FP INVESTING

Baffinland investors hope for more bids

REMOTE PROJECT

By Peter Koven

With time running down, investors are still hopeful that a rival bid will emerge for **Baffinland Iron Mines Corp.**

When **ArcelorMittal SA**, the world's biggest steel company, agreed to plunk down $433-million ($1.10 a share) in cash for Baffinland last month, it was not considered a blowaway bid. This was, after all, a $5 stock a few years ago, and the company's Mary River project is one of the world's biggest untapped sources of iron ore.

Baffinland quickly cut the deal with ArcelorMittal after it was put in play by **Nunavut Iron Ore Acquisition Inc.**, which made a hostile offer worth 80¢ a share. The stock continues to trade about a nickel above ArcelorMittal's bid as arbitrageurs hope that something else will materialize before the offer expires Dec. 20.

"The value far exceeds what ArcelorMittal is bidding for it," said Ron Mayers, head of alternative strategies at Laurentian Bank Securities. "It's a terrific asset but it's in a very difficult place."

The high-grade Mary River project is expected to churn out 18 million tonnes of iron ore a year for two decades, according to a 2008 feasibility study, and subsequent discoveries suggest it could be bigger than that. The trouble is getting it out. The project is on a remote corner of Baffin Island, and the feasibility study pegged the construction cost at a whopping US$4.1-billion.

Baffinland has been studying a trucking option that could bring the project quickly into production at a lower cost while it develops a railway. But given the scale and remoteness of the operation, there are only a few conceivable rival bidders out there: **BHP Billiton Ltd.**, **Rio Tinto Ltd.**, **Vale SA**, a state-owned Asian company, a rival steelmaker, or a second Nunavut offer.

Nunavut has not withdrawn its bid yet, suggesting it could come back. The company is intimately acquainted with the project as it is led by Jowdat Waheed, a former Baffinland consultant.

"It's an interesting project for anybody that has the wherewithal to get up there," Mr. Mayers said.

Analysts have expressed doubt another bid is coming, but have suggested that Mary River is worth considerably more than what is being offered.

"ArcelorMittal, in our view, is taking advantage of the inefficiencies [in] the way the capital markets value undeveloped iron ore projects," Raymond James analyst Tom Meyer wrote in a note.

Even if no rival bid emerges before Dec. 20, some shareholders are wondering whether they should tender to ArcelorMittal.

Baffinland has some potential catalysts in the coming weeks that could breathe life into its share price, including a report on the truck shipment option, a resource update, new drill results, and the submission of a draft environmental impact statement for Mary River.

There is also the tightening iron ore market itself. Prices are expected to rise in early 2011 after quarterly contracts are settled, which could potentially lift the whole sector.

At least one major Baffinland shareholder has not publicly endorsed the ArcelorMittal bid. Former chief executive Gord McCreary, who wrote about Mary River in his master's thesis in 1978, resigned from the board at the same time the deal was announced.

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A backhoe loads ore during bulk sampling at the Baffinland Iron Mines Corp Mary River project last month.

FP TRADINGDESK.COM

RAYMOND JAMES STARTS TIM HORTONS COVERAGE AT MARKET PERFORM, $45 TARGET

Tim Hortons Inc. is an institution in Canada, with cups of Timmy's coffee popping up from hockey rinks to office buildings and everywhere in between.

Now, the company's forays into the U.S. market, saturated with many more competitors and with no cultural attachment to a coffee giant founded by a hockey player, that's a different story.

"While the iconic status and near cult following of Tim Hortons in Canada have translated into a dominant market position, the challenge has long been the growth and evolution of the U.S. business," Kenric Tyghe, analyst with Raymond James, said in a note initiating coverage on the company.

In particular, the recent decision to close its struggling New England operations was "overdue" but an important step towards making the company more competitive.

"[The closures] are significant in our view, not only because of the positive impact the closure has on U.S. average unit volumes but also because of the change in management ethos towards the U.S. business," he said.

"AUVs in key U.S. markets continue to trend higher, which is critical for the margins of this business, which we believe will be augmented by what is at its core a considered, more aggressive and opportunistic approach to driving the U.S. business."

Raymond James initiates Tim Hortons with a "market perform" rating and $45 price target.

Eric Lam

TIM HORTONS INC.
THI/TSX, *$41.66, up 15¢*

BUY & SELL

BIG PICTURE VIEWS, CURRENT ISSUES, OUTLOOK AND PICKS. BY JONATHAN RATNER

GRAHAM HUGHES FOR NATIONAL POST

Marc Dalpé, Portfolio Manager with DalpéMilette, says stocks could jump 10% to 15% if investors start selling their bonds.

Stocks may get a lift

Top-down portfolio managers have a lot on their plates these days — whether it is fiscal concerns, military disputes or political upheaval. For Marc Dalpé, who manages about $900-million as part of a 11-person team at DalpéMilette Group, a part of Desjardins Securities, both the economy and markets are caught in different winds — some short term, some medium term and some long term.

"The economy has shown some signs of resilience and is doing better than most people would have thought six months or a year ago," Dalpé says.

He is confident that economic growth will be relatively good on most fronts over the next 12 months. So while G7 countries won't see 6% growth, it will likely be somewhere between 2% and 3%.

As for equity markets, the portfolio manager believes they are priced at a level that leaves room for upside if the good news continues. "Pricing will not act as a headwind, it will be a downwind, so it will help."

Dalpé spends a lot of time on macro themes such as demographics and politics on an international basis. He feels these factors drive a substantial portion of portfolio returns and risk, while country, industry and stock picking is a way to deliver his opinion on these trends.

The manager notes that since the beginning of 2009, there has been 22 times more money invested in bond funds in the United States than in equity funds. Yet even though the stock market has outperformed the bond market significantly during that period, bond investors have still done relatively well since interest rates have fallen.

But with long-term interest rates for bonds having risen 40 to 50 basis points recently, Dalpé says that the potential for this trend to continue could cause some serious pain for bond portfolios. He notes that the negative impact of rate increases is magnified when interest rates are so low, in the 2% to 3% range as they have been recently.

"My feeling is if the economy stabilizes and doesn't go into recession, and there are no big shocks in terms of wars or other major hard-to-predict macro issues, the stock market will continue to grow at a slow pace," the manager says.

But if investors start selling their bonds, Dalpé thinks equities could rise 10% to 15% in the next 12 to 18 months.

At the same time, he is concerned about the structural headwind formed by the combination of very large deficits, the accumulation of debt, aging populations and the capacity to maintain health care and pension payments.

"I don't think the economy will be strong enough over the next few years to take care of those problems by itself. It will need significant drastic changes by governments."

As a result, the manager believes there will be a "riot point" in the market in the next two or three years that will likely lead to a correction of 15% to 30%. "That is what it will take for governments to get their act together and institute changes that will alter the outlook for the next 10 to 15 years," he says.

Once that is accomplished, Dalpé thinks the outlook will be very good. Not only will there be a light at the end of the tunnel for G7 economies, but emerging markets will have become major contributors to global economic growth.

China, for example, didn't make much of an impact even though it was growing at 12% ten years ago. Now, as the world's second biggest economy with growth of 6%, it is creating real momentum in global markets. This trend is what Dalpé expects to see out of other emerging economies in the next few years.

The manager's equity portfolio is about 60% Canadian and 40% international, of which 85% is exposed to emerging markets such as China, India, Brazil and southeast Asia. The rest of the international portion is evenly divided between an agriculture and a nuclear ETF. He owns no U.S, European or Japanese stocks. "If these markets correct in the next few years, emerging markets will too, but not by as much," Dalpé says.

While the manager has been a strong believer of ETFs for a long time, his opinion has changed in the past three or four months. Dalpé now prefers using mutual funds to gain exposure to emerging markets since many sectors of the economy are not yet represented in major stock market indices.

For example, infrastructure has been the primary driver of the Chinese economy during the past decade. Yet over the next 20 years, other sectors will benefit from more consumption by the middle class.

"If you want to invest in what will be the significant drivers of growth in the next 10 to 15 years, you're not getting those companies by investing in the index. There were too many companies and sectors that we wanted to be in, but couldn't be in by buying the index."

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THE MANAGER

Manager: Marc Dalpé, DalpéMilette Group at Desjardins Securities
Portfolio: 50% stocks, 50% bonds (typical client)
Description: Individually managed portfolios for about 2000 clients, variations in equity and bond weightings
Style & Process: Top-down approach
AUM: $900-million
Performance: 1-year +8%, 3-year +3.45%, 5-year +7.27%, 10-year +6.79% (as of Nov. 30, 2010)
Management fees: 1.25% (typical client)

BUYS

China. Dalpé gets his exposure to China from three mutual funds — Excel China Fund, Fidelity China Fund and AGF China Focus Class.

"The Chinese market is one of the least expensive in the world," the manager says. "Part of it has to do with the fact that the market thinks the Chinese economy will be slowing down significantly over the next year or two, but I don't think that will be the case. There is a lot of firepower left with the government."

Dalpé feels the price being paid for the type of growth China will generate over the next couple of years is very good. As a result, he thinks Chinese equity markets will surprise on the upside and could climb as much as 25% in the next 12 to 18 months.

Market Vectors Nuclear Energy ETF (NLR/NYSE) The manager likes this ETF because it provides broad exposure to companies in different areas of nuclear energy production.

"Unless they discover some new technology, the need for electricity will be growing tremendously over the next 10 to 20 years," Dalpé says. "I want to invest in companies that will benefit from the growing number of plants that will be needed over the next 25 years to produce electricity."

"One of the only thing Democrats and Republicans may agree on in the next couple of years is the need to beef up their supply of electricity via nuclear," he says, adding that some countries previously unwilling to go nuclear in the past, have now made it their focus.

Market Vectors Agribusiness ETF (MOO/NYSE) This ETF invests in a wide range of global agriculture companies. While the manager doesn't consider the ETF cheap, he points out that potassium prices could rise substantially, which could drive it up 10% to 20% in the next year.

Dalpé chose the ETF as a way to play the theme of agricultural efficiency. "It's especially a concern in an environment where the amount of land used in agriculture tends to be challenged because of the growing population and climate change."

Combined with changing eating habits and the demand for more protein-based foods in emerging countries, the manager thinks this will be a dominant theme for the next five to 20 years.

SELL

U.S. stocks. While there are many reasons Dalpé is avoiding U.S. equities, one of the primary reasons is currency. The manager believes the U.S. dollar could remain challenged for the next couple of years, potentially falling 10% to 20%.

"I don't want to increase my odds on losing on the currency," he says.

"By going into emerging markets, not only am I buying significant growth, but my odds on losing money on the currency are much, much smaller than going into Europe, Japan or the United States."

He also points out that these three markets are most susceptible to major pain in the next three years due to their structural problems.