

Mining & Metals 2020: ESG front and center as trade tensions linger

The global mining & metals sector is facing one of its most challenging transitions yet, as the industry is considering how it can best position itself to regain and maintain stakeholder confidence on ESG matters

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Miners spent 2019 navigating a raft of challenges, with omnipresent concerns about a global slowdown offsetting strong fundamentals. However, what should we expect as we head into the 2020s? In our fourth annual survey, we asked mining & metals industry participants to share their views for the year ahead. Partners **Rebecca Campbell**, **John Tivey** and **Oliver Wright** of global law firm White & Case discuss some of the key findings

The global mining & metals sector spent 2019 balancing two competing forces. Concerns surrounding the macro picture grew, as a Chinese slowdown that started in 2018 was exacerbated by global trade tensions and slowing manufacturing across Europe and the US. However, this was partially offset by increasingly tight supplies of metals amid dwindling stockpiles, demonstrating that the underlying fundamentals of the industry remained strong.

At the same time, the biggest miners, supported by supply shocks in iron ore and continued revenues from asset sales, distributed record amounts of money back to shareholders. Yet concerns arose relating to the sustainability of those returns, and whether the companies were neglecting growth.

In a year when millions of people across the world marched to raise awareness of climate change, and investors and NGOs pushed hard against the continued mining of thermal coal, the scrutiny the mining industry faced—given the nature of its operations—was at times intense, forcing the biggest producers to evaluate their future in the business. But the mining industry is certainly not alone in feeling

these pressures. Companies in a multitude of sectors make pointed efforts to showcase examples of their sustainable behavior and green credentials. Environmental, social and governance (ESG) issues are now front and center in boardrooms across the entire corporate spectrum.

There was also the Brumadinho dam collapse in Brazil, which resulted in the deaths of more than 250 people. This led to a renewed focus on the safety of mining and the impact on the communities that exist around its operations, with investors



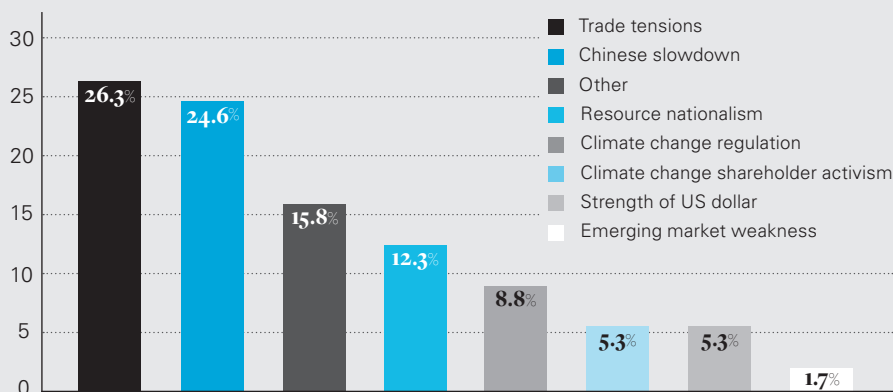
\$1,579.72

Price per troy ounce of gold on 6 January 2020, the highest since April 2013

demanding fresh transparency on how tailings dams are operated and inspected.

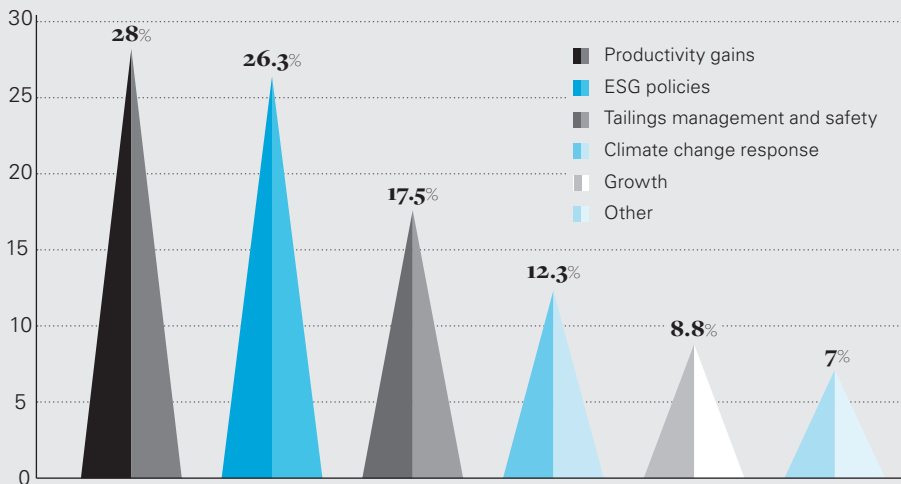
These events leave the industry at something of a crossroads heading into the new decade, with uncertainties on both the macro outlook and how miners will balance stakeholder returns with sustainable long-term investment and ESG principles. To get an idea of what to expect, White & Case has conducted its fourth annual survey of industry participants, with 64 senior decision makers sharing their thoughts for the year ahead.

What is the key risk for mining & metals in 2020?



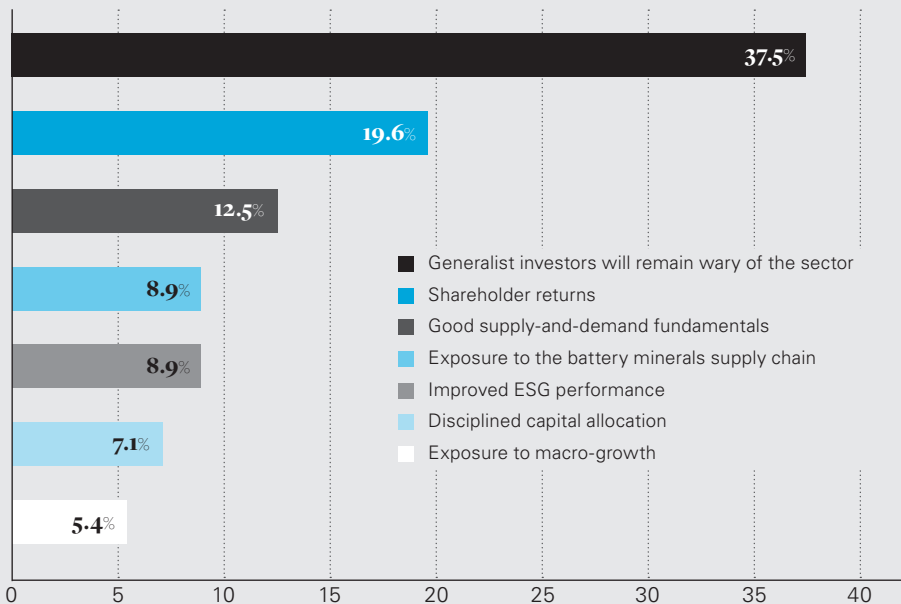
Source: White & Case 2020 Mining & Metals market sentiment survey

What will be the main priority for the mining sector?



Source: White & Case 2020 Mining & Metals market sentiment survey

What is likely to lure non-specialist institutional investors to the sector (and/or keep them interested)?



Source: White & Case 2020 Mining & Metals market sentiment survey

Responses from our survey indicate that for the third year in a row, the global economic backdrop remains the biggest concern. Yet unlike last year, it is now trade tensions—rather than a slowdown in China—that is seen as the biggest risk. After more than a year of negotiations, the US and Chinese governments have yet to strike a deal, despite repeated media reports that an agreement was close, and about one-quarter of our respondents see that continuing to be a drag on the sector.

Close behind are continued worries about the Chinese economy—consumer of about half of the world’s commodities—which continues to slow. Beyond the macro outlook, two other themes of concern are those of resource nationalism and climate change policy. Our respondents are split on how the impact of trade tensions will be felt, with roughly 40 percent expecting an actual slowdown in demand, and approximately one-third anticipating speculative pressure on commodity prices.

The big miners

For the big diversified miners, the year was dominated by record amounts of money being returned to shareholders through dividends and buybacks. The big two, Rio and BHP, funded these distributions through continued asset disposals and revenues from iron ore prices that spiked above US\$120/ton in the middle of the year. Iron ore advanced 27 percent, the most since 2016, against the backdrop of the dam collapse in Brazil and supply problems in Australia. Yet prices retreated in the second half of the year, as volumes came back online and concerns mounted about Chinese steel demand. In 2020, prices are widely expected to slip further as a surplus of ore returns. That has led banks, including Morgan Stanley and Credit Suisse, to forecast declines, and the Australian government has said it expects the commodity to average in the US\$60s per ton.

This outlook mirrors the views of our respondents. More than a quarter said they expect a continued focus on productivity gains to be the number one priority for the sector this year, up from second place last year. Pursuing ESG policies, dealing with tailings dams and responding to the challenges of climate change were all seen as more important than growth, which just under nine percent said should be the leading goal this year. Perhaps that outlook explains why more than 37 percent said they expect generalist investors to remain wary of the sector this year, up from 30 percent in 2019. While shareholder returns are expected to be the biggest factor to lure generalist investors, the number of respondents predicting this is down from last year.

Climate change response gains traction

The impact of climate change, and the global response from regulators and investors, is not a new theme. However, in 2019 it started to gain real traction and have a direct impact on the way the biggest miners operate. The year also demonstrated

that—in contrast to the global macro considerations—miners are in much greater control of what they can do to adapt to this environmental challenge, and improve their reputation as a result.

Thermal coal, for example—which is the most carbon polluting fuel—has long been the focus of institutional investors and campaigners when it comes to the impact of mining on emissions. The pressure had been building for some time, and 2019 will be looked back upon as the watershed year in which diversified miners lost appetite for increased investment into thermal coal.

While coal was a relatively small part of Rio Tinto's overall portfolio,



The industry is at something of a crossroads as it heads into the new decade, with huge uncertainties on both the macro outlook and how miners will respond to the ESG challenges



Assets under management (AUM) of the group leading the asset manager response on tailings safety

the world's second-biggest miner made the first move in 2018 when it sold its last coal operations. Last year, BHP Group, the biggest miner, started looking to exit the business with Anglo American expected to lay out a roadmap on how it will stop mining the fuel at some stage this year.

Even Glencore, one of the biggest producers of coal, was forced to implement a cap on its coal production after sustained pressure from shareholders, with its CEO, Ivan Glasenberg, saying they had little choice if they still wanted to attract investors.

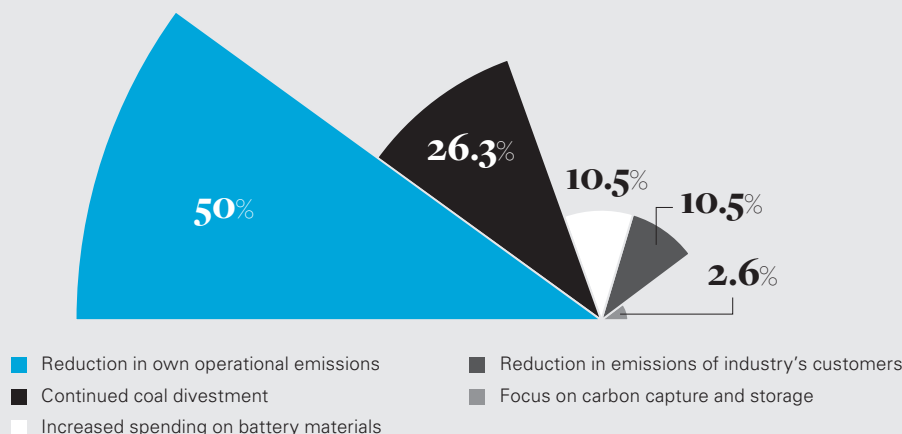
This retreat from coal by the major players is also having a direct impact on the wider industry as it comes under greater scrutiny than ever before. In 2019, Rio, BHP and Anglo all faced pressure at their annual shareholder meetings to distance themselves from lobby and industry groups with climate change policies that do not align with the Paris Agreement of 2016. That has forced the companies to audit their memberships and agree to leave any groups that have material differences.

Coal is not "make or break" for Rio and BHP, but iron ore certainly is, and the mining industry is also feeling the pressure here. The end-to-end value chain emissions from making steel (known as Scope 3 emissions) came into focus this year and both BHP and Rio said they are working with customers to tackle the issue. Taking a degree of responsibility for customer emissions can be seen as a risky strategy for the miners, but it also highlights how concerned they are by the growing pressure on the industry. In our survey, 58 percent said it should be the combined responsibility of the raw material supplier, primary manufacturer and end consumer to deal with emissions from industries such as steelmaking and cement making.

Tailings controversy

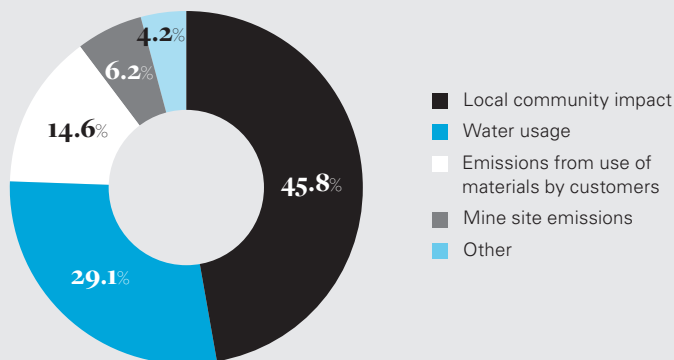
The industry has also had to deal with the fallout from the collapse of the Brumadinho tailings dam in January.

How will the mining industry respond to climate change policies and investor pressures?



Source: White & Case 2020 Mining & Metals market sentiment survey

What area of mining & metals will face the most scrutiny from investors and regulators related to the environment and social issues?



Source: White & Case 2020 Mining & Metals market sentiment survey



\$60bn

Total value of global mining M&A in 2019

Source: Bloomberg

to remain the riskiest jurisdiction, which is down from 62 percent last year. About 26 percent expect Southeast Asia to pose the biggest risk, nearly double the tally from last year.

The year also saw investors reminded of the danger of legal probes by regulators in an industry that has always been vulnerable to such issues. Glencore significantly underperformed its rivals in 2019, potentially as a result of the Serious Fraud Office joining an ongoing Department of Justice probe into corruption and fraud. However, on the back of the tailings storage issue, three-quarters of our respondents expect the environment to be the biggest issue for governmental enforcement in 2020, which 81 percent of participants expect to increase this year.

Almost half of our respondents said that the impact on local communities would be where the mining industry faced the most scrutiny from investors and regulators, while 29 percent said it would be water usage.

Already, miners have had to increase their transparency on tailings, for example, with a survey by an investor group—led by the Church of England—that holds about US\$13.5 trillion in assets finding that about 10 percent of the world's 1,635 tailings dams have had stability issues at some stage. Asset managers themselves are becoming more active on ESG matters, eager to prove to clients that holdings have been fully vetted. Many now have ESG-related criteria that must be cleared before investments are made (or maintained), making it ever more important for companies to demonstrate their credentials.

Resource nationalism and legal probe

The impact that miners can have on local communities received global attention following the Brumadinho incident, but underlying tensions with some states were less publicized. The Democratic Republic of the Congo, a key copper, cobalt and gold producer, continued to squeeze the industry

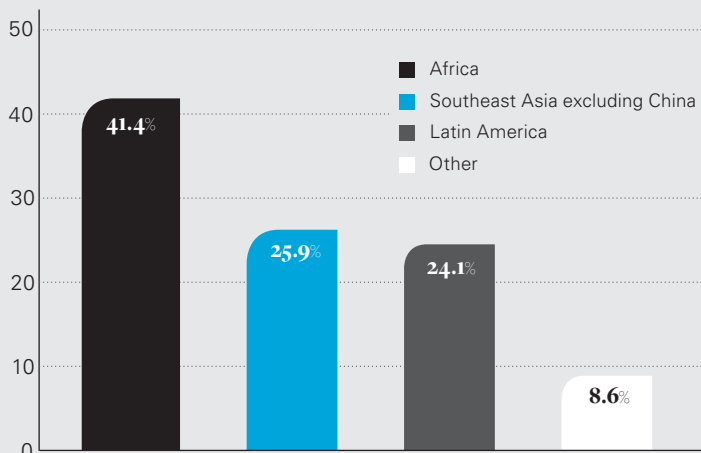
with the implementation of its new mining code that was at least partially responsible for Glencore shutting down a key mine there. Zambia remained a troubled spot for copper producers, with Vedanta falling afoul of authorities there. Indonesia impacted the global nickel market, making it the best base metal performer of 2019, as it moves to ban exporting unrefined product. In our survey, 41 percent expect Africa

Big deals

Outside of the gold space, the mining sector has seen few transformative deals in recent years, as the industry focuses on getting leaner as investors seem to have little appetite to return to the blowout M&A of the past.

Our survey suggests this theme is set to continue, with almost 50 percent saying that opportunistic deals are

Which region do you see posing the biggest resource nationalism risk?



Source: White & Case 2020 Mining & Metals market sentiment survey

most likely in 2020. Base metals and precious metals are where our respondents think activity is most likely, with battery materials dropping one position from last year into third.

When it comes to how such deals could be financed, our survey suggests there could be an increase in the use of bond and convertible debt as well as equity and project financing. However, the use of bank debt may decline.

Precious metals, and the companies that mined them, were the standout performers of 2019. Driven by both macro uncertainty and geopolitical instability, gold rose to the highest level in six years and ended the year above US\$1,500 an ounce. For the gold miners, deals were the big theme of the year—as predicted in our 2019 survey—with the industry continuing to reshape following Barrick Gold and Newmont Gold’s transformational transactions. Palladium also had a strong year, hitting record highs on fears of supply shortages, which threw a lifeline to South Africa’s previously struggling platinum miners.

Outperformers

The positive sentiment surrounding base and precious metals is also reflected in our survey when it comes to picking the metals expected to perform best this year, with 35 percent saying copper and 21 percent choosing gold. It’s a different story for battery materials after another difficult year: while 13 percent expect lithium to be a standout performer in 2020, no respondents chose cobalt.

Battery material markets remained under sustained pressure in 2019, as the full scale of new production capacities dawned on the market. Cobalt plummeted to US\$30,000 a ton after almost reaching US\$100,000 a ton at its peak in mid-2018. That forced a dramatic reaction from the biggest supplier, Glencore, which announced it was shutting down its giant Mutanda mine in the Democratic Republic of the Congo, the single biggest source of cobalt, in an attempt to put a floor under falling prices.

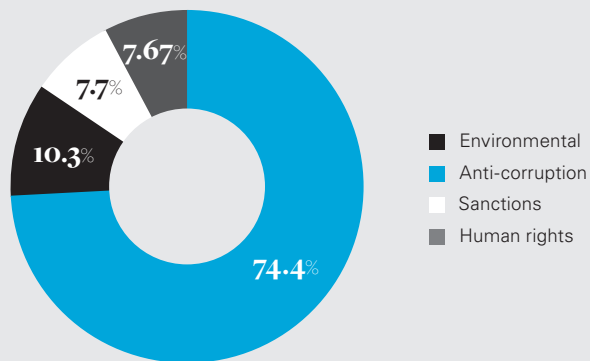


\$33bn

Value of global gold acquisitions in 2019—more than half of total global mining M&A

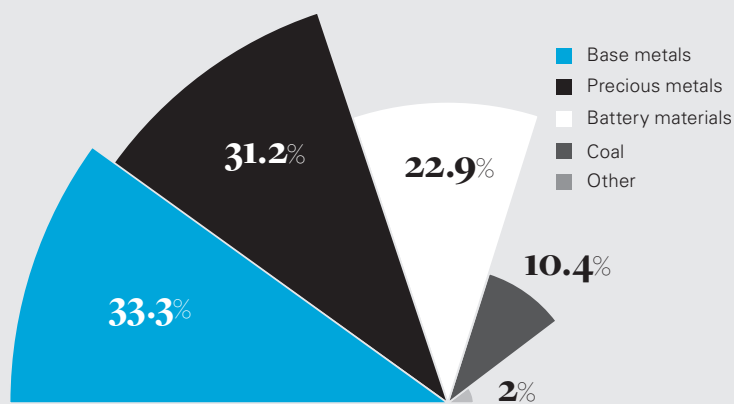
Source: Bloomberg

Which enforcement issues do you think will be most prominent?



Source: White & Case 2020 Mining & Metals market sentiment survey

What sector is most likely to experience consolidation?

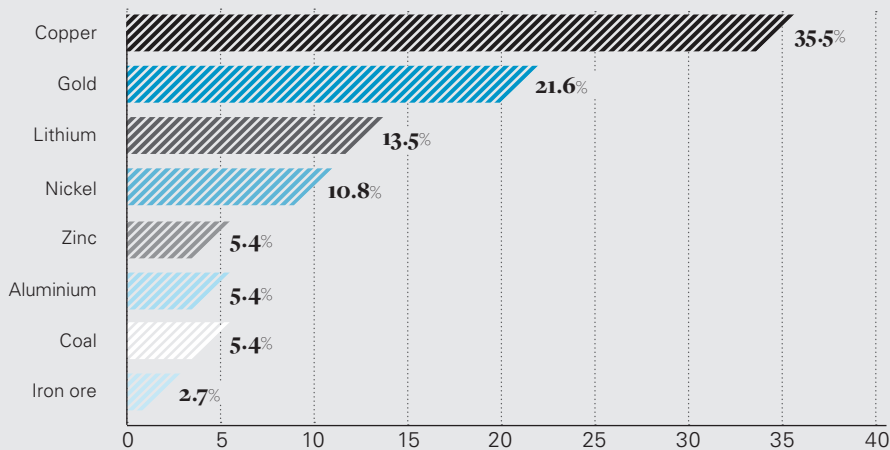


Source: White & Case 2020 Mining & Metals market sentiment survey



Three-quarters of our survey respondents say the environment will be the biggest issue for government enforcement action, which is expected to increase in 2020

Which commodity is more likely to outperform in 2020?



Source: White & Case 2020 Mining & Metals market sentiment survey

It was a similar story in lithium, as too much production came on line too early and EV takeup slowed, especially in China. Between mid-2015 and mid-2018, prices for lithium, the soft, silvery-white metal crucial for rechargeable batteries, almost tripled as the world's fleet of electric vehicles hit the five million mark. Prices have fallen by almost half since reaching that peak. At the same time, Chinese sales of cars running on electric motors have



Projected value of global automotive lithium-ion battery market by 2030

Source: Roots Analysis; Bloomberg

been falling since July, as regulators reduced subsidies.

Technology

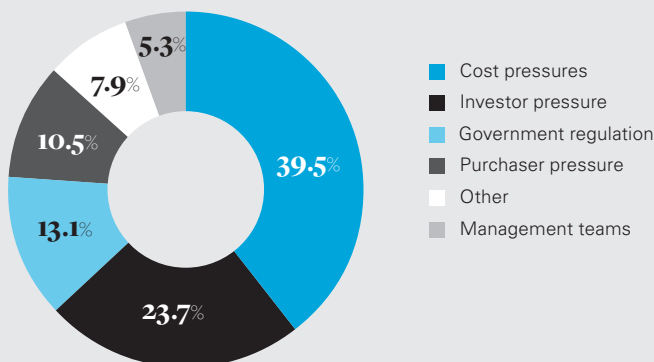
The mining industry continued to pursue technological innovations in 2019. While concepts such as blockchain grab the headlines, productivity gains reducing the environmental impact have been at the forefront of most programs. Anglo American has continued to pursue ideas such as synthetic water, which

will dramatically reduce its water needs in areas where the resource is scarce, such as Chile and South Africa, while Rio Tinto has been rolling out its automated train lines in Australia. All major miners are increasing the spend and rollout of data analytics to improve their mining and exploration activities. Our survey suggests this will continue, with cost pressures being the biggest driver for innovation for a second straight year.

Still, blockchain initiatives continue to be rolled out, especially in consumer-focused commodities such as diamonds or those with negative ESG associations such as cobalt. Our survey highlights that the experts are still split on how blockchain will be best implemented, but ultimately its use in managing supply chains and logistics had the most support, with an increased share from the previous year.

One thing is certain: The 2020s are set to be a serious transition period for the mining industry. After two decades of supercharged Chinese growth and omnipresent concerns about a global slowdown, other issues, such as resource nationalism and trade pressures, compliance and ESG considerations are taking center stage for investors and throughout the value chain.

What will be the biggest driver of innovation in mining?



Source: White & Case 2020 Mining & Metals market sentiment survey



Copper is expected to outperform other mining commodities in 2020, but it's a different story for battery materials, with cobalt not even making the list of anticipated top performers this year

Rebecca Campbell

Partner, London

T +44 20 7532 2315

E rebecca.campbell@whitecase.com

John Tivey

Partner, Melbourne

T +61 3 8486 8083

E jtivey@whitecase.com

Oliver Wright

Partner, Washington, DC

T +1 202 626 3580

E oliver.wright@whitecase.com

whitecase.com

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