

## *Commodities Priced for the Future?*



The recent drop in commodities prices is a warning that despite all the hype about consumption growth commodity prices are cyclical.

At this stage it is just a warning, but increased exploration and development expenditure will result in production catching up with demand (as a rule Malthus is wrong).

The growth in industrial demand for construction materials which started to rise suddenly from the early 2000's and rose far more quickly than supply could respond to resulted in very substantial increases in commodity prices.

For decades resource companies underinvested in exploration and development limiting new projects and constraining supply to meet the growing demand. Management teams and expertise required to bring projects on had also been laid fallow.

These price rises have resulted in massive increases in profitability for resource companies and in turn massive increases in exploration and development budgets over the last 10 years. For instance in 2000, BHP's earnings were \$1.7 billion and their capital expenditure was approximately the same. Compare that with profits of just under \$13 billion and capital expenditure of nearly \$11 billion in 2010. Supply will inevitably increase as new billion dollar plus projects come into production.

Next year alone, BHP will invest \$15 billion and RIO some \$11 billion to fuel future production. It is difficult to predict when exactly supply will catch up with demand but at current commodity prices the margin over cost of production is so large that there is significant downside in prices when this does occur (or rather when it becomes apparent).

For large resource stocks prices are generally a far bigger driver of profitability than volumes. Stock levels (the number of days of stock held for the annualised consumption) reached extremely low levels in the period 2005-08 but have been trending upwards for some time.

We are comfortable with the notion that volumes of iron ore, copper, coal etc will continue to rise but commodity prices are in our view unlikely to be maintained indefinitely.

One can argue that demand will remain strong in emerging economies and economic growth is returning to the US and in a more modest way to Europe. This is a plausible argument but commodity demand can keep on growing long after the prices have peaked.

Another aspect is the explosion of speculative activity. The financial crisis has dented confidence in financial assets and increased the demand for physical assets including commodities as evidenced by the large open positions on commodity exchanges.

For those of a cynical nature the partial sale of the giant commodities trader Glencore (the Summo sized baby of legendary trader Marc Rich) could be an indicator that we are well into the second half of the game.

- Hugh MacNally, Director

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## *Sugar on the Move*

As Asia's incomes have increased so too has their appetite for a sugary diet. Since over 90% of the sugar grown in Australia is exported, the industry is highly strategic for an agribusiness with customers in Asia. It therefore comes as little surprise that change is afoot in the Australian sugar industry. We have participated in the consolidation by owning shares in Maryborough Sugar.

The Australian sugar landscape is in the midst of a shake up. Historically the industry was divided into sugarcane growers, millers, and marketers. However, the sale of CSR sugar to Wilmar (Asia's leading agribusiness group based in Singapore) signalled the entry of multinationals and the commencement of consolidation.

Mitr Pohl (a Thailand based agribusiness company) owns about 19% of Maryborough Sugar, and Bunge (a US based agribusiness with a large Asian base) launched a bid for Tully Sugar. They intend to consolidate the sector, starting with the sugar millers followed by the marketers. We believe Mitr Pohl will bid for Maryborough and most likely before the end of the year.

A prudent way of playing this industry consolidation is through ownership of a sugarcane miller as milling is the production and ultimately marketing constraint. Maryborough has a unique position as the only ASX listed sugar miller providing an exclusive point of exposure to this investment theme. Further, the company is well managed, has a solid balance sheet, and has a large foreign cornerstone shareholder, who we believe has grander intentions of owning the whole business.

- Elton Doyle, Director

## *Apple Tops Brand Stakes*

Technology companies have affirmed their position as the driving force in Western economies as a recent report highlights the growing value of their brands.

The report released last week by brand consultancy Millward Brown says Apple is now the world's most valuable brand, worth a staggering US \$153 billion: an increase of 84% over the last year and enough to narrowly edge out second place Google and third place IBM. This means the value of Apple's brand alone is roughly equal to 10% of the sum total of all Australian listed companies.

Six of the top ten global brands are now technology companies and American companies continue to dominate the brand stakes with nine of the top ten brands headquartered in the USA.

The largest increase in brand value came from Facebook, whose value increased 246% to just over US \$19 billion. The Chinese search engine provider Baidu also posted impressive growth with a brand value now at US \$22 billion, a stellar 141% increase.

China's ever growing economic influence is evident in other areas as well, with a number of new debuts and China Mobile earning a place with the world's elite brands at number nine.

Somewhat disappointingly, there were no Australian brands among the top 100 globally. Perhaps indicative of our resources fuelled economy or a lack of focus by local big brands like Telstra, the big four banks and Qantas. Qantas' exclusion is justifiable as the airline industry broadly continues to struggle and no airlines were represented within the top 100. Telstra and the big four banks can only point to their regional nature as rationale for exclusion.

- Kris Vogelsong, Corporate Development

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