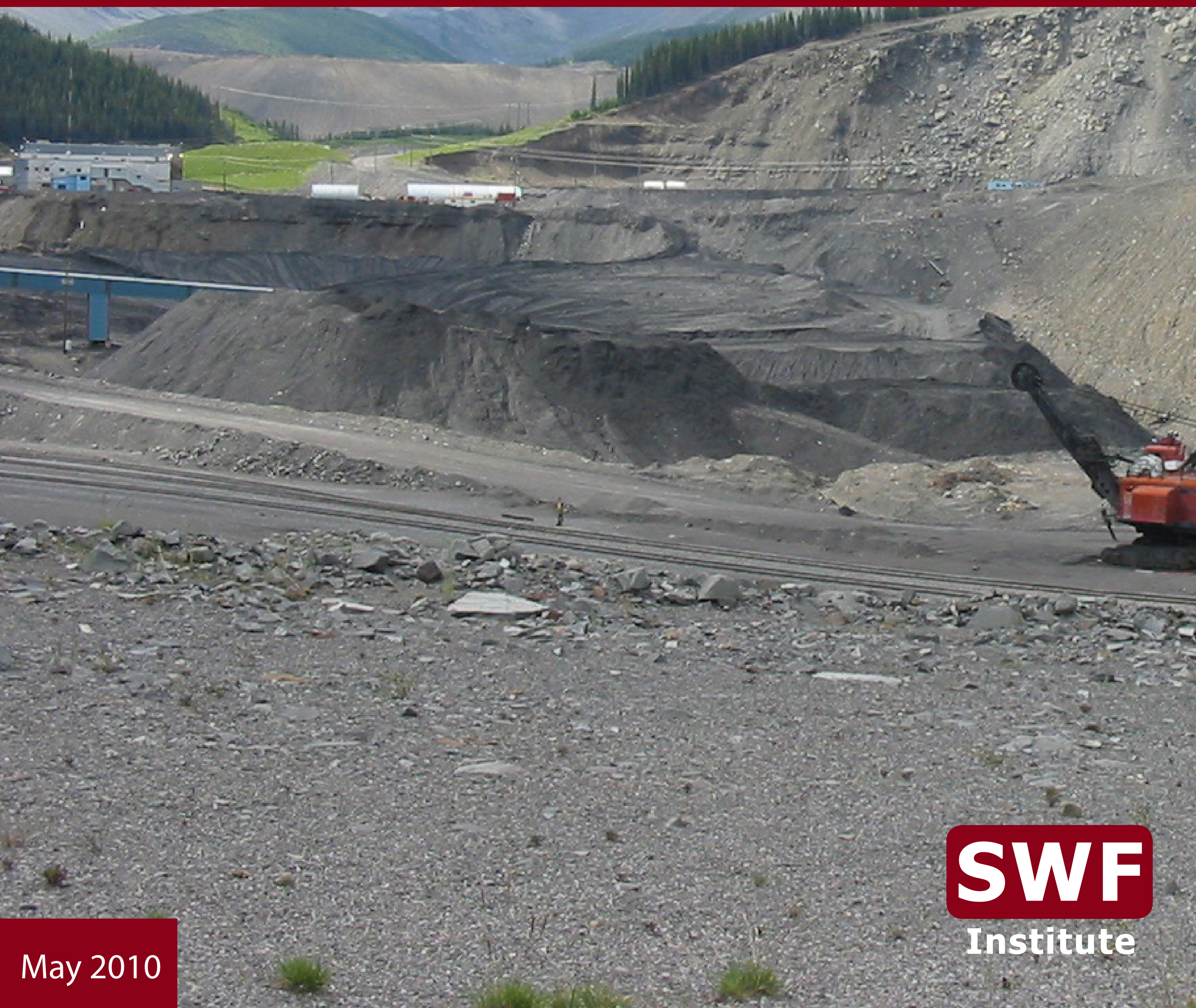
Investment Themes:

Non-Commodity Sovereign Funds continue to invest in Resource & Mining Firms



May 2010

SWF Institute

"A Commitment to Providing Un-Biased Reasearch on Sovereign Wealth Funds"

SWF

Institute

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Why invest in mining and metals?

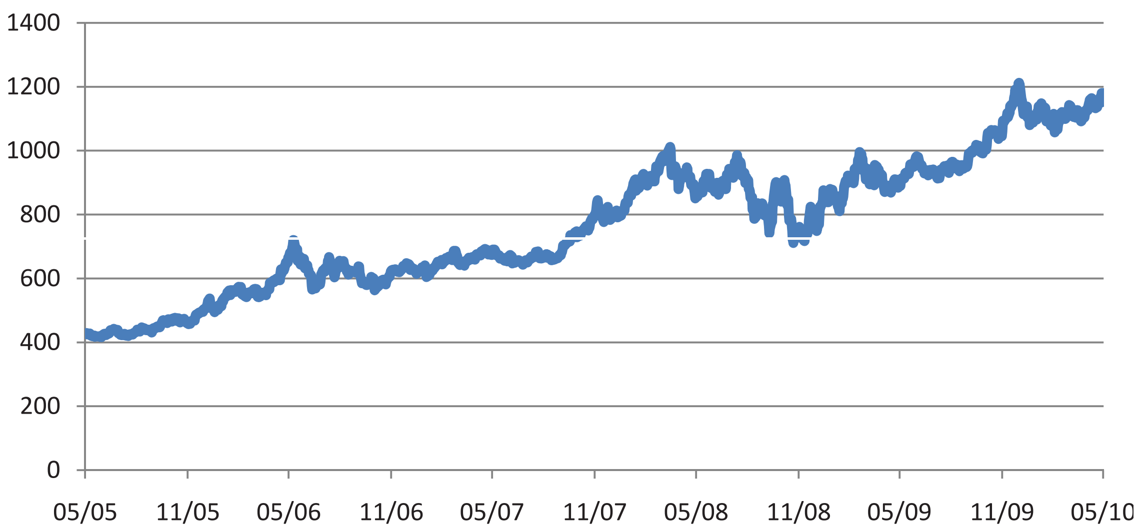
Late 2008, capital expenditures in the mining industry slowed down to preserve capital and wait for commodity prices to rebound. Mining exploration firms were in need of cash infusions for various reasons such as servicing debt to pay for past M&A transactions. However later in 2009, as the credit economy began to slowly thaw, a yearning demand from India, China, and other rapidly developing economies created the stage for more commodity consumption. Zinc, platinum, iron, and gold were in demand, especially with the onset of commodity based exchange traded funds (ETFs) and more institutional investors playing in the commodity space. Mining companies began the call for capital to augment investment in mineral deposits in the Americas, Southern Africa, and Northern Asia. Mineral rights were obtained and firms began to consolidate geographic holdings and projects. The outlook for the resource sectors has been looking positive in 2010. More importantly, a number of sovereign wealth funds continue to search for mining firms with resilient free cash flow, less than average political risk, attractive mining prospects, and the ability to develop strategic ties. SWFs want direct exposure to commodity producers selling to China and India.

Where is the capital coming from?

The commodity urge was there in 2009 but financing availability still cumbersome. Banks, hedge funds, high net worth investors, and other lenders were battered and tattered from the fallout of 2008. The cost of money was expensive for many resource companies, in addition the equity value of mining companies were unattractive at the time for most investors. Sovereign wealth funds were cautiously optimistic in jumping into another sector, especially when a number of SWFs had large paper losses financials. Sophisticated investors understand that mining and exploration is a high risk business and is often fraught with project, profitability, and political risk.

Sovereign investors have always had a slight eye on commodities, even before the financial melt down. Traditionally the oil based sovereign wealth funds such as the Kuwait Investment Authority, Abu Dhabi Funds, and Libya who have a deep history in commodities invest in mining, but we have seen non-commodity SWFs enter into the mix. Our hypothesis is that several non-commodity SWFs come from countries that are growing and need access to commodities to further their expansion and achieve economic objectives. In addition, many non-commodity SWFs want to diversify, just like any other institutional investor. Strategically, non-commodity SWFs can benefit from investing in mining and resource companies. Whether the governmental investor is China or India, they will continually need raw input for growth, or Singapore, looking to diversify from traditional sectors, demand will continue for eye-catching resource companies. Mining and resource firms accept sovereign wealth funds, since they see them as a stable and strategic source of capital with longer investment horizons.

5 Year Price History of Gold Bullion US$ / Troy Ounce



Source: London Bullion Market

Temasek Holdings has been planning for years to diversify, even going out and hiring Chip W. Goodyear, a former executive at BHP Billiton, to spearhead a commodity acquisition binge. Mr. Goodyear eventually left for other reasons, but it did not stop Temasek Holdings in their pursuit of resource firms. Temasek invested in Inmet Minings and Platmin, both Canadian mining firms, with operations worldwide. Platmin has extensive operations in the Bushveld complex in South Africa. Sovereign investors began to make tactical acquisitions beginning mostly in 2008 in the mining sectors. SWFs began to recruit and strengthen their investment staff with commodity experts and hire investment consultants with such expertise and experience. We even saw the China Investment Corporation take calculated opportunities in investing in Teck Resources, a Canadian mining firm, and mining firms in its northern neighbor, Mongolia. Teck Resources perceived the China Investment Corporation as a strategic investor, since China is the most prevalent consumer of Teck's seabome coking coal.

Gold Industry Financial Data (Aggregated Data)

	Gross - Property Plant and Equipment		Net Sales		Total Debt Outstanding	
	Annual Growth	Billions USD	Annual Growth	Billions USD	Annual Growth	Billions USD
2004	41.4%	125.92	16.9%	17.13	78.6%	7.93
2005	21.0%	110.60	12.1%	19.21	25.3%	9.94
2006	56.3%	80.14	39.2%	26.74	42.9%	14.20
2007	38.0%	51.29	27.7%	34.16	26.4%	17.94
2008	13.9%	42.38	28.1%	43.77	2.7%	18.43
2009	12.1%	29.97	17.9%	51.60	19.3%	21.97

[1] Companies must be listed
[2] 105 Listed companies used in the aggregate study
[3] Listed companies must have had over US$10 million in LTM Sales (May 2010) to qualify in the aggregate study
[4] Financial data observed by fiscal year

Source: Sovereign Wealth Fund Institute

Risk and Returns

Taking a macro perspective, sovereign wealth funds invest in all types of investment vehicles in the mining and resource sectors. We observed the China Investment Corporation multiply their holdings in the SPDR Gold ETF. We have also seen funds hire commodity trading advisors. This white paper is about non-commodity sovereign wealth funds investing in mining and resource firms by taking direct stakes.

Listed mining company returns are more closely correlated to the stock market, than investing in raw commodities through forward or futures contact. Investors take on idiosyncratic risk and bear tremendous business risk. On the other hand, the returns can be quite high with these concentrated positions, especially if they are set up advantageously to the investor. Placing funds in mining firms carries substantial risk and institutional investors comprehend this. Economic extraction of minerals from deposits can fail due to operational, environmental, and political risk. Many of these mining activities are in countries with emerging, or even limited democracy. Fluctuations in commodity prices, interest rates, and currency deeply affect the profitability of these mining operations.

Besides returns, sovereign funds can benefit from investing directly into mining and resource companies. Externalities such as a relationship being developed between the home country of the SWF and the mining company can be beneficial to both parties. Granted Singapore itself might not have much use for zinc investments, but immense production powerhouses like China certainly do. Investing in resource firms in emerging economies also opens foreign government's access to raw materials. For instance, Mongolia, which has been a rural country, is now developing thanks to its widespread mineral deposits, in coal, copper, gold, and uranium. Since 2005, GDP growth in Mongolia has averaged around 7.24%. The Ovoot Tolgoi coal mine has been selling coal to the Chinese. Furthermore, the China Investment Corporation is helping it mine the resources faster, by providing capital to SouthGobi Energy Resources Ltd.

Direct stake deal structures

Deal structures can vary when sovereign wealth funds or sovereign wealth enterprises invest directly in commodity mining companies. It greatly depends on the type of exposure, liquidity, and risk return profile the investor wants. Sometimes the institutional investor will purchase the listed equities on the open market, other times, if the sovereign fund wants a significant stake it will undergo investing in a private placement. Around late 2008/early 2009, SAFE Investment Company, a part of the Chinese State Adminstration of Foreign Exchange, purchased around $272 million worth of Anglo American Plc. If a private placement is involved, how much of a discount will the price be and what effect will it have on current shareholders? Does the firm have the capacity to execute and drive shareholder value, are the company fundamentals solid? Sometimes sovereign funds will require provisions to protect their investments. This could lead to structuring more investments as convertible securities, than common equity. If the investment in the firm is structured as a convertible debenture, basically meaning not asset backed, conversion price, rights offerings, board representation, and higher coupon payment terms will be favored towards the SWF. Sovereign investors feel that convertible debt is useful, since it helps protect the SWF investment and allows them a higher claim on assets with a coupon component. In addition, a large majority of convertible debt in these deals, the parties agree to a fixed conversion price. This can be detrimental for the SWF, we have seen this with the Abu Dhabi Investment Authority's large loss with Citigroup, which is currently being disputed. The Abu Dhabi Investment Authority is forced to convert the Citigroup security at a fixed price. One way around this is to let SWFs back out of a convertible deal, if the investor does not want to convert by a specified date. We viewed this in Temasek's deal with Platmin. Temasek placed money in convertible debentures, with a right to leave, if Temasek does not fully convert by the maturity date. Some SWFs will invest in mandatory conversions like the ADIA/Citigroup convertible debt deal, but there must be fundamentally sound assurances the company will continue to grow and be able to service a higher payout Ultimately, listed companies with a greater story to tell with experienced management teams will usually be able to do a raise in common equity. For many reasons, sovereign wealth funds will create sovereign wealth enterprises, which is a sovereign investment vehicle that is owned and controlled by a sovereign wealth fund. The Qatar Investment Authority has a famous SWE called Qatar Holding, LLC, the China Investment Corporation has a SWE called Fullbloom Investment Corporation. Transparency, political, and legal reasons are why many SWFs create these types of entities.

Sovereign deal sizes can vary; usually open market purchases are less than $40 million dollars and are bought over a period of time to prevent spikes in prices. Private placements on the other hand can vary from as low as $4 million to as high as around $ 2 billion. The China Investment Corporation through a SWE invested in PT Bumi Resources Tbk, an Indonesian resource company, for around $1.9 billion in a debt-like instrument. Lastly, many SWFs can include what we call kickers. For instance, when Temasek Holdings placed money with Inmet Holdings, the kicker was that the money is being held in escrow. The funds were held pending changes to Panama's legislation to allow foreign government bodies to own equity in its mineral resources. If Panama's Mineral Resources code is not changed by September 30, 2010, the funds plus interest will be return in Temasek Holding's sovereign wealth enterprise, Ellington.

Top Diversified Metals & Mining by Market Capitalization

Data in US Billions
Market Data as of May 6, 2010

	Listed Company	Market Cap	Total Debt FY 2009	Cash FY 2009	Country	Sub Industries
1	Bhp Billiton Ltd	114.48	17.27	11.60	Australia	Diversified Metals & Mining
2	Rio Tinto	71.65	24.02	4.93	UK	Diversified Metals & Mining
3	Anglo American	50.74	14.32	3.27	UK	Diversified Metals & Mining
4	Barrick Gold Corp	42.27	6.34	2.78	Canada	Gold
5	Goldcorp Inc New	31.29	0.74	0.90	Canada	Gold
6	Freeport-Mcmoran Copper & Gold	29.44	6.35	2.66	US	Diversified Metals & Mining
7	Newmont Mining Corp	26.30	4.81	3.27	US	Gold
8	Anglo Platinum Ltd	24.95	3.11	0.38	South Africa	Precious Metals & Minerals
9	Southern Copper Corp	23.62	1.28	0.80	US	Diversified Metals & Mining
10	Teck Resources Ltd	21.14	7.63	1.27	US	Diversified Metals & Mining
11	Eurasian Natural	20.15	0.43	0.88	UK	Diversified Metals & Mining
12	Gpo Mexico Sa	18.55	3.42	1.36	Mexico	Diversified Metals & Mining
13	Impala Platinum	16.07	0.27	0.44	South Africa	Precious Metals & Minerals
14	Anglogold Ashanti	14.80	1.95	1.11	South Africa	Gold
15	Newcrest Mining	13.61	0.36	0.30	Australia	Gold
16	Antofagasta	13.09	1.63	3.22	UK	Diversified Metals & Mining
17	Kinross Gold Corp	12.35	0.69	0.63	Canada	Gold
18	Kazakhmys	9.82	1.65	0.96	UK	Diversified Metals & Mining
19	Agnico Eagle Mines Ltd	9.74	0.73	0.28	Canada	Gold
20	Vedanta Resources	9.63	5.11	4.99	UK	Diversified Metals & Mining
21	Gold Fields Ltd New	9.19	1.11	0.40	South Africa	Gold
22	Fresnillo Plc	8.80	na	0.31	UK	Precious Metals & Minerals
23	Soc Min Cerro Verd	8.58	0.00	0.20	Peru	Diversified Metals & Mining
24	Eldorado Gold Corp New	8.42	0.19	0.28	Canada	Gold
25	Lihir Gold Ltd	8.29	0.05	0.47	Papua New Guinea	Gold
26	Sumitomo Metal Mng	8.17	2.21	1.52	Japan	Diversified Metals & Mining
27	Eramet	8.01	0.39	1.88	France	Diversified Metals & Mining
28	Inds Penoles Sab D	7.76	0.47	0.91	Mexico	Precious Metals & Minerals
29	Shandong Gold Mine	7.74	0.31	0.06	China	Gold
30	Yamana Gold Inc	7.72	0.53	0.18	Canada	Gold
31	Randgold Resources	7.62	0.00	0.61	Jersey	Gold
32	Zhongjin Gold Co	7.06	0.79	0.29	China	Gold
33	Jinduicheng Molybd	6.94	0.01	1.11	China	Diversified Metals & Mining
34	Iamgold Corp	6.56	0.01	0.23	Canada	Gold
35	Ivanhoe Mines Ltd	6.42	0.98	0.98	Canada	Diversified Metals & Mining
36	Silver Wheaton Corp	6.42	0.50	0.23	Canada	Precious Metals & Minerals
37	Kghm Polska Miedz	6.30	0.23	0.51	Poland	Diversified Metals & Mining
38	First Quantum Minerals Ltd	5.64	0.63	0.92	Canada	Diversified Metals & Mining
39	Red Back Mng Inc	5.61	0.00	0.15	Canada	Gold
40	Exxaro Resources	5.39	0.65	0.14	South Africa	Diversified Metals & Mining
41	Saudi Arabian Mini	5.17	2.34	3.08	Saudi Arabia	Diversified Metals & Mining
42	Lonmin	5.04	0.41	0.28	UK	Precious Metals & Minerals
43	Afrn Rainbow Minls	5.01	0.48	0.44	South Africa	Diversified Metals & Mining
44	Intl Nickel Indone	4.89	0.15	0.26	Indonesia	Diversified Metals & Mining
45	Im Baotou Steel Ra	4.65	0.36	0.22	China	Diversified Metals & Mining
46	Harmony Gold Mng	4.08	0.05	0.25	South Africa	Gold
47	Yunnan Copper Indu	4.06	2.50	0.39	China	Diversified Metals & Mining
48	Western Mining Co.	4.06	na	na	China	Diversified Metals & Mining
49	Walter Energy Inc	3.89	0.16	0.17	US	Diversified Metals & Mining
50	Mitsubishi Materls	3.78	7.15	1.00	Japan	Diversified Metals & Mining

Source: Sovereign Wealth Fund Institute, Reuters

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