrill Lynch Investment Managers

Investment Manager of Global Mining Investments



October 2005

# Agenda

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- MLIM Natural Resources Team
- Sector Summary
- The Cycle
- Strategy & Outlook
- GMI – The Rationale
- Fund Performance

## Who are MLIM Natural Resources?

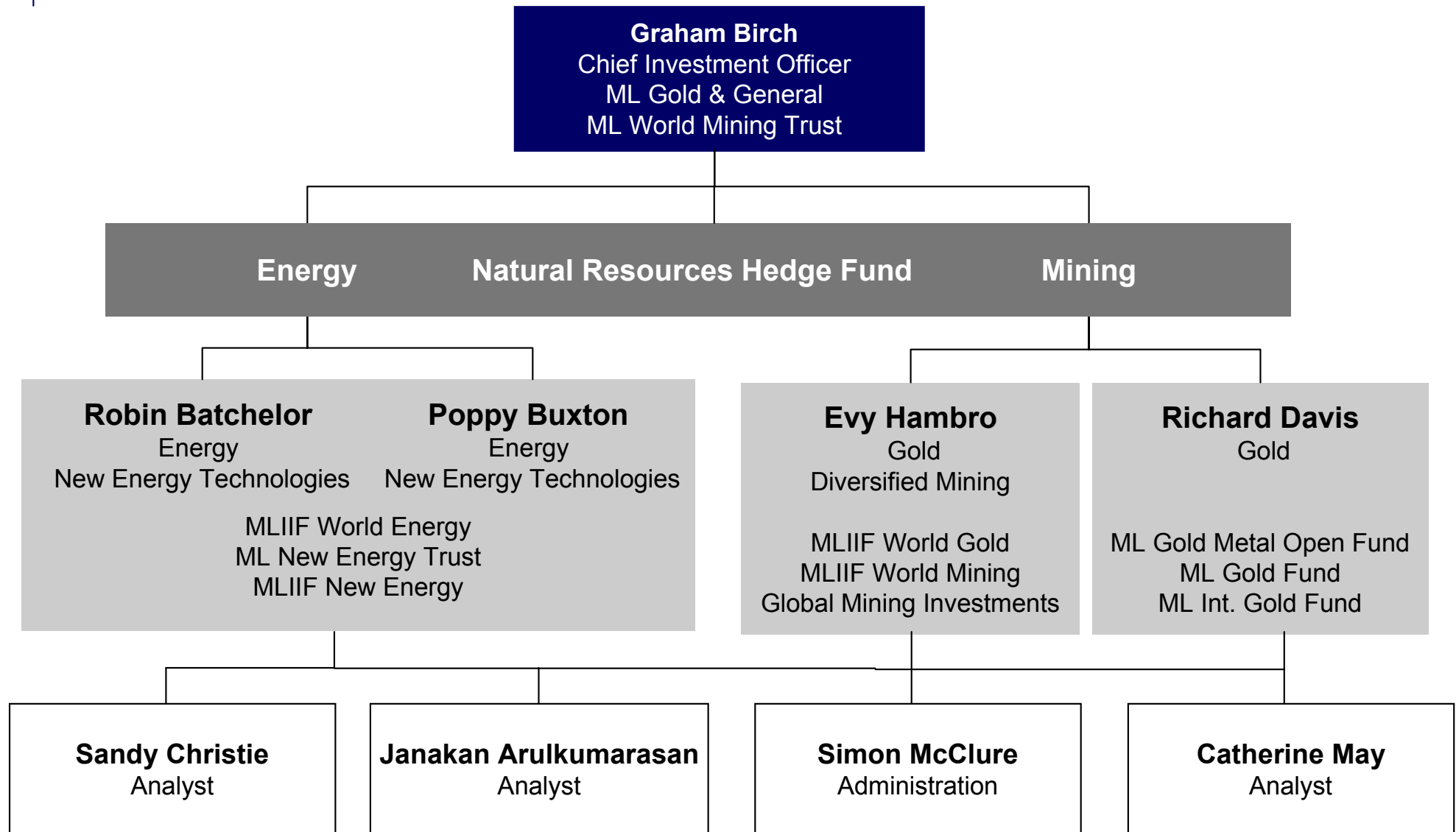
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### **MLIM Natural Resources Team**

- Started by Julian Baring in 1991 at former Mercury Asset Management
- Team has grown considerably since then with AUM of US\$12bn\* and a range of products including mining, gold and energy funds as well as a hedge fund.
- Core of team has been working together for over 10 years
- Only Natural Resources Team rated “AAA” by Forsyth Partners and S&P Group

\*As at 30 September 2005

# Natural Resources Team Structure



As at October 2005

# **Sector Summary**

## High Metal Prices translate into Record Earnings

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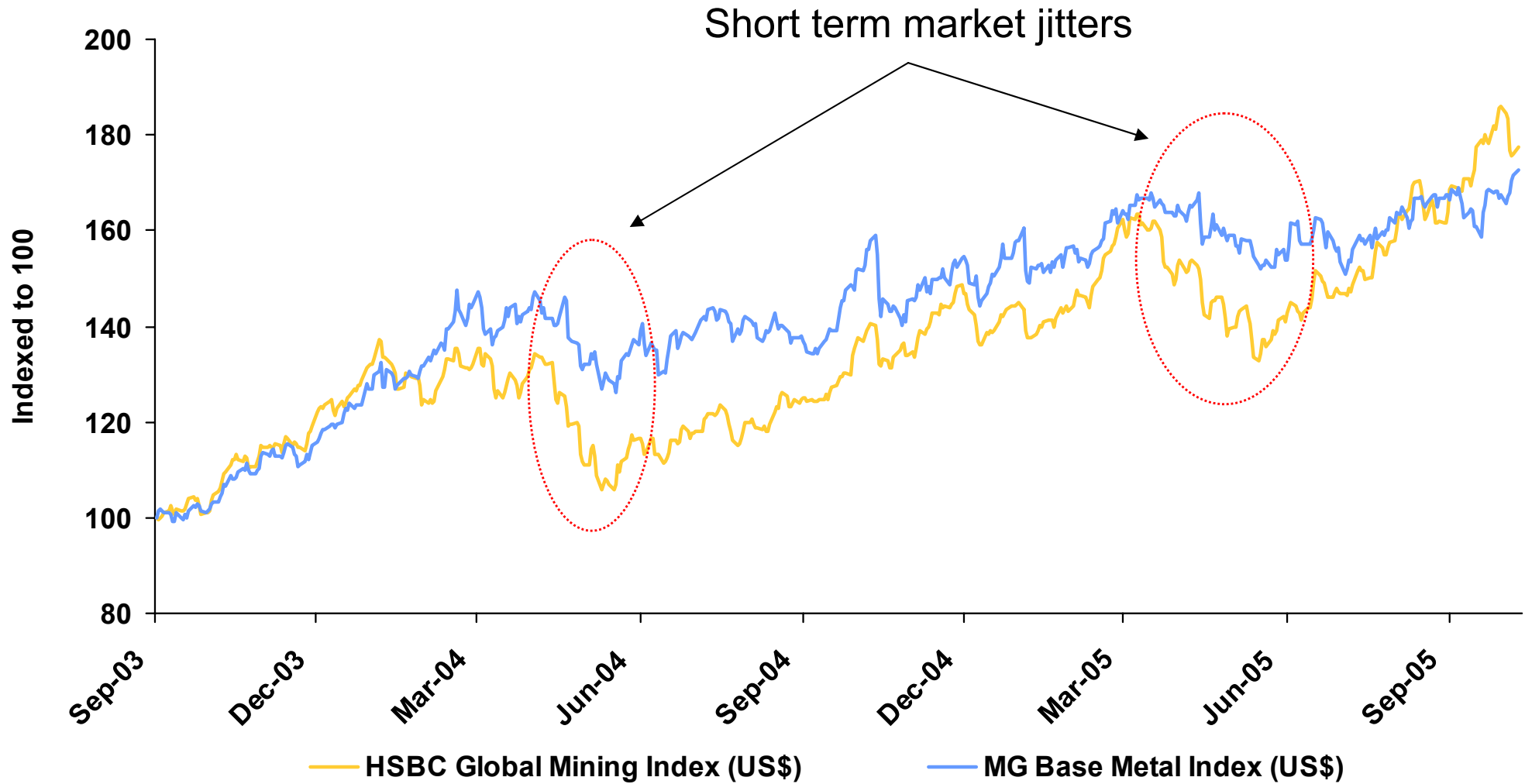
### **This is an industry enjoying the best market conditions for a generation**

- 2004 saw a string of records broken by the mining majors.
- GMI's top four holdings (CVRD, BHP Billiton, Rio Tinto and Xstrata) all reported record earnings, cash flows and paid record dividends in 2004
- Results for 1H 2005 are even better and 2005 set to be another blockbuster year
- Signs for 2006 are very encouraging
- Huge cash flows are triggering new trend of capital management:
  - Since June 2004, majors\* have returned over US\$7bn to shareholders through dividends and sharebuybacks.
- In our view, there is more to come

\*Anglo American, BHP Billiton, Rio Tinto, Xstrata

Source: Company Financial Results, Reuters

# Mining Shares vs Metal Prices



Source: Datastream. Data as at 10 October 2005

# Commodity Prices

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## Base Metals

- Base Metal Prices have held onto strong performance
- Some metals, such as copper, have hit multi-decade highs
- On the whole most metal prices trading above long term average levels
- Demand growth in key consuming nations has been better than forecast
- Supply growth has been muted by delays, strikes and higher costs

## Bulk Commodities

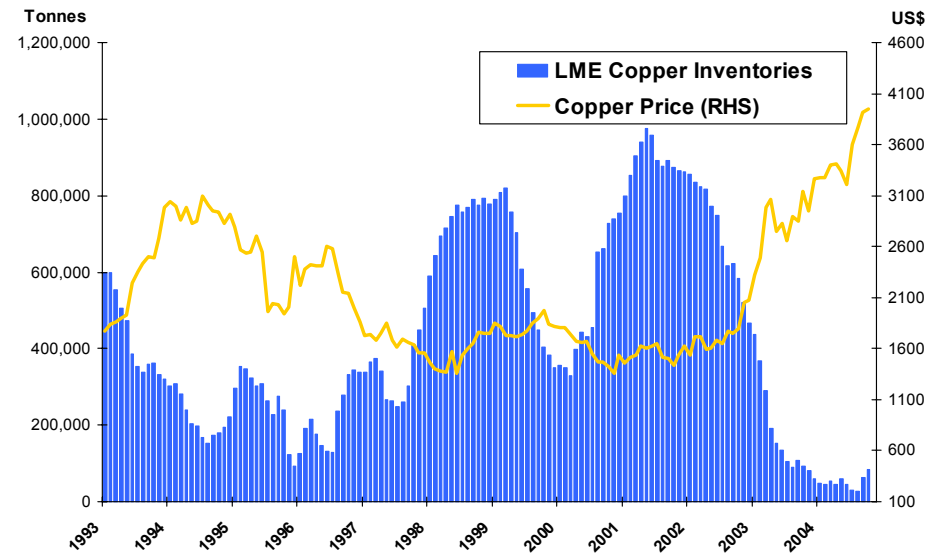
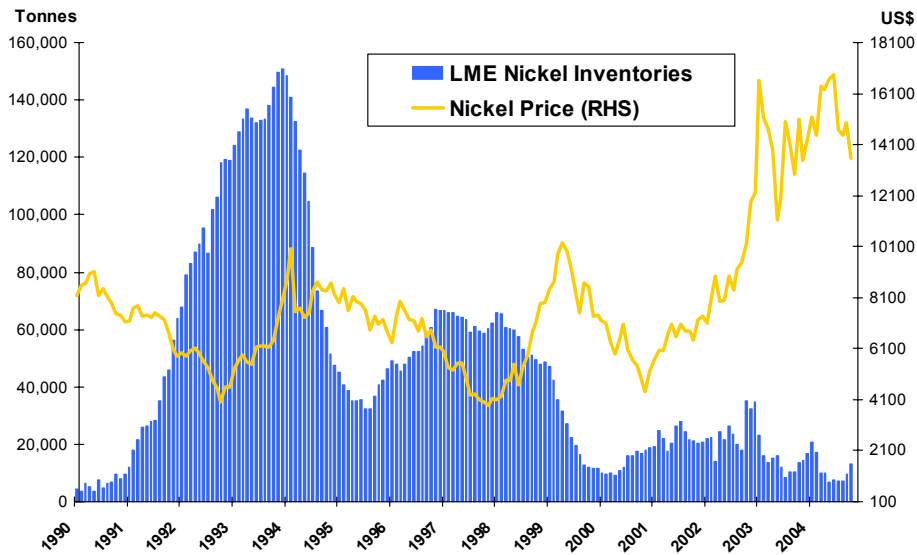
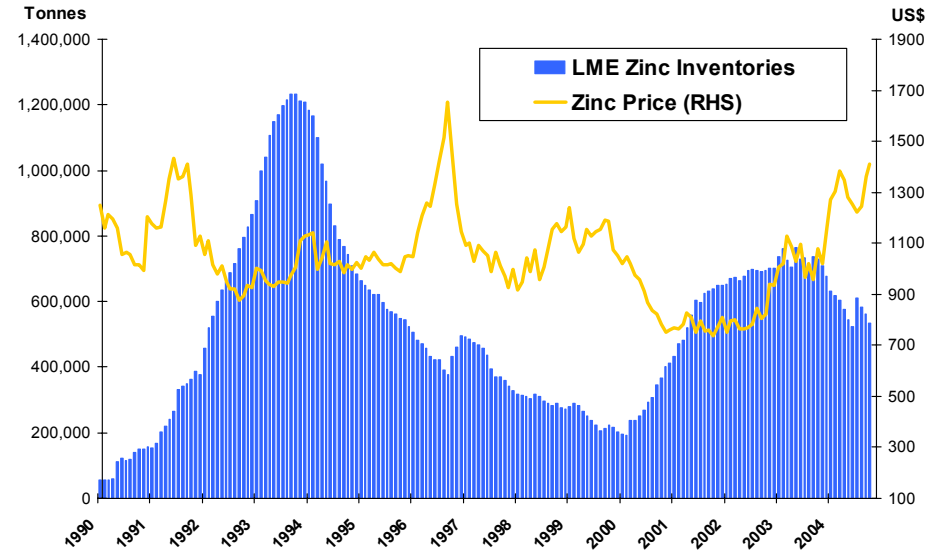
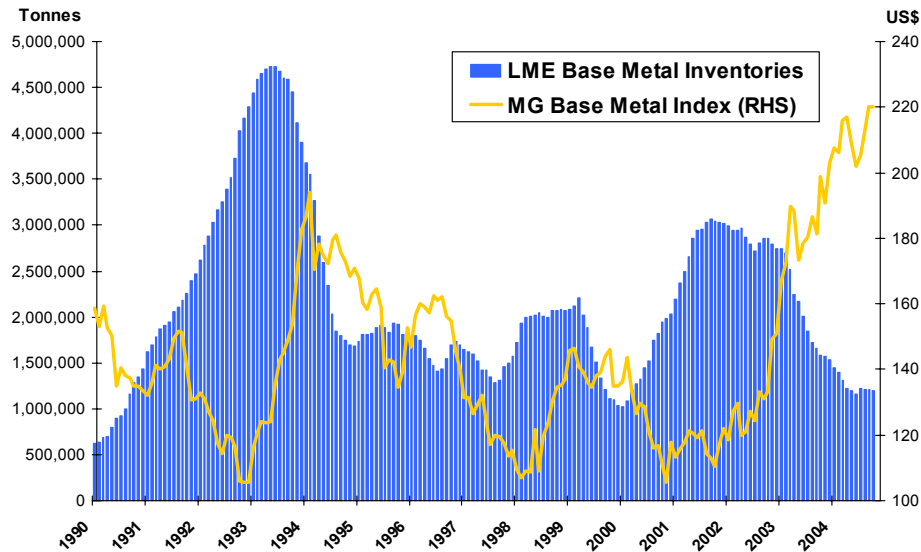
- Bulk commodities have been outstanding
- Record price increases in iron ore, thermal and coking coal

## Precious Metals

- Gold price has broken out to new long term highs
- Platinum and sister metals have continued strong run



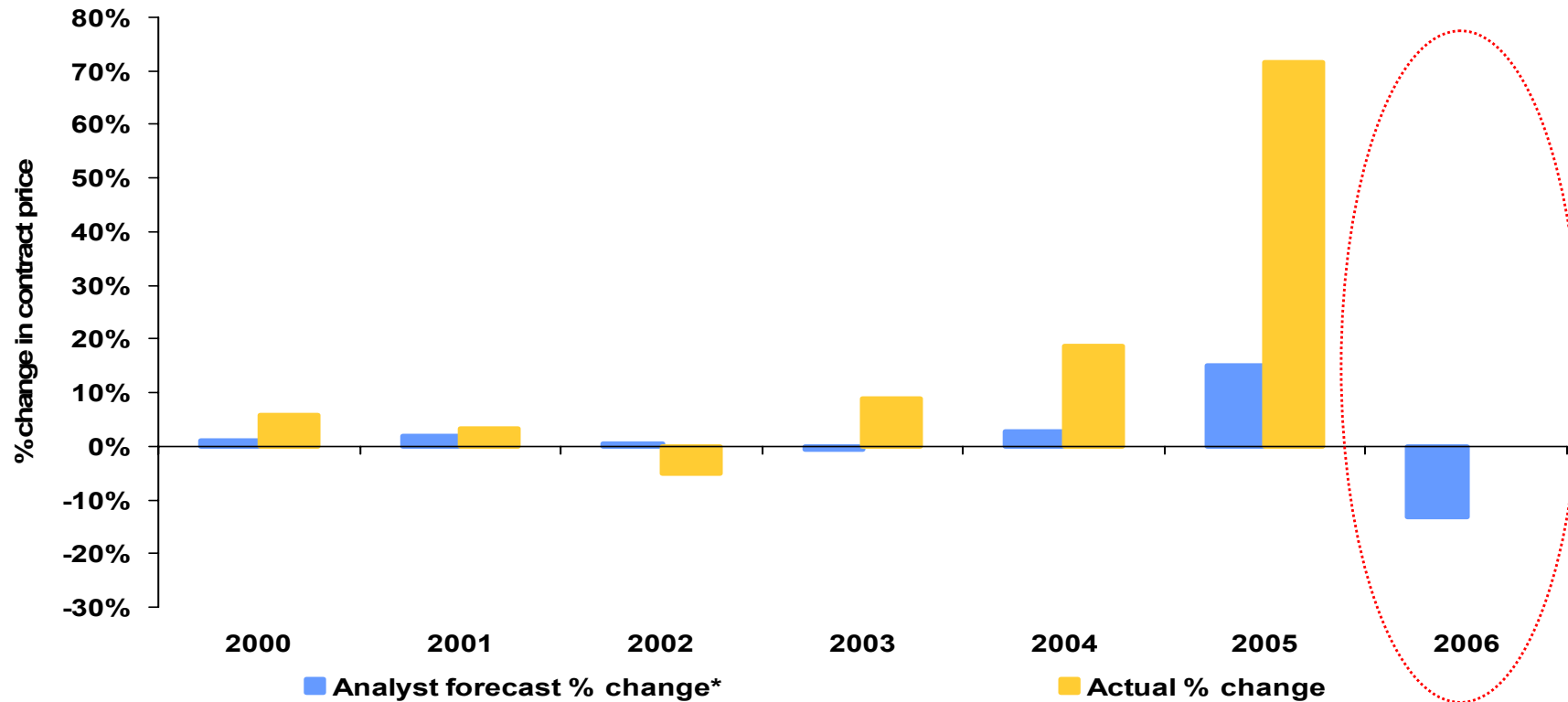
# Base Metals – Index, Zinc, Nickel & Copper



Source: Datastream. Data as at 30 September 2005

## Iron ore price vs. market expectations

- Market has underestimated price increases over last 3 years
- Analysts are having to revise expectations for 2006 upwards
- This has been key value and growth opportunity in the sector



Source: Internal. \*Survey of three major mining houses. Next year forecasts taken as at date of current year's price negotiations

## Base metal prices vs. market expectations

- Analysts are still underestimating the strength of the market
- Upgrades to price estimates occurred as expected, but still remain below current spot prices for most metals

USc/lb	Est 2005 (Jan '05)	Est 2005 (July '05)	2006 forecasts	YTD 05 Average	Spot Prices*
<b>Aluminium</b>	81	82	80	84	84
<b>Copper</b>	124	144	122	158	179
<b>Lead</b>	38	42	36	43	44
<b>Nickel</b>	590	687	597	701	616
<b>Zinc</b>	54	58	59	59	64

Earnings upgrades throughout 2005 as analysts revise their commodity price forecasts

Source: Reuters 2005 Base Metals Poll (January & July 2005), DataStream. \*Spot prices as at 30 September 2005

# Analysts upgrading forecasts

**JPMorgan** 

North America Equity Research  
20 September 2005

**Gold**  
Gold scenarios and the new price deck

 **UBS**

**Iron Ore and Global Mining Strategy**

Raising iron ore price forecasts for 2006E and 2007E

 **Merrill Lynch**

**GLOBAL**

*Structural Change in the Iron Ore Industry to Drive Higher Long Term Prices*

**JPMorgan** 

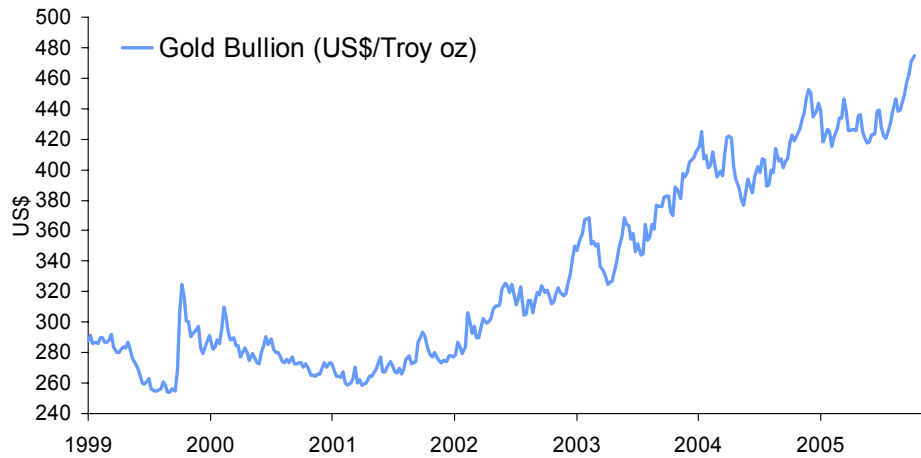
European Equity Research  
22 September 2005

**Copper**  
Looks to us unlikely to ever trade below \$1.00/lb again

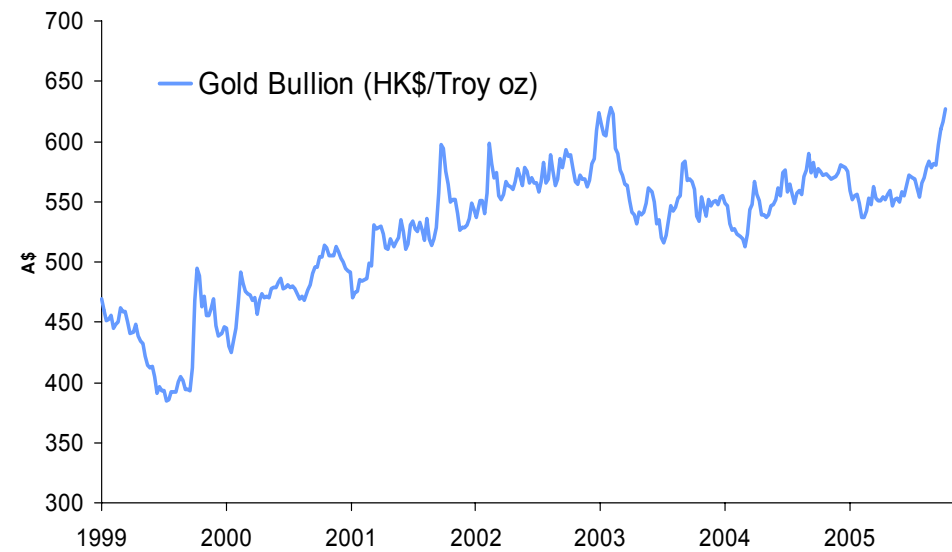
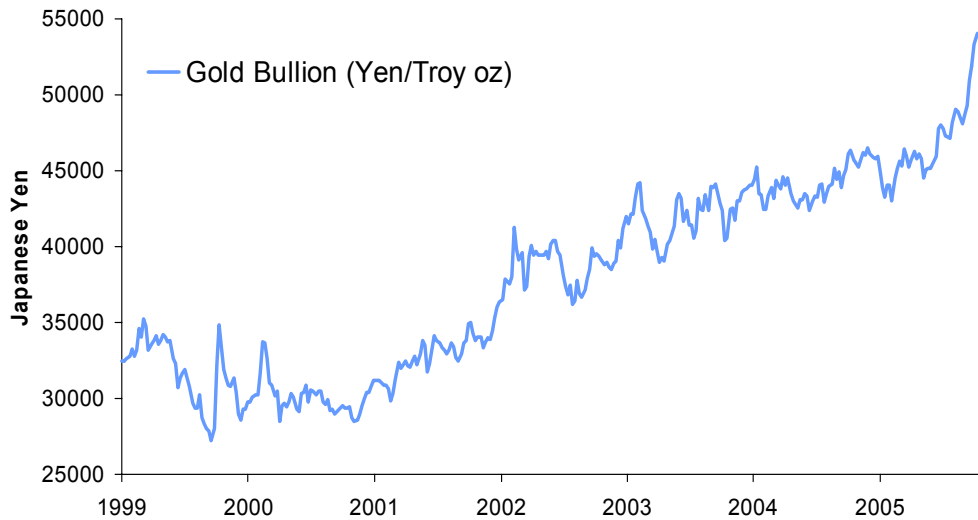
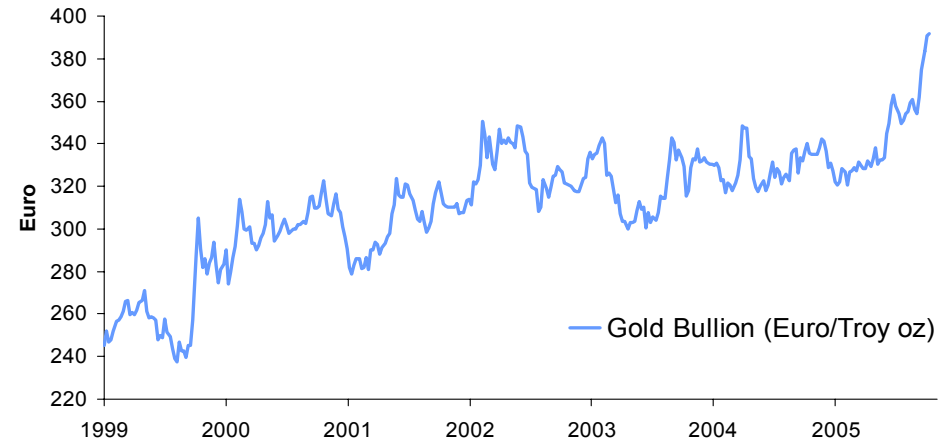
Source: UBS, ML & JP Morgan research notes (September 2005)

# Gold Price

Gold price hits 18 year high...



...hitting highs in other currencies too

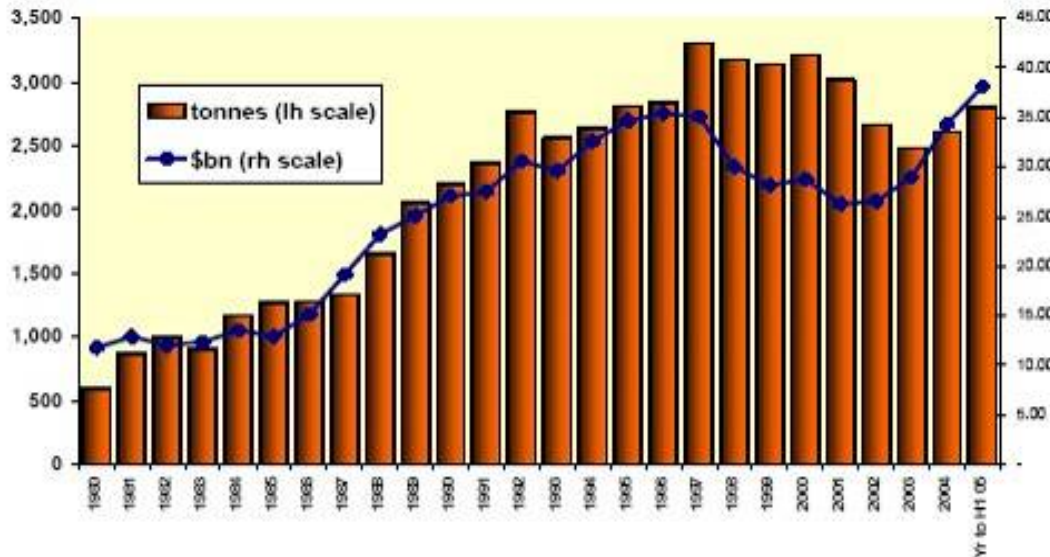


Source: Datastream. Data as at 7 October 2005

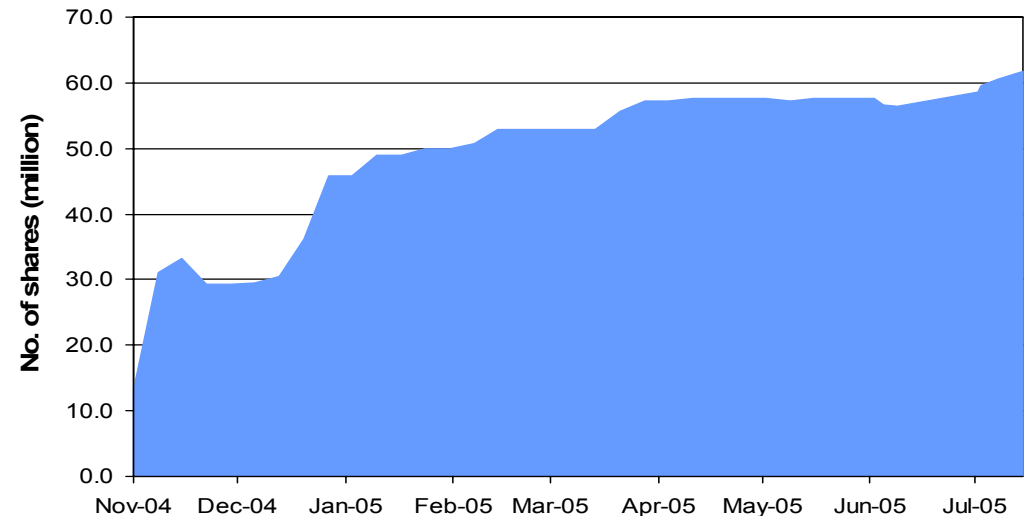
# Gold Market Fundamentals: Strong Demand

- Total gold demand in H1 2005 increased by 21%
- Jewellery demand at record high: \$38bn for year to June 2005, +17% in H1 2005:
  - India (~20% total demand) saw highest ever quarterly demand in Q2'05, increasing 42% yoy in tonnage terms.
  - China saw jewellery demand grow by 11% in Q2'05. Now 3% of global market – still a long way to go!!!
- Investment demand up 66% for H1 2005

Jewellery demand 1980-2005, tonnes and US\$



StreetTRACKS Gold Trust shares in the market



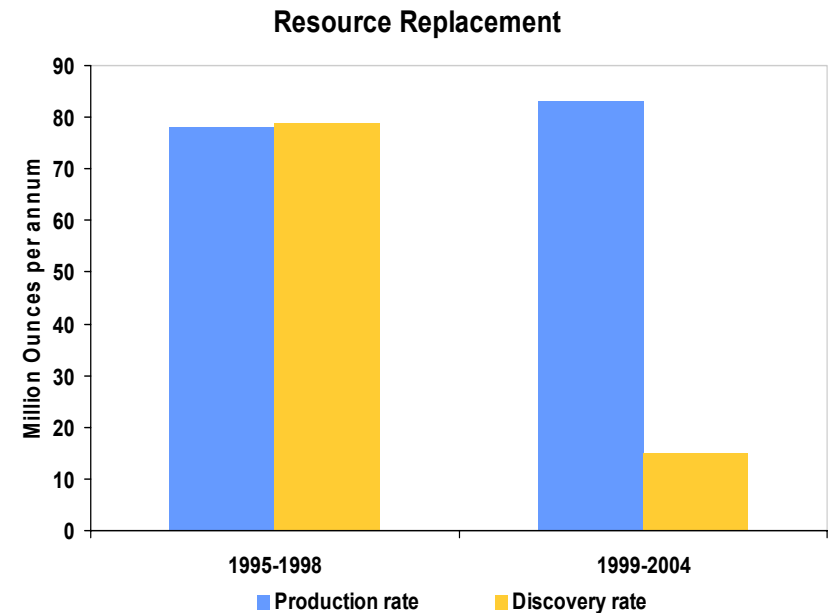
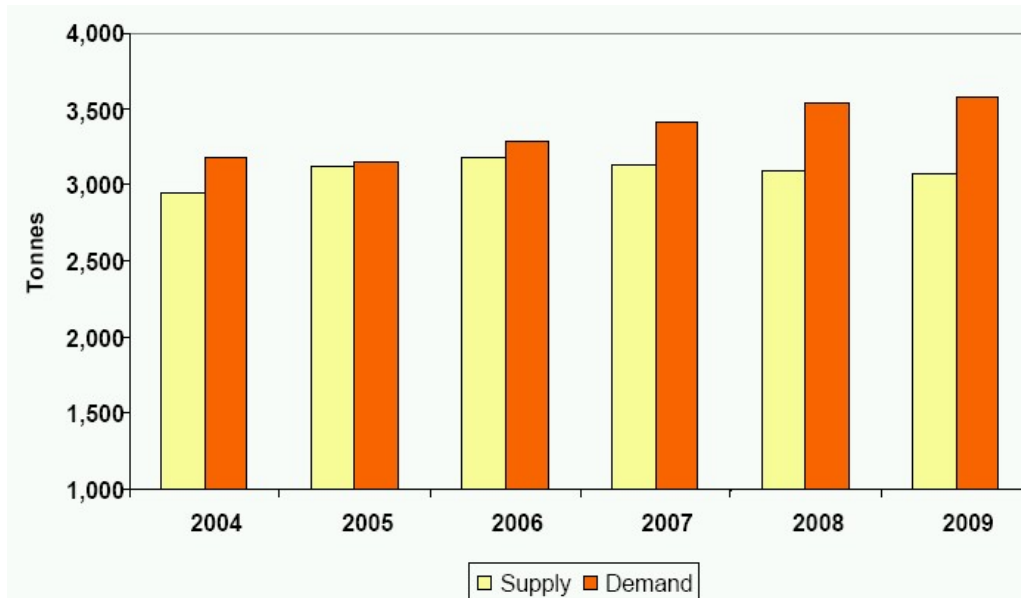
Source: World Gold Council, GFMS, Bloomberg. All percentages show growth in tonnage terms

# Gold Market Fundamentals

## Limited Supply

- Production declined by 4% in 2004 - largest annual decline since the 1940s
- Central Bank sales down 19% in 2004
- Total supply down 13% in 2004

- Since 1998, exploration budgets of gold mining companies cut by 76%
- Discoveries at all-time low
- Less than 30% conversion of discovered ounces to production



**Strong market fundamentals supportive of a higher gold price**

Source: AngloGold Ashanti, World Gold Council, MLIM

# The Cycle



# The Commodity Cycle

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## Market wrestling with the question:

*Is this the peak of a normal cycle or the early stages of a supercycle?*

- The argument for a supercycle:
  - DEMAND – the China effect (and don't forget India)
  - SUPPLY – lack of investment in the previous decade and long lead times limits supply-side reaction
  - Consolidation of the industry
- To a greater or lesser extent the same patterns can be found in all commodities

## Chinese economy remains buoyant

- GDP growth in Q2 2005 of **9.5%**
- Industrial production growth in August 2005 of **16.0%**
- Fixed Asset Investment growth in August 2005 of **27.4%**



Source: National Bureau of Statistics of China

## Urbanisation of China fuels construction growth

- Market fears of slowdown appear unfounded
- Shakeout of “speculative” developers earlier this year lead to lower growth
- Return of high growth rates in construction activity and steel consumption
- Chinese stainless steel consumption thought to grow at an average of 9% pa for next decade
- Not just in China – 2005 first year in history that more people live in cities than rural area

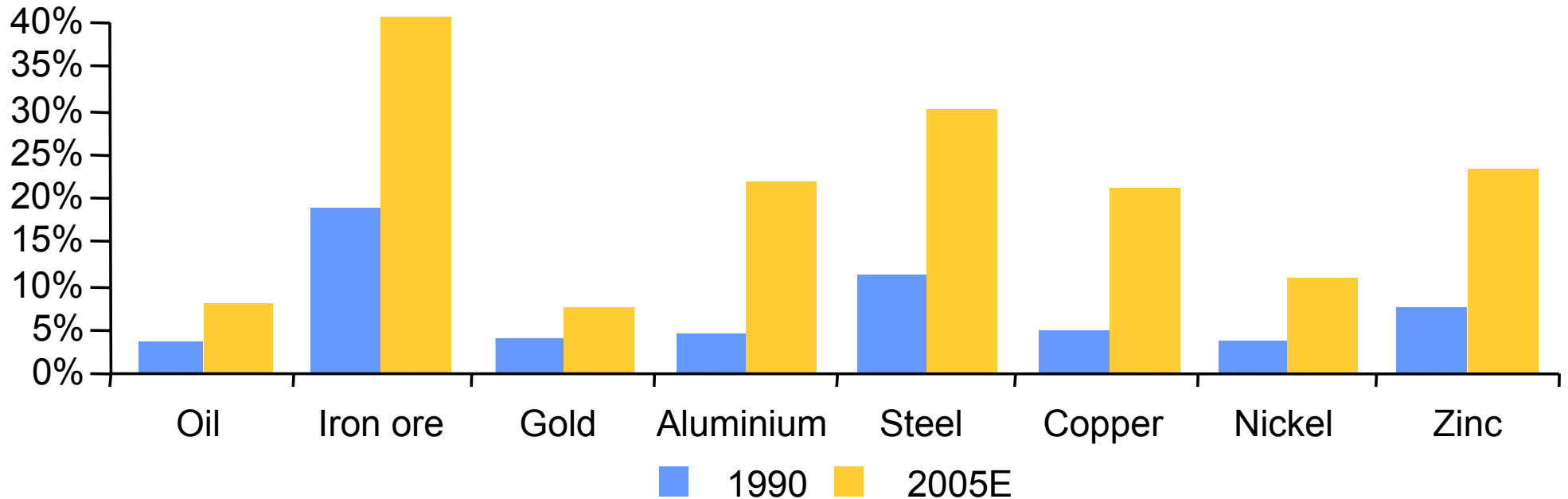


Source: BHP Billiton, UBS, September 2005

## Demand

- Industrialisation and urbanisation of China is having a huge effect on the commodities markets
- China is fast becoming the largest consumer of raw materials in the world

**China's Share of Global Demand**



Source: UBS, Chinese Customs, Datastream

## Mining Sector Consolidation

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- Company balance sheets strong, debt at all time low, cash flows at all time high
- Quality growth opportunities remain sparse
- Rising capex (machinery, labour, raw materials) deterring management from building new operations

### ***Conclusion:***

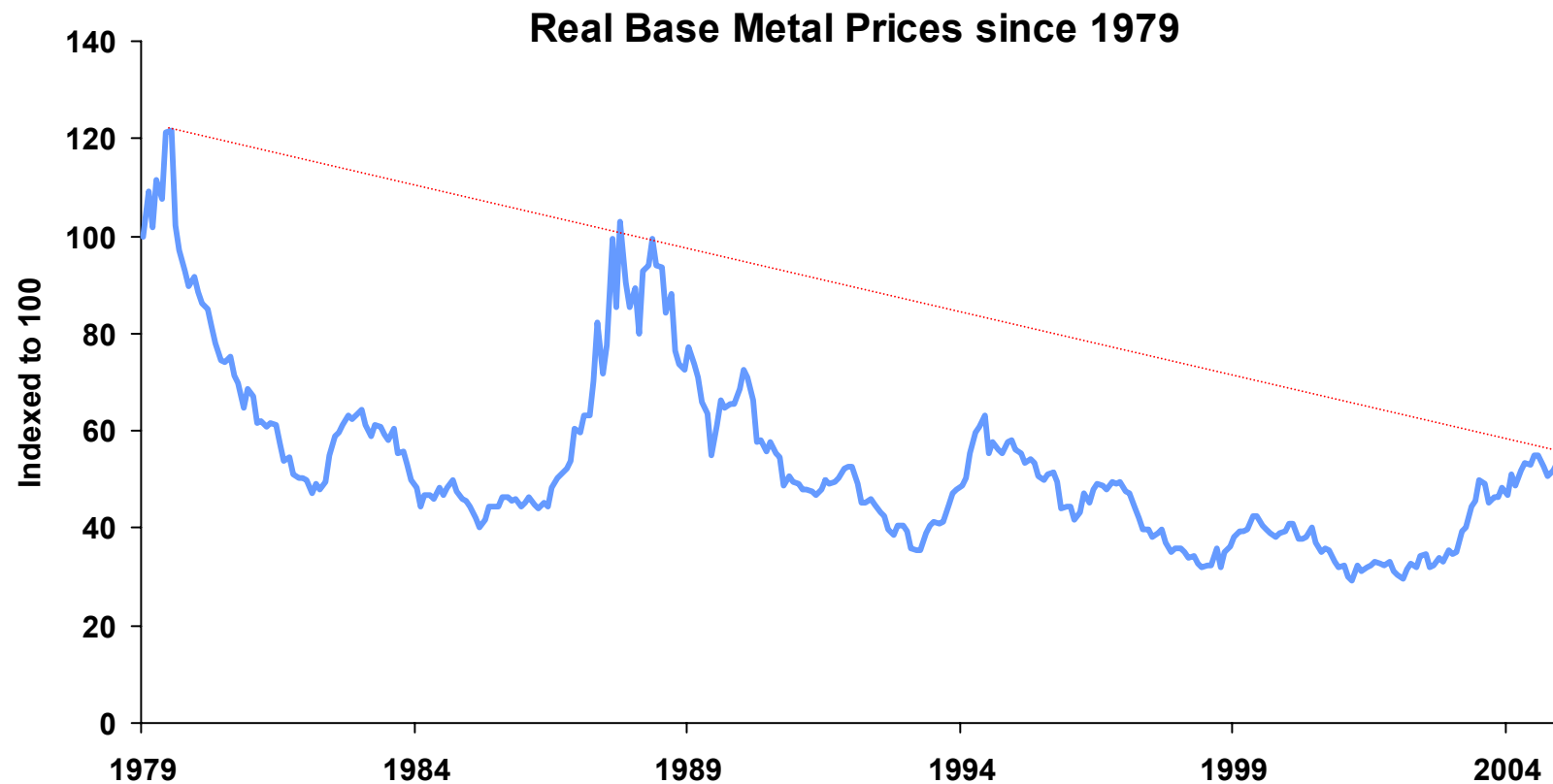
**Consolidation will continue as companies look to increase production growth cost effectively in this high commodity price environment**

e.g.

- Inco and Falconbridge (October 2005): US\$11bn
  - BHP Billiton and WMC Resources (August 2005): US\$7bn
  - Goldcorp and Wheaton River (February 2005) US\$2bn
- We believe there are still more to come...Anglo American amongst others?

## Real Base Metal Prices

- Are we experiencing a structural change in prices?
- Better capital discipline, consolidation of the industry, lack of new supply and unprecedented demand event (China) have lead to a real price increase.



Source: Datastream.

# **Portfolio Strategy & Outlook**

# Strategy

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- General Themes
  - Aggressive view on demand vs supply
    - eg China vs lack of new projects
  - Bias towards shareholder return focused management
  - Limited “pure exploration” but selective holdings in high growth juniors
  - Focus on value and commodity beta
  - Increasing emphasis on emerging new producer nations eg China, Africa, Former Soviet Union and India
- Key is to balance mix of core holdings with smaller high growth opportunities and companies with significant commodity beta
- Aim to provide exposure to global mining sector rather than just Australian mining investments



## Outlook

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- Record earnings and cash flow yet again this year
- Deficits by and large intact whilst inventories remain stubbornly low
- Change in market structure could reverse real price decline trend
- Management determined to deliver returns to shareholders
- Valuations at attractive levels
- Gold price showing potential to have major break out above US\$500oz
- Other precious metals enjoying high prices

# **GMI – The Rationale**

### Global Mining Investments Ltd

- Rationale
  - Australian resources sector has shrunk following takeovers by international companies during the last decade
  - Australian investors unable to access the opportunities outside the country
  - Not all of the best natural resources deposits are located in Australia
  - Growth in sector coming from “new” countries eg Russia, China, Zambia, India
- Portfolio objective: to exceed the return of the HSBC Global Mining Index over the medium to long term. GMI invests globally in natural resource companies, predominantly metals and mining companies.
- Launched 6<sup>th</sup> April 2004 with AUM of A\$75.2m
- Strong portfolio performance since inception; AUM now A\$120m\*, +60% since launch

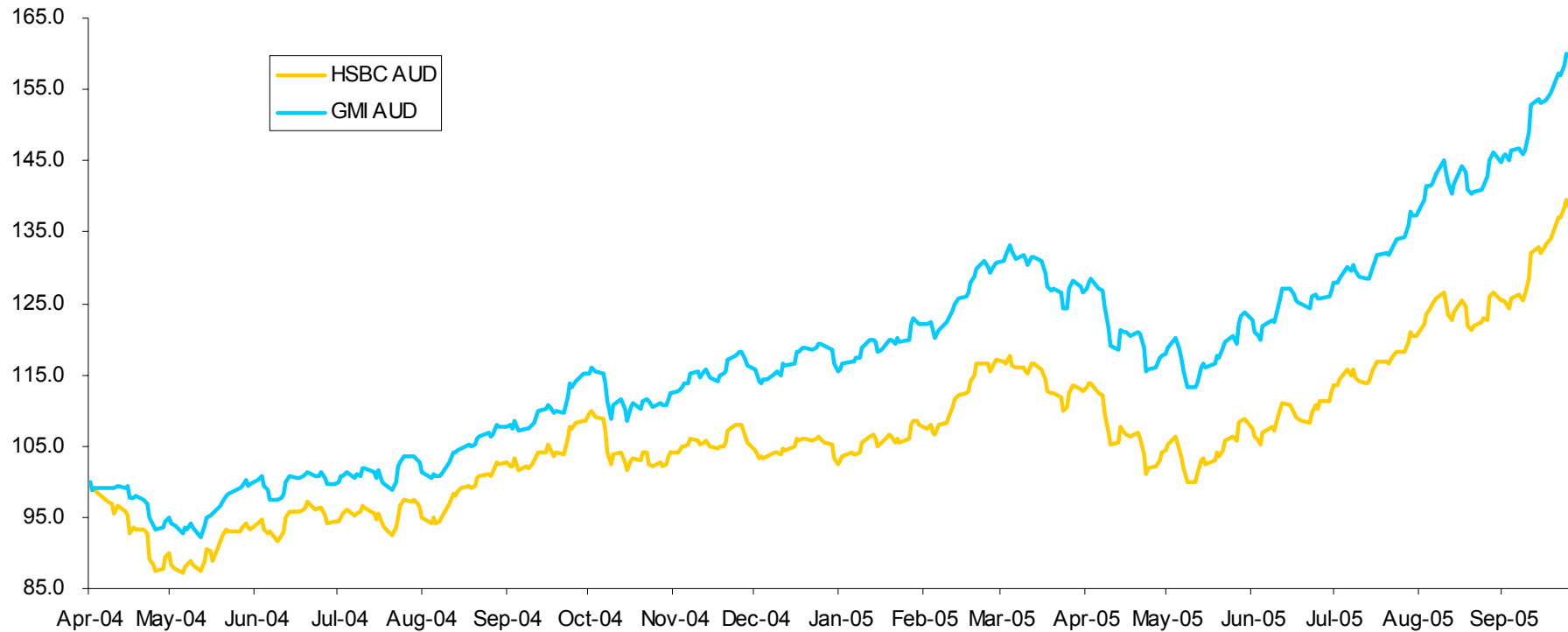
\*As at 30 September 2005

# Fund Performance

# Global Mining Investments

- At launch April 2004 AUM A\$75.2m
- As at end Sept 2005 AUM of A\$120m; +60% since inception

GMI v HSBC Global Mining Index \$A to 30 September 2005



Source: Bell Potter. Data to 30 September

## Key Performance Drivers

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- Large weighting in diversified companies key to majority of performance
- Selective exposure to individual base metals
  - e.g. copper vs. aluminium
- Excellent performance from key growth stocks
  - e.g. First Quantum (+125.3%), Eramet (76.6%), Grupo Mexico (+72.4%), Zijin Mining (+71.3%), Oxiana (+61.5%), Aur Resources (+54.9%)\*
- Corporate activity within sector
  - BHP Billiton & Xstrata battle for WMC Resources
  - Noranda bid for Falconbridge
  - Xstrata & Inco battle for Falconbridge

\*Share performance in A\$, 30/06/04 to 30/09/05. Source: Datastream

## Top 10 Holdings

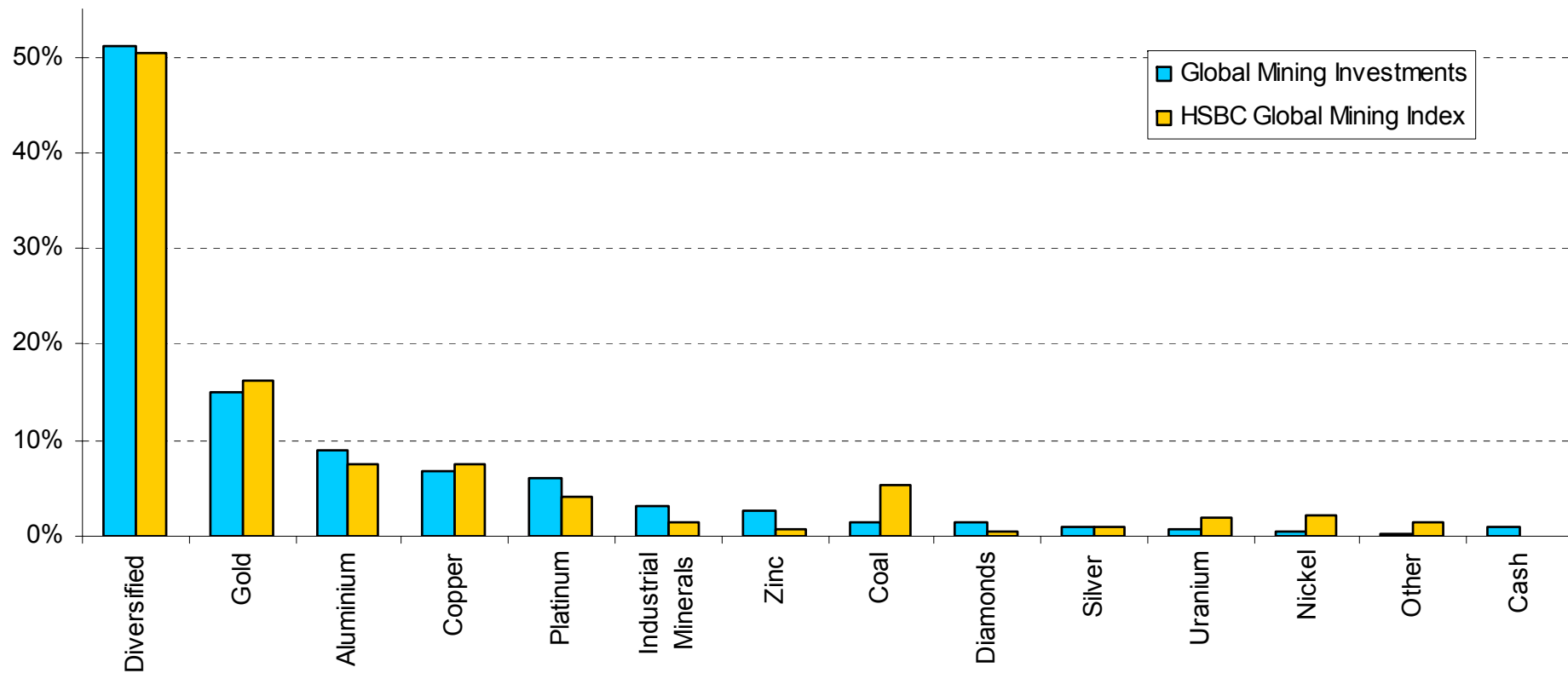
Description	% of Portfolio	Geography	Commodity
1 CVRD	10.6	Brazil	Diversified
2 BHP Limited	9.1	Global	Diversified
3 Rio Tinto Plc	8.3	Global	Diversified
4 Xstrata Plc	5.7	Global	Diversified
5 Impala Platinum Holdings Limited	5.3	South Africa	Platinum
6 Falconbridge Limited	4.8	Nth America	Nickel
7 Anglo American Inc	4.6	Global	Diversified
8 Minas Buenaventura	4.5	Peru	Gold
9 Alumina Limited	3.9	Australia	Alumina
10 Teck Cominco Limited	2.9	Nth America	Diversified
<b>Total:</b>	<b>59.6</b>		

**59.7**

Source: Internal as at end September 2005

# GMI Ltd - Asset Allocation

GMI v HSBC Global Mining Index Commodity Allocation September 2005



Source: Internal as at 30 September 2005



