

Norman MacDonald dials up his energy exposure

Morningstar Insight

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08 Jul 09

Nexen's "world-class" assets lauded. Taking profits in gold stocks. Uranium giant still favoured after its huge run-up.

The long-term case for investing in commodity-related stocks geared to the industrialization of China, India and other emerging economies remains intact, says Norman MacDonald, vice-president and portfolio manager at Toronto-based Invesco Trimark Ltd.

"These economies have withstood the global recession and are growing." Against this, the supply of most commodities essential to their growth "remains constrained," says MacDonald, who assumed the lead management role of Trimark Canadian Resources at the end of May. He had been co-manager of the fund since joining the firm in late 2008.

A value manager, MacDonald's discipline is to buy companies with "good assets and good management at a substantial discount" to his estimated value of the business. He adds that there are times when a company with a strong suit of assets can trade at a discount to his estimated net asset value per share, because of investor concerns about management quality. "This can provide a buy opportunity."

His assessment of the underlying business value of a company does contain a long-term price assumption. "With the volatility in commodity prices, it is important to base your investment decision on a commodity price that you consider to be sustainable," he says.

At the end of June, Trimark Canadian Resources had assets of \$425 million and 52 names. It held sector weightings of 40.2% in oil and gas, 10.6% in oil and gas services companies, 15.4% in gold stocks, 13.3% in base metals (including uranium), 9.3% in forest products and 6.2% in cash. The foreign content in this fund is roughly 30%.

Over the past seven months, the biggest change in the portfolio has been the increase of the weighting in energy producers to around 40%, up from 28% in early December, and the reduction in the weighting in gold stocks to about 15%, from 25% at the beginning of December.

"Gold stocks had done well and were factoring in a bullion price above my long-term price estimate of US\$850 per ounce, whereas energy producers were trading at valuations that were based on an oil price that was less than my long-term price estimate of US\$55 per barrel," MacDonald says.

With his emphasis on energy producers, MacDonald established and built up a holding in Nexen Inc., which is now the largest holding in the fund at 4.4%. "This senior Canadian producer has world-class assets, principally in the UK North Sea, Western Canada, U.S. Gulf of Mexico and offshore Nigeria," MacDonald says. He notes that some 80% of Nexen's production is in oil and 20% in natural gas.

At the end of last year, Nexen's president and CEO Charlie Fischer retired and was succeeded by Marvin Romanow, who was formerly the company's chief financial officer. "The market was skeptical about this succession," says MacDonald, "and I was able to buy the stock below \$17 a share, compared to my estimated net asset value of the company of \$33 a share."

In paring back his gold holdings, MacDonald sold some stocks outright and trimmed others, including his largest gold holding IAMGOLD Corp. He kept 3% of his portfolio in the company, which has operating mines and development projects on three continents.

"Over the past seven years, management has had a tough time meeting its production targets, but it now has the assets in place to provide a more consistent production growth profile," MacDonald says.

IAMGOLD's focus is on West Africa, the Guiana Shield of South America and Quebec. Its acquisition of Orezone Resources Inc. was "a good move that greatly enhanced its West African mining interests." The company should also boost production at some of its existing mines, MacDonald says.

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An outright sale from the portfolio was Yamana Gold Inc., which has interests in South America, Central America and Mexico. "This gold stock was factoring in aggressive production growth numbers and these could prove to be overly optimistic."

The manager's largest base-metal holding is Saskatchewan-based uranium giant Cameco Corp. "I am positive on the long-term demand for uranium and nuclear power."

MacDonald participated in the company's public offering of common shares at \$17.25 a share this February. "The stock has had a huge run since, and I would not be adding aggressively to my holding at this juncture."

Cameco's problems at its Cigar Lake project in Saskatchewan have taken longer than the market anticipated to rectify, he says. "But the company is growing production at McArthur River mine and its other mines in Saskatchewan."

Its management has articulated a willingness to participate in the consolidation under way in this industry, "which could mean that Cameco will be making acquisitions." The stock trades at 23 times earnings-per-share estimates for 2009 and 13 times EPS estimates for 2010.

When it comes to the fund's forest products weighting, MacDonald says an emphasis is on timberlands. "It is a long-term call. These businesses are currently trading at a significant discount to their historical averages."

MacDonald recently added to his holding in Plum Creek Timber Co., Inc. of Seattle, Wash. This real estate investment trust is the "largest private timberland owner in the United States," and has excellent management.

Plum Creek is selling down certain assets to institutional investors such as pension funds "at a significant premium to the depressed valuation being placed on those assets by the public market," MacDonald says. The REIT is then using the proceeds to pay down its debt. Plum Creek is trading significantly below MacDonald's net asset value estimate, and its dividend yield is around 6%.

About the Author

Sonita Horvitch is a Morningstar columnist who specializes in reporting on money managers and their strategies. A veteran financial journalist, she was formerly with the National Post and its predecessor, the Financial Post. At the Post she was best known as the author of the popular Buy & Sell column, which she wrote from its inception in 1994 to December 2008. She holds a master's degree in business economics from the University of the Witwatersrand in Johannesburg, South Africa.