Pengana Global Resources Fund – Stock Insights

SOUTHERN COPPER CORP: (SCCO-US)

IDEA GENERATION

Southern Copper Corporation produces 4% of total world copper mine production from four major open pit mines located in the Americas. Its production assets are extremely long life comprising the world's largest mineral reserves. A subsidiary of Grupo Mexico, it is headquartered in Phoenix, Arizona, and listed on the New York Stock Exchange.

Our view of copper in the medium term is positive based on its broad industrial demand and an ongoing market supply/demand deficit due to declining world mine production as a result of a "structural" shift downward in average copper ore grades by the major producers.

Southern Copper has some distinct advantages compared to other major copper producers; it is integrated between mine and smelter, retaining both the benefit of smelting and refining charges, and by-products molybdenum, silver and zinc revenues and margins. It is also a significant growth company, nearing completion of a five year major expansion (87%), in copper production capacity together with replacement and modernization of its downstream operations. Southern Copper's All-In Sustaining cost of production, including by-products, is around $US1.40 per pound. This operating cost, and the return on capital, will be even more competitive once the expansion is completed.

EOG RESOURCES INC: (EOG-US)

IDEA GENERATION

EOG Resources is one of the largest independent crude oil and natural gas companies in the United States with proven reserves in the United States, Canada, Trinidad, the United Kingdom and China. However, it is has been the company's ability to gain first mover advantage in strategic shale basins in the United States that has seen the company grow production and earnings strongly.

SCREENING

EOG Resources was a standout in our screening process on a number of metrics. The company has peer leading Return on Equity and Return on Capital Employed, a conservative level of gearing and has achieved strong earnings growth – importantly beating consensus expectations regularly.

RESEARCH

The ability of the company to grow its drilling inventory strongly whilst at the same time improve its returns through a combination of increased output and higher margin output – a switch in product mix favouring more crude oil and liquids was a unique combination. Furthermore, the improvements in well completion technology, buoying up of the business through utilising the company's owned crude by rail infrastructure as well as containing costs through self-sourced sands placed it in a very strong position. This position has been further enhanced by continued balance sheet discipline and a commitment to managing growth within the company's means.

BOLIDEN AB: (BOL-SE)

IDEA GENERATION

Boliden is an integrated mining and metal company with assets in Sweden, Finland, Norway and Ireland. The company's key commodity exposures are zinc and copper; other metals include lead, gold and silver .Boliden is divided into two divisions: mining and smelting, with the majority of smelting income generated by processing third-party concentrates, so earnings are affected by changes in copper and zinc total costs.

In a moderate growth environment the Fund is favourably biased to commodities that are supported by supply constraint and companies that are able to grow earnings through volumes growth and cost control. A long term underinvestment in the zinc industry has culminated in significant mine exhaustion with a lack of new projects to supplant lost production. Ultimately, higher zinc prices will be required to incentivise new production.

SCREENING

Globally, there is simply a dearth of pure play zinc exposure. While many of the large diversified mining companies operate zinc assets, the contribution from these assets is drowned out by larger commodity exposures. Boliden AB, listed in Sweden screened as the best listed zinc exposure in terms of balance sheet strength and earnings outlook.

February 2015

SOUTHERN COPPER CORPORATION

eog resources

NEW BOLIDEN

SCREENING

Southern Copper is well ranked on most key financials with 5 Yr. Avg. EBITDA margins of 49% and Return on Equity of nearly 40%. Gearing is toward the upper end of its peer group reflecting the end phase of its major expansion program; gearing will reduce significantly in the next 2 years along with a sharp improvement in free cash flow and dividends, independent of any improvement in copper prices. The company's organic growth profile is also very EPS accretive in the next 2 years.

RESEARCH

With a low free float and institutional holding, Southern Copper tends to be "under-researched" in the market and has provided an advantage for Pengana to research its own insights into this large, relatively complex global copper producer.

VALUATION

On most key valuation ratios, Southern Copper has been toward the upper end of its peer group due to its 5 year investment in growth capital. On a prospective 2 year view, due to its strong organic growth, the company is trading 18% below its US$35.90/share value

MARKET SUPPORT OVERLAY

Weaker than expected global growth could delay the forecast recovery in copper price.

PORTFOLIO CONSTRUCTION

Southern Copper is a key non-ASX stock in our portfolio with a target 3% weighting to the copper sector.

VALUATION

When the Fund's original position in EOG Resources was established the base case NPV for the company was a value of US$153/share. EOG Resources was initially bought by the Fund at US$119/share, with 28% upside to our base case valuation of US$153/share.

MARKET SUPPORT OVERLAY

Weaker than expected global growth and growing inventories of crude oil and natural gas in particular could lead to lower prices received.

PORTFOLIO CONSTRUCTION

The company has been our standout US shale producer given the company has successfully executed its focussed business plan and been able to exploit its first mover advantage in gaining large positions to high returning onshore Basins in the United States. This position has been further enhanced by industry leading productivity improvements and a favourable switch in product mix. The company has been a mainstay of our oil and gas exposure for a number of years. However, we recently pared back our position in light of the share price continuing to gain despite a sharp retreat in oil price over the past 6 months. We currently hold a 2.9% position in EOG Resources within the portfolio.

RESEARCH

While the near-term outlook for many commodities is challenging, the medium-term prospects for Boliden's key commodities, zinc and copper remain robust. Moreover, strong forecast volume growth (25% copper equivalent growth 2014-17) funded by free cash-flow and existing debt facilities will help deliver efficiencies to drive unit cost 20% lower over this period. With growth capital peaking, aided by low Eurozone inflation and a favourable currency tailwind, higher production and lower costs, free cash-flow and dividends are anticipated to markedly improve 2015/16E. Boliden's smelting exposure performed well in the face of a sharp decline in metal prices and is forecast to continue to improve offering a more defensive exposure versus non-integrated mining peers.

VALUATION

Boliden is presently trading 0.77x Price/Net Present Value, 10x, 2015 Price Earnings Ratio and 5x EV/EBITDA, with limited downside risk at spot. On base case the stock is valued at Swedish Krona173/share.

MARKET SUPPORT OVERLAY

Weaker than expected global growth could delay the recovery in zinc and copper prices

PORTFOLIO CONSTRUCTION

An undervalued company offering both operating leverage and exposure to a preferred commodity the portfolio was under represented in. The portfolio has low relative and absolute exposure to Euo-area currencies. Boliden is presently a 3% long holding in the Fund

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