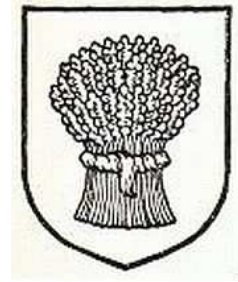


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Thinkpiece

Christopher Ecclestone
cecclestone@hallgartenco.com

A Tale of Two Cities Super-Powered or Real Estate-Powered

A Tale of Two Cities

Super-Powered or Real Estate-Powered

- + The Australian superannuation scheme system has been a great success accumulating \$1.6 trillion in slightly over a decade
- + Much of this money is self-directed and it has been instrumental in creating a pool of capital to support mining development stories
- + A “perpetually” ebullient property market in Vancouver has acted as an underpinning for speculative investment in junior mining stocks in Canada
- ✘ The Canadian mining market is sustained by a thin layer of capital that can be vaporized in a market downturn
- ✘ Canadian mining capital is not self-sustaining and thus can run absolutely dry at times, as has been seen over the last 12 months
- ✘ The Canadian pension system is very underfunded and what pension money that there is does not filter into investment in anything below the “blue-chips” of the mining space
- ✘ The excessive valuations of some Australian mining stocks was a result of an excess of funds available
- ✘ Pension funds with over-bias towards mining stories are faced with the risks of one of the most notoriously volatile and cyclical sectors

That What Ails Ye

The hot topic of the moment is the dire state of the Canadian mining equity market. Boosters might point out a slight revival in the flow of financing of late in the Canadian market but these constitute a very small amount compared to the total size of the group of needy. Yes, the Titanic did have lifeboats, no, there were not enough to save everyone. Thus it is probably fair to say that the groups most able to raise money at the moment are those who least need it.

Thus we were surprised to run into a broker from an Australian firm at a London conference a few months back who said that the financing scene was not all that bad in Australia. That is not to say, however, that stocks are not battered pricewise on the ASX.

So this got us thinking about the differences between the two markets.

Comparisons are Odious?

The two cities we shall compare are Vancouver and Melbourne. Not fair you say! However to advance our case that is the comparison we shall make. In some ways it is a comparison of the sublime to the ridiculous. Vancouver is home to hundreds to small explorers whereas Melbourne is home to the head

offices of the likes of BHP Billiton, RTZ and Newcrest as well as the base for scores of junior and mid-sized miners. However, we are talking about where the funding money comes from mining equity investment rather than where the target companies have their lair.

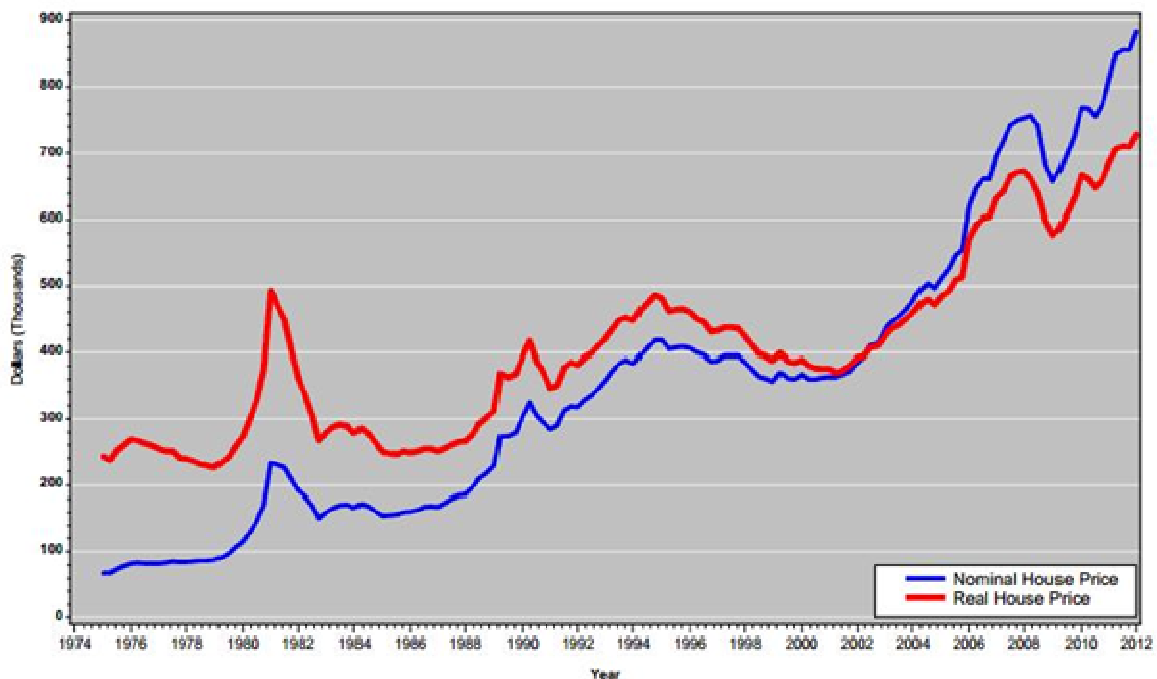
Melbourne has been the centre of mining finance in Australia since the 1850s. Sydney, probably much to the surprise of non-Australians, is scarcely relevant in any mining category except coal mining (where Sydney had and has a strong local team advantage, though being encroached upon by Brisbane these days).

Perth's appearance on the scene is relatively recent, dating back merely to the Nickel Boom of the 1960s. Thus some might argue that that Melbourne- Vancouver is not apples to apples. However we would sustain that the problem in Vancouver's equity markets is not seed capital, but sustaining capital.

The Well of Capital

Why is it that the Canadian markets are in such a pit of despair? Firstly we should ask where is the White Knight to ride to each market's rescue.

Vancouver : House Prices



Notes: (1) UBC Centre for Urban Economics and Real Estate calculation of Royal LePage Survey of Canadian House Prices data for standardized house type: avg. of bungalow and two storey executive
(2) Real prices in 2002 Q2 Dollars

We have been pondering a thesis for a while now that there is a connection between the Vancouver property market and the fate of the TSX-V. Before you scoff at this idea, the US consumer boom between 2002 and 2007 was linked to the ATM-like attributes of the refi market in mortgages. Why

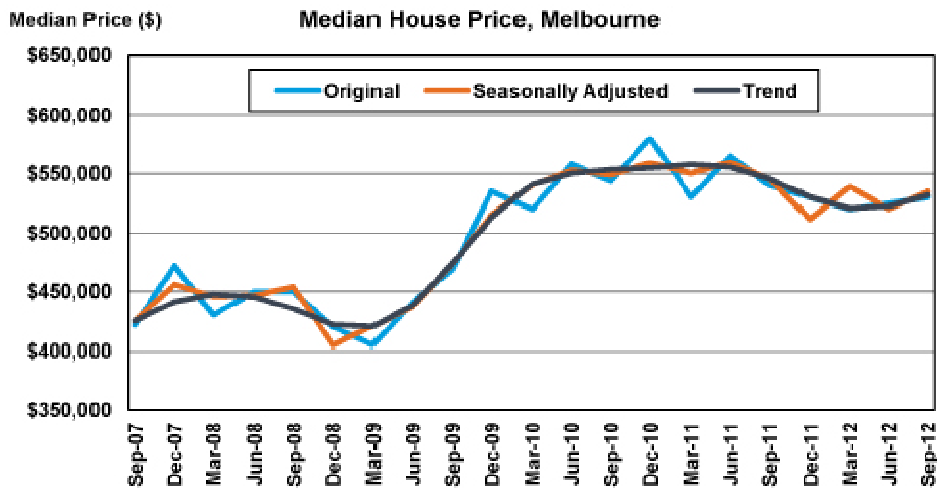
shouldn't the perpetual motion machine of the Vancouver property market have had a similar effect in over-stimulating the lower echelons of the mining market?

The drivers for the Vancouver property market might be synthesized as:

- Weather-wise Vancouver is "best of a bad lot" in the generally harsh range of Canadian alternatives
- Limited geographic space to expand
- The Asian influx in the run-up to the return of Hong Kong to China which has gone on ever since

Now the values of even the most ordinary of properties in Vancouver are the stuff of legend. In 2008, the market scarcely missed a beat while the rest of the world came tumbling down. We might also speculate that the rapid rebound in gold after the 2008 slump had a reinforcing effect and thus bullish commodity markets over the period after 2003 fed back into the property market, combining with Asian demand to create a Perfect Storm for residential property demand and values.

Australia's cities have not exactly been passed by either. The 2008 crunch is referred to by Australians as the GFC (Global Financial Crisis), as if this was some sort of disastrous event there, when in fact it had very limited effect in Australia with some very peripheral financial institutions biting the dust with limited losses. Moreover the Australian residential property market also sailed through with minimal retreat on prices and soon regained its poise. The dynamic in Australia can better be explained by the lack of restraints. For instance room to expand is only a cramping feature in Sydney, and even then it's only relative for Sydney's farthest suburbs are already at 50 kms from the centre. Likewise weather is all relative and everywhere has bearable weather to one degree or another.



The thing that both markets have in common (but that minor Australian cities do not share in) is the Asian factor. Australia became also something of a bolthole, not so much from HK being subsumed into China, but as a long-term bet on economic growth. This was combined with a hunt for Australian passports amongst the so-called Overseas Chinese (including Singaporeans) and Indians and this was

linked to the tertiary education system where Australia's proliferating fee-based universities, both public and private, sold courses with a form of tacit "free passport included". This practice (as in the US and UK) has been cracked down of late (without governments ever admitting to the masses that the scam ever existed). This has cooled the furore in Australian property markets leaving legitimate immigration and natural population growth as the sole motors for property market prices. Of course, neither of these come with a propensity to pay up to get positioned as the "non-dom" Asians did. Thus property markets are somewhat winded in Australia but not in retreat.

However, as Australians don't get a tax-break for mortgage interest payments the tendency is to pay down one's mortgage as fast as possible (particularly as mortgages are also mainly floating rate). Thus refis (as a form of ATM to fund stock market speculation) are not a factor.

Absolutely Super!

What does make a difference is Australia's pension system..... Once upon a time Australia had a non-funded pension arrangement with some workers in government job, public-owned utilities and some generous private companies being recipients of pension schemes. Seeing the writing on the wall long ahead of places like the US and Greece (yes, justly joined as Siamese Twins for this argument) the Australian governments moved towards privatizing pensions with the establishment of Superannuation Schemes.

In 1992, the Keating Labor government introduced a compulsory "Superannuation Guarantee" system as part of a major reform package addressing Australia's retirement income policies. It was calculated that Australia, along with many other Western nations, would experience a major demographic shift in the coming decades, resulting in the anticipated increase in age pension payments placing an unaffordable strain on the Australian economy.

Before the advent of the Super (the penchant of Australians for abbreviation being evident) scheme, the only workers receiving Super were government employees. Thus by introducing a non-government funded scheme (through a mix of employer and employee contributions) it seemed like the government was giving the Great Unwashed access to the perks they had long envied civil servants enjoying.

The key factor here in the channeling of funds to mining investments both high and low is that the investment by the individual went to build a pension fund that could be self-directed if they so choose. We would note however, that many pass the management of their funds over to institutions to manage.

How it Works

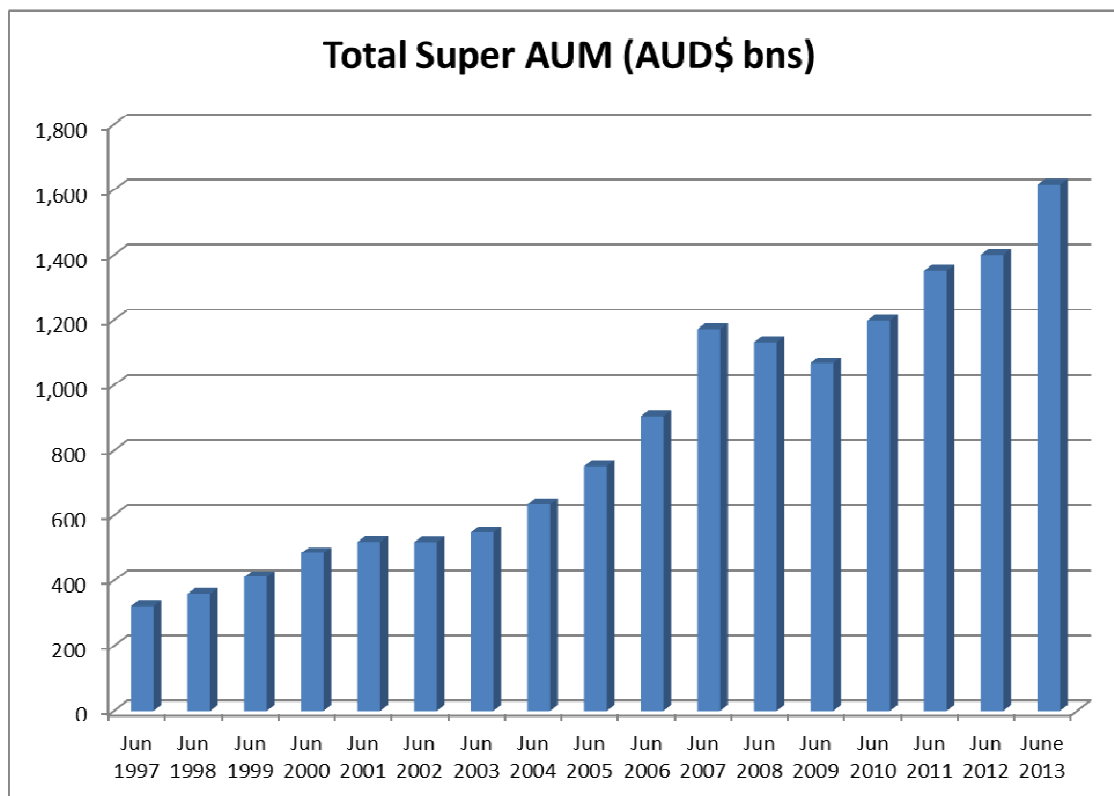
Therefore in Australia now, superannuation arrangements are government-supported and encouraged, and minimum provisions are compulsory for employees. Employers are required to pay a proportion of an employee's salaries and wages into a superannuation fund, but people are encouraged to put aside additional funds into superannuation. The minimum obligation required by employers is set to increase to 12% rising in increments annually from 2013 to 2020.

The original scheme was set up with a "three pillars" approach to retirement income:

- A safety net consisting of a means-tested Government age pension system
- Private savings generated through compulsory contributions to superannuation
- Voluntary savings through superannuation and other investments

The change came about through a tripartite agreement between the government, employers and the trade unions. The trade unions agreed to forego a national 3% pay increase which would be put into the new superannuation system for all employees in Australia. This was matched by employers' contributions which were set to increase over time to a proposed 12%. Subsequent changes meant this has been capped at the lower employer rate of 9%.

Since its introduction, employers have been required to make compulsory contributions to superannuation on behalf of most of their employees. This contribution was originally set at 3% of the employees' income, and has been gradually increased by the Australian government. Since 1 July 2002, the minimum contribution has been set at 9% of an employee's ordinary time earnings. The 9% is thus not payable on overtime rates but is payable on remuneration items such as bonuses, commissions, shift loading and casual loadings.



Source: Australian Prudential Regulation Authority

The effect of this has been to create one of the largest private pension systems in the world with the amounts of money accumulating burgeoning by the month as the preceding chart clearly shows.

The outcome has been a dramatic skewing towards investment. As can be seen from the table below:

	Per cent of GDP			
	Gross National Saving		Investment	
	(2001-2005)	(2006-2010)	(2001-2005)	(2006-2010)
	Australia	21	24	26
NZ	19	16	23	22
US	15	13	19	18
Japan	27	26	23	22
Germany	20	24	18	18
UK	15	14	17	16
France	20	19	20	21
Italy	20	18	21	21
Canada	22	22	20	22
OECD average	22	21	22	22
G7 average	20	19	20	20

In the long tradition of Australia's Labor Party (on the Left) wanting to control savings, the former Prime Minister Paul Keating criticized the Liberal government (led by John Howard) that succeeded Labor in office for its reluctance to increase the compulsory rate of superannuation. Keating argued that had the compulsory rate been 15% since 1996, rather than the 9% rate, total superannuation assets in Australia would have been approaching \$2 trillion at that time (2007). However, the amount under management already is over \$1.6 trillion and high rates of deductions would just have been an excessive burden on workers and employers leaving the former with lower take-home pay and the latter with higher costs of taking on workers.

The quality of the investor base

While lauding the Super scheme as a potential source of captive (potential) mining capital it should also be noted that another element favours mining investment which is not evident on the Canadian scene. This factor is the participation of the very heights of the investment community in the very most junior players in the mining industry. For a long time the massive mutual life office, AMP, was the biggest shareholder in nearly everything. Thus one could find AMP (or the other life offices such as National Mutual, T&G, Colonial Mutual, City Mutual etc) on the register at Tinpot Mining NL and usually the largest shareholder after management. Why? Well it was a case of throwing money at everything and seeing what stuck. Some would be winners, some losers and some also-rans.

This did not mean these mega-institutions were passive shareholders. In fact they were very pro-active and usually had the home phone number of the top execs to voice their displeasure should it be stirred to anger. The key difference again, is that any Tinpot Mining NL could become the next up and coming miner (e.g.Oxiana). Institutions didn't want to be buyers when the story had evolved. They wanted to be in at the ground floor. Nearly everyone was dedicated to production and should the production pan out, then the institutions knew there would be dividends. And as life insurance companies or pension fund managers, these dividend flows were music to their ears and gave their actuaries the only thrill in their otherwise humdrum lives.

As we well know Canadian miners of all shapes and sizes don't believe that investors are necessarily entitled to dividends. Pension funds with long term liabilities (such as those in the UK or Australia) could not park a significant part of their mining book in the "trust me, we will be taken over" school of junior miners. A non-dividend paying major miner could NEVER be called a blue-chip stock in either the UK or Australia.

The Effect

The superannuation fund phenomenon in Australia has negated the need for Australian miners to go a-wandering to collect capital in the last decade. With a limited pool of investment choices, the Australian public themselves tended to stay home and this produced a fishbowl in which miners and investors swam around chasing each other's tails. It has also produced overvaluation on a stupendous scale. We remember two examples. One was a potash company that when we met in 2011 that had an AU\$120mn market cap which management were bemoaning was down from AU\$600mn. Frankly for the stage of development it was at it would have not been likely to have been valued in 2008 at CAD\$120mn if it had been listed in Canada. And by 2011, it would have been lucky to have had a CAD\$20mn market cap. Another was a South Australian copper play that was rather low grade and had no resource. When we met them in 2011 they had an AU\$300mn market cap. In Canada such a company would have been most blessed to have had a \$30mn market cap. Thus the sheer amount of money lurking in Australian super accounts is a big plus for miners there. By giving miners higher market caps it has made the local mid-caps much more resilient to takeover threats. It also meant there was little need to do financings overseas or seek share buying interest from distant markets.



The chart above compares the ASX Mining & Metals 300 Index against the GDXJ, which (sort of) measures the performance of Canadian (mainly) producing mid-caps and prospective junior miners. While not strictly apples to apples, we would not say the groups are too dissimilar. Well not dissimilar in nature for in performance they are poles apart. The performance of the GDXJ is so dramatically worse

that there needs some explaining done of how two groups of miners, mainly pursuing the same metals can have ended up with such dramatically different performances. There is clearly something greater that ails the Canadian miners, or holds up the Australian ones.

The wailing of the Canadian miners and investors about the "global" slump in mining needs to be heard in the context of this chart for its clear that one patient is much sicker than the other. Some heartfelt analysis must bring us back to the fundamental question on the origin of the investor base in both markets and the existence of Super schemes in Australia and the absence of any similar dedicated source in Canada. The Super schemes are the 800lb gorilla in that discussion.

However we would not say that Australia is all smiles and hugs at this time. The moans about the current slump are all relative considering the bloated valuations of days gone by. The global crunch in 2008 largely washed over Australia like water off a duck's back (banking and credit system-wise) yet left a lot of mining companies at a lower level in terms of public investor interest and price levels (and a few casualties like Oz Minerals). The Super mountain continued to grow but miners did not get what they felt was their "fair share" anymore. This has spurred some Australian miners to test the international waters again. This seems to be less as a source of financing but as a means to add larger portfolio investors to their register and create some international buzz about their names and projects.

We need to stress here again though that all things being equal between an Australian and Canadian miner in project or resource terms, it is still the dividend (or the prospect thereof) that gives an ASX-listed entity a head-start over a TSX-listed miner with an unreconstructed attitude towards shareholder rewards.

Canada's Pension Black Hole

In September of 2012 the well-regarded Fraser Institute published a report that claimed that Canada's federal and provincial governments were facing a \$254 billion unfunded liability as part of their share for public-sector pensions. This rather eye-popping number flies in the face of the view commonly held outside Canada that all is hunky-dory with the generous social security safety net in northern climes.

The report, "Canada's \$254 Billion Iceberg: Public-Sector Pension Liabilities" by Milke and Lang, examined public-sector pension plans for which the federal and provincial governments are solely or jointly responsible. It looked at the "gap" between what such plans expect in contributions and investment returns, and expected future pension payouts. The authors calculated that Canada's federal government alone currently faced \$155.4 billion in pension liabilities, adding that "the \$155.4 billion is the clearest example of an unfunded liability for taxpayers: the promise for defined benefit pensions has been made, but there are no assets behind that promise." Of the provinces, Quebec had the greatest reported pension liability at \$75 billion.

The study notes that over the past decade, governments both in and outside of Canada have grossly underestimated the true cost of pension commitments to public-sector workers. The norm has been hikes in contribution rates from taxpayers and public-sector employees to cover these costs. In addition, explicit bailouts of underfunded public-sector pension plans have occurred in Ontario, British Columbia, and Alberta, among other provinces.

The study also looks at the growing disparity between pension plans in the public and private sectors in Canada. From 2010 data:

- 87.1% of public-sector employees were enrolled in some type of registered pension plan compared to just 24.4% of private-sector employees.
- Of those enrolled in a registered pension plan in the public sector, 94% were in a defined benefit; just 4.8% were in a defined contribution plan, with 1.1% in "other."
- Of those in the private sector enrolled in a pension plan, 52.3% were in a defined benefits plan while 28% were in a defined contribution plan and 19.7% enrolled in "other."

It is never too late to start solving such a problem. Australia had a big benefit in launching its scheme right at the start of an ebullient economic run. This meant there were few gripes from either workers or employers. It is quite a lot harder to do when the economy is softer as it has been since 2008. The cry will always go up that new burdens cost jobs. In the Australian case some of the burden on employers was eased because the employer payments to the government for social security were adjusted down.

Conclusion

It would appear as if Australia has found its solution but what is Canada's solution? We have noted before that institutions investing in mining stocks in Canada are notoriously weak in numbers and AUM, and those that there are tend to be run by gurus (e.g Sprott, Iwantash) with big visions, rather than wonkish number crunchers. Australia on the other hand has long had mainstream institutions like life assurance companies and a very large mutual fund (i.e. unit trust) industry. To this has now been added the massive superannuation industry, while the Canadian mining markets still rely on speculators with one eye on house prices to gauge their mood du jour.

With so many other similarities between Australia and Canada (excepting the weather) in social schemes and benefits (and economics) the failure of Canada to follow the example of the Australian super schemes is notable. Clearly Canada also has an unfunded pension liability problem that is only going to get worse. Unlike the US, it does not have a political system that would bury its head in the sand or eschew comparative schemes (Australia's or the AFPs in places like Chile). The time to act is now.. or rather was preferably in the Golden Days before the 2008 meltdown.

Creating in Canada a captive base of equity investors (on a far greater scale than the wishy-washy 401K lookalikes that countries have tried) would be a major step forward in building a less "feast or famine" market. A good comparison between the two would be to liken the markets to a casino in Reno, Nevada full of slot machines with the Australian investor and Canadian investor starting out with a bucket of quarters. Both investors feed the coins in and lose their money but the Australian finds that his bucket never really gets empty because it is constantly restocked by his super contributions and those from his employer. On the other hand the Canadian investor frequently runs out of money altogether and needs to go and pawn something to get back in the game.

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