2019: BOOM & BUST, SUPERCYCLE REVIVAL OR SOMETHING NEW?

Since the nadir of 2015, at a time when Glencore had to do a rights issue, Anglo American was seriously proposing selling almost half of its assets to forestall that possibility and BHP Billiton retreated from its progressive dividend policy, the global diversified mining companies have moved onto a different plane.

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From not having enough cash, the current problem – if that is what it can be called – is deciding on the most efficient way to return excess cash to shareholders. Share prices have reacted to the change in circumstances (Figure 22), with increases ranging from 97% to 480% (Rio Tinto and Anglo American, respectively, in pound sterling terms), easily outpacing the underlying indices (on the London and Johannesburg stock exchanges).

01/ MINERS KEEP THEIR HOUSE IN ORDER

With another set of results just completed, the business strategy for most of the global diversified miners is starting to look eminently sensible:

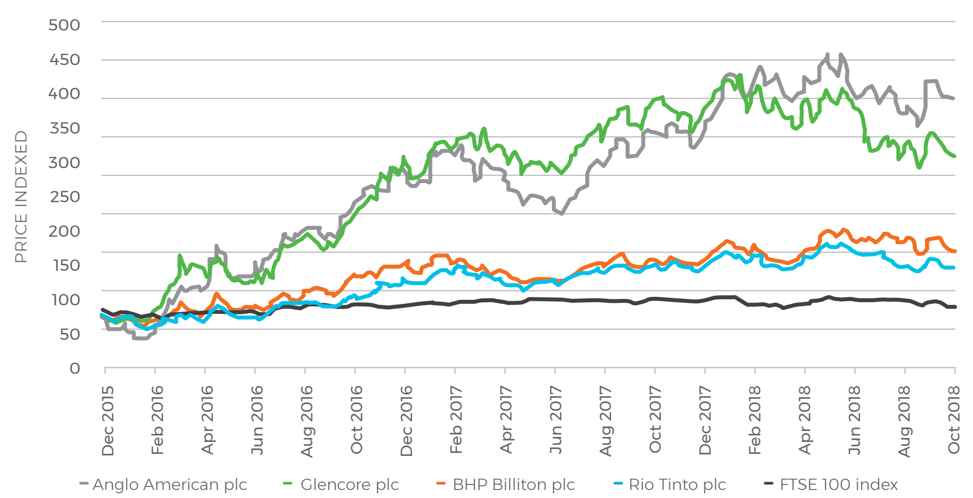
- Run the operations as lean as possible, improve productivity and reduce unit costs;
- Look for some low-cost, incremental "brownfield" expansion possibilities, eschewing any capital-intensive and high-risk greenfield expansions; and
- Return excess capital to shareholders, either through share buybacks or dividends.

Companies are maintaining a guarded approach even when this strategy is tweaked. For instance, in the case of Anglo American approving the greenfield development of its Quellaveco project in Peru, the risk was lowered by selling down the stake to 60% rather than going gung-ho with a full 100% stake.

Does this approach mean that boom/bust cycles in the mining industry are over, that investors can look forward to a steady stream of dividends in the future and that the lower volatility in earnings will lead to a general re-rating of the sector? Well, as always, it's not quite that simple.

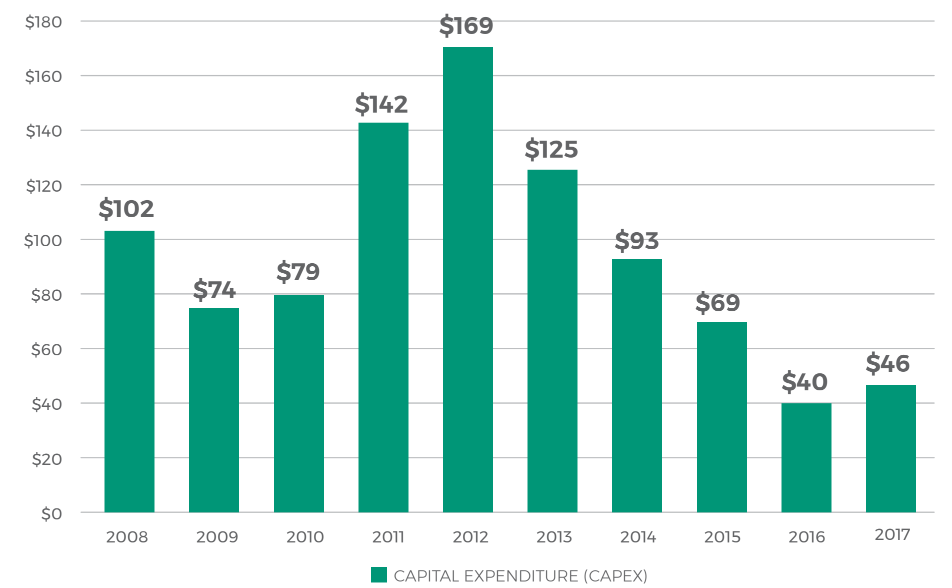
To a large extent, the companies have done what they can to fix their internal situation. With the oil price increasing and labour availability tightening in most of the major mining regions, the scope to rebase costs has lessened.

FIGURE 22: MINING HOUSES' SHARE PRICES REFLECT A CHANGE IN FORTUNE



Source: FactSet

FIGURE 23: CAPITAL EXPENDITURE IS BETTER UNDER CONTROL (US$ BILLIONS)



Source: Mine 2018 - PwC

02/ MINING REINVENTED

A more progressive approach to the use of technology and data offers potential for the industry to continue to push through productivity enhancements, but most companies are at a relatively early stage in the implementation of these strategies, so improvements must be seen to be delivered for investors to have confidence.

As it stands, the consensus is probably that costs have been cut as much as could be expected in this cycle, and now it becomes a relative game of who can control future cost increases the best.

Capital spend has also been well controlled from the heady days of 2011-2013 (Figure 23). 2016 probably saw the bottom of this cycle, and although the increase into 2017 was relatively small (around US$6 billion or 15%), this was stay-in-business (SIB) capital expenditure returning to more normalised levels rather than an increase in project spend. New projects will happen, and are needed.

Taking the copper market as an example. This market is essentially in a rough balance, with global resources research and consultancy group Wood Mackenzie forecasting a market deficit in 2018 of

Credit: Tobias Jussen

25 000 tonnes , out of a total market demand of over 23 million tonnes. Wood Mackenzie estimates this market will continue to grow at a rate of over 400 000 tonnes per annum (tpa) through to 2040. Anglo American's recently announced project, Quellaveco, is forecast to produce 300 000 tpa for the first 10 years of production, so the market will need almost 1.5 new Quellaveco mines a year for the next 20 years just for the copper market to remain in balance.

Other markets are in similar circumstances, to greater or lesser extents. The nickel market is probably tighter in the medium term than the copper market, depending on how fast electric vehicles move from an interesting sideshow into the mainstream. Meanwhile, the iron ore market is probably better supplied over the medium term, with lower growth potential as "peak steel" hits the Chinese steel producers.

Overall, there will be production growth across the metals and commodities space but, importantly, this growth has to be well managed, brought on timeously and on budget, and achieve the returns that investors crave, and which mining executives promise.

All of which ultimately brings us back to the most important factor and the one that the companies can't influence: the macroeconomic situation.

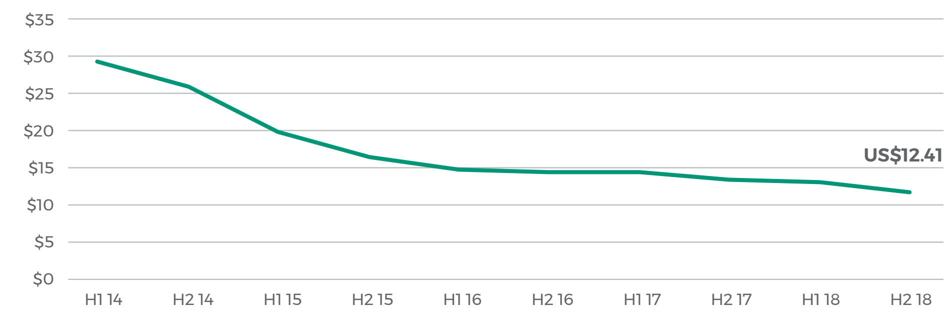
03/ RESILIENCE TO BENEFIT SHAREHOLDERS, REGARDLESS

The current macroeconomic environment can probably be viewed as benign, but with a cautious outlook. Despite concerns over the impact of trade wars, China is still reliably showing GDP growth of 6%-7% a year, at least officially, with growth in demand for commodities from that economy still looking at a 3%-4% range. The US expansion is heading into its tenth year, with strong quarterly growth figures still being printed. However, once the impact of the tax cuts has passed through, and with unemployment in the US touching all-time lows, it is debatable how much longer that economy can continue to grow above trend. Europe continues in fits and starts, with the German engine coming under some pressure, and Italy and France stalling even though the likes of Spain appear to be doing well. And there remains the big "What if?" Brexit turns out to be a complete shambles for all concerned. The 10-year anniversary of the 2008 global financial crisis (GFC) seemed to coincide with an uptick in concerns about when the next recession is due, but the ingredients for a slowdown – trade wars, rising interest rates and rising oil prices – are starting to appear and making enough people nervous.

So the industry sits in a slightly unusual position. Following a period of prosperity, albeit relatively short, the industry is well capitalised, with strong balance sheets and no sign of the distress seen in 2015. There's no new wave of production ready to hit the market, and shareholders are seeing some decent returns. If there is to be a downturn, and that's not a given by any means, most companies are robust enough to continue with current strategies and still provide shareholders with an above-average dividend yield for the foreseeable future. If the global economy avoids a downturn, decent ongoing demand growth will mean that prices for most commodities will have to increase to induce new capacity to be built, providing the mining houses with a nice boost to the bottom line.

Is it an exciting sector to be in at the moment? Probably nowhere near as exciting as it has been, but that's the point. A bit more caution, a bit more of a conservative approach to capital and project spend, and a bit more concern about shareholders' returns appear to be here to stay. That should mean that most of the industry will be able to comfortably weather any sort of a moderate downturn, while any continuation of a steady global economy should see strong returns for shareholders.

FIGURE 24: BHP BILLITON WESTERN AUSTRALIA IRON ORE CASH COST/TONNE



Source: BHP Billiton