

An award-winning fund

Craton Capital won this year's *Mining Journal* fund-management award

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AT A black-tie dinner in London last month, Craton Capital Ltd was confirmed as the winner of the 2010 Mining Fund Management award, which is sponsored by Collins Stewart.

This award is based on a technical adjudication by Financial Express, which assesses the performance of international funds through its Trustnetoffshore.com website. The funds considered by Financial Express were those in which international investors can currently participate, are managing assets worth over US\$50 million and have in excess of 50% invested in natural resources.

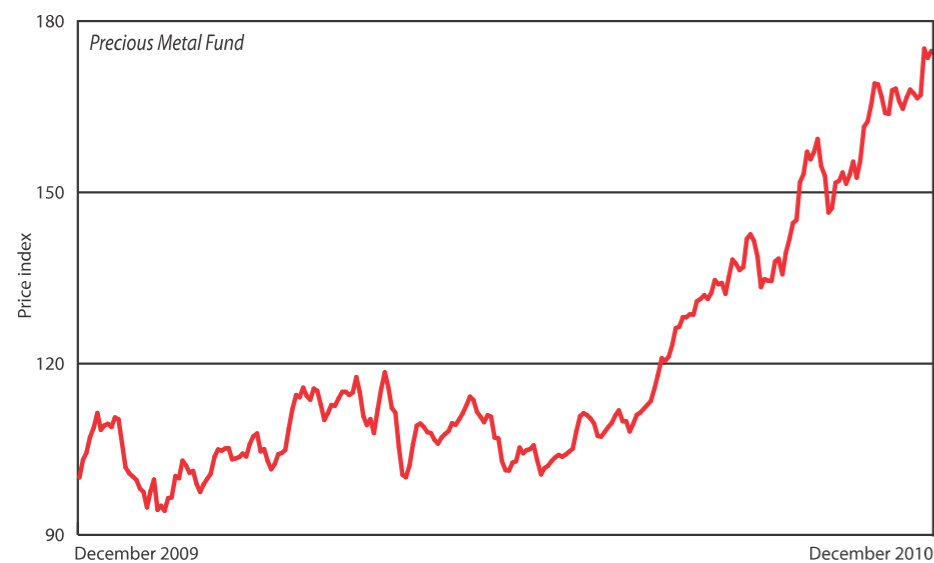
Previous recipients of the award have included Adrian Schmitz of Switzerland's Falcon PB (the winner in 2009), UK-based Carmel Daniele, Graham Birch, Nick Grace and Jim Rutherford, Australia's Joanne Warner, and Frank Holmes in the US.

Craton's Precious Metal Fund won with a growth of over 68% in the 12 months to end-October 2010. The award was presented to the firm's UK representative, Jeremy Beswick (the managing director of Caldeu Capital), by the head of mining at Collins Stewart, John McGloin.

SOUTH AFRICAN BASE

The manager of Craton's Precious Metal Fund is the company's founder, Markus Bachmann. He took the company's imaginative name from the geologic term, and so suggesting stability, the hosting of natural resource and strength (the origin for these ancient crustal plates being the Greek for strength, kratos).

Mr Bachmann described himself as "humbled and delighted" when told of the award. He emphasised that managing other people's money is a great responsibility, and stressed the difference between investing and gambling.



Indeed, Mr Bachmann believes investing in exploration and mining companies is not as complex as it is painted, arguing "mining is not a black box". He concedes that it is certainly risky at times, particularly during the interpretation of geology and the exploration phase. However, this risk can be influenced (Mr Bachmann quotes Gary Player's famous remark: "The more I practice, the luckier I seem to get").

There is also the political risk. Mr Bachmann rules out investing in Venezuela, and anywhere else where there is a high risk of nationalisation, uncertainty (he names Russia in this regard) or corruption. Investors, he emphasises, need certainty, which is one of the reasons that the mooted new tax in Australia caused such disquiet, he says.

"The more I practice, the luckier I seem to get"

In mining, the development and production phases are more predictable. Factors influencing the investment decision can be qualified and quantified. In many ways, Mr Bachmann says investing in the mining sector is easier than in the finance or pharmaceutical sectors (the latter, for example, is very reliant on research success).

INVESTMENT RESEARCH

In mining, there are "lots of unknowns" but Mr Bachmann argues that most of these can be solved. In its investment process, Craton applies a combination of a 'bottom-up' and 'top-down' approach.

The top-down component of this research involves the modelling of markets to determine likely commodity prices and rates for currency exchange, interest and inflation. This macro-economic framework is then used to help identify trends that may influence sectors and the relative performance of individual companies within that sector.

Most of Craton's investment decisions are made on the basis of a 'bottom-up' company analysis. Mr Bachmann says that the team seeks investments that:

- Trade at a discount to calculated fair value;
- Have high internal rates of return;
- Reinvest earnings at rates of return in excess of the company's cost of capital;
- Are favourably placed within a sector from a strategic perspective; and
- Generate alpha for the portfolio ('alpha' is a risk-adjusted measure of the return that is in excess of the fund's benchmark level).

Mr Bachmann says that the companies selected are also likely to become involved in "value-enhancing corporate activity". Good companies will become a target, sooner or later, of merger and acquisition interest, and Craton seeks to get in before such activity.

Mr Bachmann is passionate about the industry, and about the skills required to ensure sound investments. Some of the tools applied by Craton, he says, are to "understand history", "learn from the past" and to "apply common sense". Having achieved this, he describes the industry as "predictable", and his investing role as "fun to do" and "like playing chess".

Mr Bachmann is particularly keen on the fundamentals for gold, especially its value as a store of wealth and its prospective role as a currency. He describes gold as "the most complex commodity, with a fascinating history and probably also an interesting future – at least in the current fiscal and monetary environment".

Craton is also invested in the agricultural sector (through the Global Resources Fund, *see below*), which also involves complexities because of influence of the weather and demographics.

CRATON TEAM

The Craton team comprises eight individuals covering the areas of fund management, equity research, quantitative research, risk management, and sales and operations. The company has its main office in Johannesburg, with another office in Zurich.

Analysts on the Precious Metals Fund include Douglas Orsmond and Andrew Nesbitt, while Nathalie Han focuses on the firm's two new funds (*see below*): the Global Resources Fund and the Renewable, Alternative and Sustainable Resources Fund.

Mr Orsmond has over seven years' experience as precious metals analyst, and five years of mining-industry experience. He worked as a metallurgist in the South African gold-mining industry before moving to the UK as a consultant in financial modelling. Mr Orsmond returned to South Africa with JP Morgan prior to joining Craton.

Mr Nesbitt has over ten years in the mining industry, with extensive management, technical and operational experience, and three years of buy-side experience.

He worked as a mining engineer in the South African gold and diamond industry, and then as a strategic planner and management consultant to the mineral industry (heading the transaction-valuation department of SRK in South Africa).

Ms Han is a fund manager with over 12 years' experience. She has extensive experience in natural-resources investment gained in Canada at an independent research firm, a private-equity firm and a large pension fund.

Mr Bachmann himself holds a business degree from the University of Berne in Switzerland, and he began his

career in Credit Suisse's corporate finance department. In 1997, he joined the emerging markets team of SBC Brinson as an analyst and portfolio manager responsible for the markets of Greece, Portugal, Israel, the Middle East and South Africa.

In 2000, Mr Bachmann joined Coronation Fund Managers in Cape Town as a senior portfolio manager. The following year he received the S&P award as manager of the best-performing large capitalisation equity unit trust in South Africa. Mr Bachmann left Coronation in 2003 to set up Craton Capital.

"Gold has a fascinating history, and probably also an interesting future"

FUNDS UNDER ADMINISTRATION

The long-only Precious Metal Fund was launched in November 2003 with initial capital of just US\$2.2 million. The fund, which focuses on companies with a small to medium market capitalisation, now has assets of some US\$310 million under management. Since inception the fund has returned an annual 20.8%, compared with 12.6% of the benchmark index.

Craton covers its costs in Johannesburg with an annual management fee of 1.5% for the Precious Metal Fund, and makes its profit from a 10% charge on any outperformance relative to the fund's benchmark (the FT gold mines index). The fund's aim is "to generate alpha of 5-8% annually over a three-year rolling period versus the index".

Craton has recently launched another two funds, with a total of US\$25 million of assets currently under management. These two funds have a slightly higher annual management fee (1.6%).

■ The Global Resources Fund was launched in December 2008. The fund invests primarily in the metals and mining sector, materials (including forestry, chemicals and steel), energy and power, and agriculture, utilities and services.

■ The Renewable, Alternative and Sustainable Resources (RAS) Fund was launched in August 2009. The fund invests primarily in renewable energy and power, agriculture, forestry, water, resource efficiency and environmental services. Almost 60% of the holdings have a US domicile, with 24% of the assets in agriculture and renewable resources, and 19% in sustainability.

Mr Bachmann describes himself as "very excited" about both new funds. He manages the Global Resources Fund, with Ms Han managing RAS.

He believes that the Global Resources Fund "... is going to be a real blockbuster, and it is of particular interest to me as it covers the entire resources spectrum, everything. It is a one stop shop and hence has the utmost flexibility in terms of sector allocation and stock picking."

Such is his confidence, Mr Bachmann says he is putting his money where his mouth is by investing all of his daughter's school and university money into the fund (she is currently two and a half years old).

The Precious Metal Fund, Global Resources Fund and the RAS Fund all fall under the umbrella structure of Craton Capital Funds. All have the same

characteristic of daily pricing and liquidity. The funds are registered for distribution in the UK (with the FSA), where they enjoy 'reporting-fund' status, as well as in numerous other European countries.

The minimum investment in these funds is one unit (approximately US\$360 in the case of the Precious Metals Fund), except in the case of institutional-class investors, where the minimum investment is US\$1 million. No exit charges apply and initial charges are also generally not applied (though may be levied by intermediaries).

Craton's administrative office is in Liechtenstein (through Liechtensteinische Landesbank AG). Mr Bachmann is enthusiastic about this European country. He describes Liechtenstein as being 'Swiss', competitive and with easy access to the rest of Europe.

Most of Craton's investors are based in Europe, and when deciding on a domicile there for the company seven years ago, Mr Bachmann considered 17 criteria.

Liechtenstein came top (Ireland was shortlisted but ultimately rejected as being "too expensive and complacent").

ASSET ALLOCATION

Craton's mandate for the Precious Metal Fund is to offer investors "the opportunity to invest in companies that are active worldwide in the mining and processing of precious metals (gold, silver and platinum group metals) and diamonds".

Mr Bachmann currently holds 33 companies in this precious-metals portfolio, with an

investment horizon of three to five years. This holding is, according to Mr Bachmann, "about right". It is, he says, a compromise between the 10-20 of the smaller funds and the over 50 holdings of the very large funds.

The fund's holdings are in line with the European Union directive on Undertakings for Collective Investment in Transferable Securities (UCITS). These directives provide guidelines that allow collective investment schemes to operate freely throughout the EU on the basis of a single authorisation from one member state.

For example, under the latest directive (UCITS III), no fund may invest more than 5% of its assets in transferable securities, or money market instruments, issued by the same body.

Asset allocation by commodity in the Precious Metal Fund is currently around 72% in gold, 15% platinum, 6% silver, 3% other commodities (including diamonds) and 4% cash. By domicile, the holdings are overwhelmingly Canadian (over 68%), with 13% in the US, 9% Australia, 6% UK and 4% cash.

The fund's more significant holdings have included Avion Gold Corp, Brigus Gold Corp, Detour Gold Corp, Dundee Precious Metals Inc, Eastern Platinum Ltd, Extonne Gold Mines Ltd, Minera Andes Inc, Rainy River Associates Ltd, Rio Novo Gold Inc and Silver Standard Resources Inc (the latter two being recent investments).

Being largely invested in North American companies but based in South Africa, most of his dialogue is via conference calls rather than face-to-face meetings. Nevertheless, much of Mr Bachmann's time is spent in the air.

Markus Bachmann

