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STRATEGIES FOR SUCCESSFUL INVESTING

## STRATEGY

*Foreign investors choose Canadian small caps to...*

# PARTNER FOR PROFIT

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CANADIAN SMALL CAP RESOURCE stocks provide compelling investment opportunities and can play a significant role in enhancing a diversified portfolio.

Before I expand on Canadian small caps, let me step back and highlight why Canada is still one of the globe's hottest spots for investors in natural resources.

Canada has the advantage of an abundance of natural resources but also a long legacy of resource discovery and development. It has a strong record of entrepreneurial spirit in the resource sector with prolific discoveries in base metals, gold, diamonds, potash, and oil and gas.



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According to Natural Resources Canada, this country has been the number one destination for exploration investment in 16 of the past 30 years and it is among the top five countries for exploration in 15 minerals and metals.

A continuing theme in resource investing is the bigger role that government-sponsored entities play in providing capital. This comes in the form of both strategic investments and acquisitions.

Government-owned entities have several advantages over private capital for investment purposes – cost of capital, large financial resources and an extremely long-term investment horizon.

Take China for example; as it continues its booming growth rate and urbanization, it is actively investing and acquiring resource assets in Canada. China needs a secure supply of raw materials to continue industrialization in order

to maintain its rapid rate of growth, particularly copper, oil, and iron ore.

China consumes 30 per cent of the global supply of copper. It imports 50 per cent of the oil it uses, and it imports 70 per cent of its iron ore consumption.

Also, China is the largest holder of U.S. treasury securities. As it diversifies its exposure to the U.S. dollar, it is accumulating hard assets such as mining concessions and direct investments in foreign companies. With our stable currency and transparent capital markets, Canada makes a good partner.

A recent transaction that illustrates the trend towards foreign investment in Canadian resources is PetroChina's \$1.9 billion investment in Canada's oil sands.

In August 2009, PetroChina, China's largest energy company, acquired a 60 per cent stake in Athabasca Oil Sands' MacKay River and Dover oil sands projects in Alberta.

China is now one of largest automobile markets in the world. It already imports 50 per cent of its oil, and with strong growth in car ownership, China needs to secure its oil supply.

PetroChina's investment provides development financing in exchange for an oil asset that will continue producing for decades, making the partnership attractive for both parties.

Another example is the Korea

Gas natural gas deal with EnCana.

Korea Gas is the world's largest importer of liquid natural gas (LNG) since South Korea has no domestic gas production.

In February 2010, Korea Gas Corporation announced a deal to spend \$1.1 billion for a 50 per cent stake in a set of EnCana's natural gas fields in British Columbia. Production is expected to begin by 2017 and to continue for about 40 years.

Korea Gas is also involved in the development of a proposed LNG export facility in Kitimat, British Columbia and has agreed to take up to 40 per cent of its LNG production.

As well as having raw natural resources, we also need a sophisticated and vibrant capital market system that can develop these projects and turn them into final products.

The Toronto Stock Exchange, or TSX, (the second largest exchange by listed companies in the world) has the know-how to support small to medium-sized companies in both the energy and mining sectors.

The TSX's smaller counterpart, The TSX Venture Exchange, is the only public venture capital exchange of this size and scope in the world dedicated to micro-cap, early-stage companies.

The TSX positions itself as a gateway to North American financial markets. By listing on the Canadian exchanges, a company gains access to large and robust economies and a group of investors experienced in investing in smaller cap companies.

For these reasons, many foreign public companies list both in Canada and on their home exchanges. More than 250 inter-

national issuers list on the TSX and the TSX Venture Exchange giving Canadian investors excellent exposure to small cap companies with ventures in many different parts of the world. Many companies bring projects from abroad to the attention of Canadian investors this way.

Here are two companies we believe are well positioned to benefit from foreign investment.

**Quadra Mining Ltd.** (TSX:QUA, \$13.74).

Quadra, a Canadian corporation, is a mid-sized copper producer with its main assets in the United States and Chile. The company has signed a memorandum of understanding to form a joint venture with a subsidiary of the State Grid International Development Limited, China's largest utility company and a significant consumer of copper wire.

The joint venture is a 50/50 partnership, with State Grid purchasing a 9.9 per cent equity position in Quadra.

Quadra will contribute Franke Mine, a Chilean mine that is already in production, as well as its copper project at Sierra Gorda. In return, State Grid will fund the first \$900 million required for development at Sierra Gorda.

State Grid will lead efforts to bring debt financing to the \$2 billion project and will have the right to purchase 50 per cent of the expected 300 million pounds of annual copper output from Sierra Gorda.

Quadra is also merging with Sudbury-based company, FNX Mining. The new combined Quadra/FNX has a strong growth profile and the financial ability to fund Sierra Gorda.

**Consolidated Thompson Iron Mines** (TSX-CLM, \$8.87).

Consolidated Thompson has entered into an agreement with China's Wuhan Iron and Steel (Group) Corp. Known as WISCO, this firm has made a \$240 million strategic investment in Consolidated Thompson in return for a 19.9 per cent equity stake in the company, a 25 per cent direct interest in the company's Bloom Lake iron ore project, and the right to purchase 50 to 60 per cent of the iron ore produced over the life of the project.

When the deal was signed in March 2009, access to equity and debt capital was difficult because the stock markets were at, or near, their lows.

The partnership with WISCO allowed Consolidated Thompson access to the capital it needs to forge ahead with its development of the project. Without it, the company would have faced significant delays.

For its part, WISCO will come out of the deal with a secure future supply of iron ore.

Consolidated Thompson is expected to ship the first ore from Bloom Lake by June 2010. If it can produce at expected volumes and costs, the stock price should react positively.

Consolidated Thompson has the potential to double its overall capacity to 16 million tonnes annually in 2013. We believe that China and India's rapid growth provides a strong long-term outlook for global steel consumption – and iron ore is the major ingredient for steel makers.

## WHY SMALL CAPS?

Over the last 40 years, small caps have outperformed the

broadly-based TSX by a cumulative 43 per cent; we believe this strong performance will continue over the long term.

Why should Canadian small cap stocks be part of every investment portfolio?

53 per cent of small caps have exposure to natural resources, seven per cent more than large caps do. We are of the view that small caps supplement growth and are an excellent complement to an investor's portfolio which are typically dominated by large caps stocks.

While small caps have less exposure to energy, they are more concentrated in natural gas

stocks, which complements the greater concentration in oil among large caps.

The higher exposure of small caps to copper and gold also counterbalances the big weighting in financials among large caps. Foreign investors are playing an ever-growing role in bolstering Canada's small cap stocks. This is especially true in the resource sector, which is supported by a capital markets system designed to sustain its success.

Foreign investors can see many advantages in Canadian small caps. For all the same reasons, Canadian investors should have confidence in the role small caps can play in a

diversified portfolio. ▼

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