

Mining & Metals 2019: China and trade tensions top industry fear list

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Miners were caught up in a raft of geopolitical challenges that contributed to a largely stagnant 2018. But what does the underlying picture look like for 2019? In our third-annual survey, we asked mining & metals industry participants to share their views for the year ahead. Partners **Rebecca Campbell** and **John Tivey** of global law firm White & Case discuss some of the key findings.

The global mining & metals sector spent 2018 in the thrall of macro uncertainty and geopolitical tensions. The impact was a challenging year for commodities, especially those susceptible to speculative money flows rather than underlying fundamentals. While most accepted gauges for base metals, such as LME stockpiles and end-user demand, signalled bullish signs, metals across the board from copper to aluminium suffered significant price declines last year. Even gold remained

relatively flat in 2018, but corporate activity not seen elsewhere has given that sector a shot in the arm that should play out this year, and analysts expect prices to move up as investors may start to turn to 'safe' assets.

Uncertainty dented appetite among investors for mining & metals stocks, and despite reporting substantial profits, often at multi-year highs, in addition to further record distributions to shareholders, most equities ended the year in the red, following two years of outperformance. Therefore,



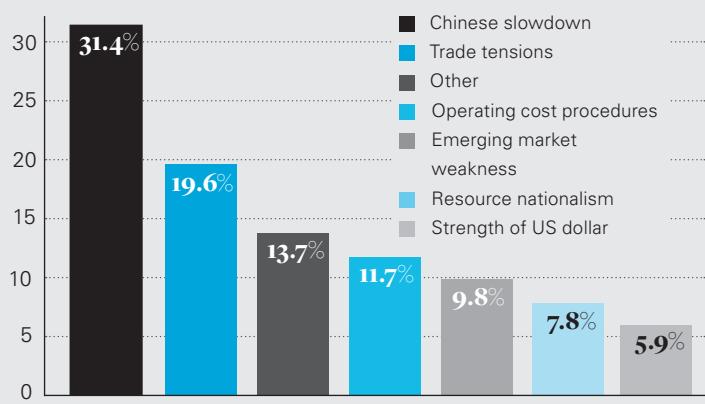
**US\$
1,300**

Gold prices held relatively firm in 2018, around US\$1,300 per ounce

the sector faces a large degree of uncertainty heading into 2019. To get an idea of what to expect, White & Case has conducted its third-annual straw poll of industry participants, with 51 senior decision-makers providing us with their thoughts for 2019.

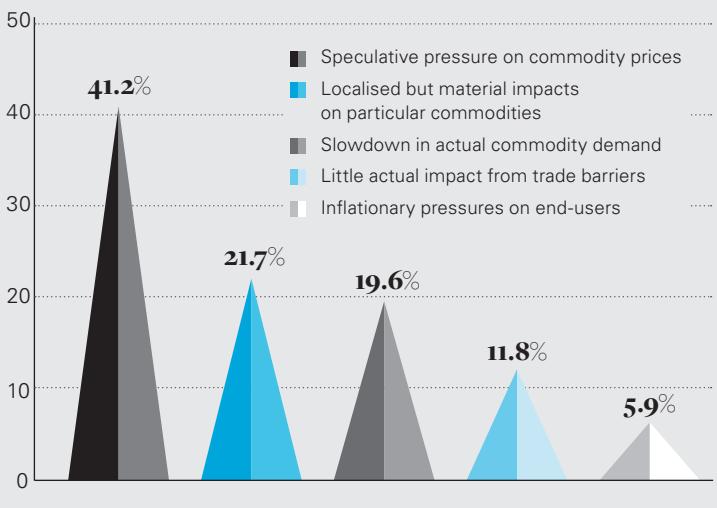
Responses from our survey indicate that an economic slowdown in China, consumer of about half the world's commodities, is the single biggest fear for the mining & metals sector this year, with one-third of our respondents highlighting that as the key headwind. It was closely followed by trade tensions, which have ramped up in recent months with US President Donald Trump's increasingly aggressive trade policies with China. About 20 per cent of respondents see this as the key risk to the sector for 2019.

What is the key risk for mining & metals in 2019?

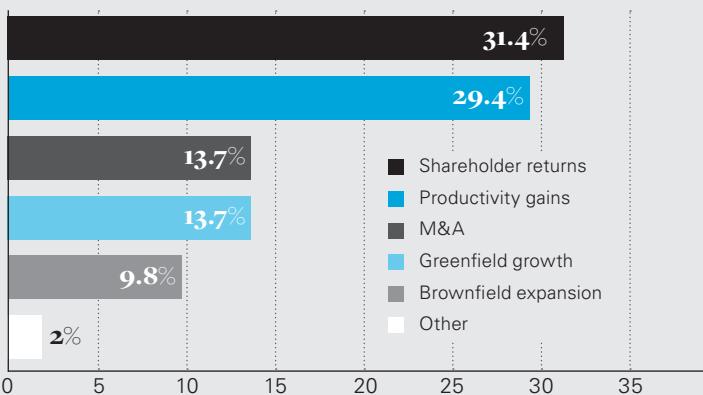


Our industry survey suggests that economic slowdown in China will be the most key risk to the mining & metals sector in 2019

What impact are trade tensions likely to have in 2019?



What will be the main priority for the mining & metals sector in 2019?



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The biggest impact of trade tensions in 2019 is going to be on speculative pressure on commodity prices, rather than any erosion of underlying demand for the hard commodities



**24.28
ml mt**

Projected global copper output for 2019

Source: International Wrought Copper Council

Speculative pressure

So far, markets seem to have absorbed the impact of the current raft of trade barriers—US import duties on steel and aluminium, and defensive safeguards from the EU and elsewhere in the world—and there is cause for optimism. Our survey results indicate that the biggest impact of trade tensions this year will be on speculative pressure on commodity prices, rather than any erosion of underlying demand for the hard commodities. The current cycle should continue to be demand-driven, with miners likely to continue to focus on productivity gains to deliver a measured supply-side response to demand, with less visibility than in previous years.

In the world of the big diversified miners, 2018 was a year of getting leaner. Rio Tinto offloaded business, including Europe's biggest aluminium smelter and the giant Grasberg copper mine in Indonesia, while BHP Group sold its US shale business for US\$10.5 billion, recouping some of the tens of billions it spent on the assets. The two biggest miners are returning the proceeds of these sales to shareholders, along with dividends from their continuing operations.

Glencore, the most acquisitive of the major miners, has been relatively quiet on the deal front, with its billionaire CEO, Ivan Glasenberg, saying he sees little to buy, while it is also subject to a US Department of Justice probe. Anglo American is the only big mining company to have green-lighted a major new copper mine in 2018, having given the go-ahead for the US\$5 billion Quellaveco copper project in Peru, together with an upsizing of Mitsubishi's equity stake in the project to further share development and construction risk.

M&A on the back burner

This focus on getting the most out of current assets while returning money is what our respondents expect to be the major theme in

2019 too. Shareholder returns will be the mining sector's number one priority, according to 31 per cent, closely followed by productivity gains, according to 29 per cent. That's a similar picture to what our respondents expected last year, when a similar percentage expected shareholder returns to be the main goal for management. However, looking back to our 2017 survey, it was debt reduction that was seen as the keen focus, showing how successful the sector has been in moving from balance sheet recovery to rewarding investors.

2018 was a quiet year for deals in the mining sector, with most companies looking to offload unwanted assets rather than seek acquisitional growth. Our survey showed that it's likely to remain on

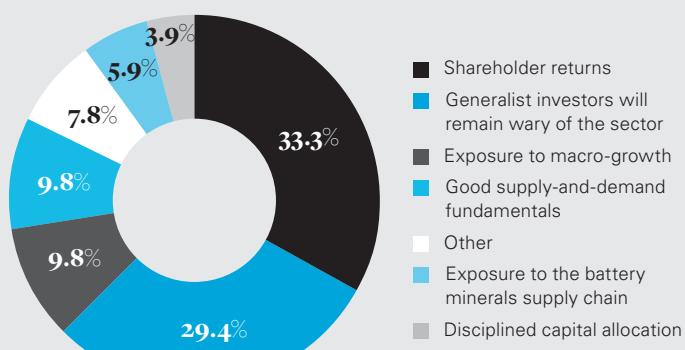
the backburner. The recent Barrick-Randgold merger has already spurred a US\$10 billion reaction, and may be the catalyst for other transactions in the gold sector over the next 12 months. The combined company's new CEO, Mark Bristow, has said that he sees the deal as just the start-up to an industry shakeup. China's miners also remain acquisitive, albeit on a smaller scale, with Zijin Mining buying into assets in both the Congo and Serbia this year.

Where there are deals, more than 50 per cent of our respondents expected last year's theme to continue with opportunistic swoops for assets being the primary driver, rather than major transformational deals. A combination of financing methods is expected to be used for funding such purchases, according to our survey.



With shareholder returns topping the list of the mining sector's priorities for 2019, the focus on getting the most out of current assets is expected to be another major theme

What is likely to lure non-specialist institutional investors to the sector?



Balance sheets to fund growth

The industry's wary approach to growth and lack of major deals has seen sector financing take something of a backseat in 2018. The major producers have plentiful cash on hand such that they're able to fund much of the limited growth they are pursuing. Anglo's new Peruvian copper mine will be funded through cash flow, while many of the additional brownfield expansions planned by the majors will be paid for from earnings. While our respondents expect to see a combination of financing this year, balance sheet funding is seen as the most likely route, and raising equity is seen as the least likely, as investors are still reluctant to pay for new capacity.

Still, the one area in which our respondents expect to see real growth is the use of streaming and royalty funding, with two-thirds seeing an increase this year. Traditionally the preserve of the precious metals sector, royalty deals are gaining more traction, with Glencore creating a specialist streaming business and Anglo Pacific growing its base metal and coal royalty business. Cobalt 27 is also offering a new way of financing mines for battery materials, and it inked deals for both cobalt and lithium last year.

Even with record returns to shareholders, the mining sector continued to gain little traction with generalist investors in 2018, creating a valuation gap compared to the wider equity markets that are now firmly entrenched, according to research from Sanford C. Bernstein. That could remain the status quo in 2019, with 29 per cent of respondents expecting non-specialists to remain wary of investing in the sector. Some 33 per cent of respondents see shareholder returns as the most critical catalyst for luring a broader shareholder base to the space.

Copper bulls

Battery materials have been the most compelling 'good news' story



**22.44
ml mt**

Projected global copper demand for 2019

Source: International Wrought Copper Council

in mining for the past four years, but 2018 will likely be remembered as the year when that enthusiasm faced its first real test. Cobalt, after surging to almost US\$100,000 a tonne, came under serious pressure in the second half of the year as demand failed to match some of the more optimistic projects and a wave of new supply, induced by higher prices, is looming on the horizon.

Yet those jitters, which have seen some Chinese buyers already renege on pre-agreed sales at higher prices, is also showing why people like the cobalt story. Supply is heavily dependent on the Democratic Republic of Congo and especially Glencore's mines there. While the world's biggest commodity trader has reined in its supply targets for next year, others, such as ERG, a diversified natural resources producer, plan to increase cobalt output from the DRC—news that will most likely be greeted positively by the market.

It has been a similar story in lithium, where new projects are being developed from Australia to South America, prompting price declines of more than 50 per cent from their peak in late 2017. However, respondents to our survey see lithium rebounding next year, with some 22 per cent expecting the metal to outperform this year. The only commodity that has more support in our poll is copper, with 43 per cent selecting this as their top pick. This bullish view on copper has now become a consistent theme in our polls, with it being the favoured commodity for the third straight year.

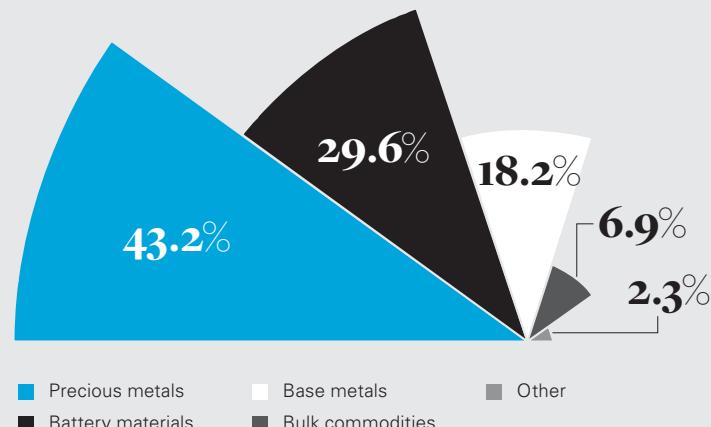
Our respondents are in good company with that expectation. The mining industry is universally bullish on the metal: Demand is forecast to continue to rise as cities and transport become increasingly electrified, while supply looks constrained. However, growth is hard to come by. Rio Tinto, with perhaps the strongest balance sheet in the sector, has been vocal in its pursuit of big copper mines, but



US\$100

Price of thermal coal for most of 2018, the highest since 2011

What sector is most likely to experience consolidation?



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The bullish view on copper has now become a consistent theme, with it being the favoured commodity for the third straight year in our polls

its CEO has repeatedly stated that the company won't overpay. This has prompted more attention to be placed on exploration and buying into promising ground, as BHP did when it bought a 16 per cent stake in explorer SolGold, overtaking Newcrest as its biggest shareholder and potentially setting up a competitive bid situation for the company further down the line.

Gold consolidation

In what was a somewhat staid year for the mining industry, Barrick Gold's US\$5.4 billion swoop for Randgold Resources in September suddenly gave the industry something to talk about. The fallout from the deal has already begun, with Barrick's

acquisition being trumped by the announcement in January 2019 that Newmont will buy Goldcorp in a US\$10 billion deal that will create the world's biggest gold miner. The trend is unlikely to end there, with pressure now being put on other producers such as Newcrest and AngloGold to respond. Both Barrick and Newmont are also expected to dispose of non-core assets after the deals, making mines available for smaller producers.

The prospect for a very different gold market to emerge in 2019 is certainly something highlighted in our poll, which showed that there is confidence that the gold sector is the most likely to see deals this year, with 43 per cent of our respondents seeing precious metal miners most likely to lead consolidation efforts, compared to just 18 per cent who thought base metals M&A was most likely.

Yet any tangible recovery in gold mining equities is unlikely without a resurgence in the underlying price of bullion. So far, gold has been resistant to many of the macro-challenges and geopolitical risks that dominated 2018. In a year when the US and China, the world's

two biggest economies, repeatedly clashed over trade policies, the gold price held relatively firm around the US\$1,300 per-ounce mark.

Clean skies to hurt coal

Thermal coal was one of the standout commodities in 2018, with prices sitting above US\$100 per tonne for most of the year, the highest since 2011. The fuel is largely immune to speculative money given that most contracts are settled directly between producers, traders and customers without the same level of securitization or open trading platforms that exist in base metals or oil, but it has also been supported by increasingly dislocated supply-and-demand fundamentals.

China dominates both factors, mining and burning more coal than any other country, and it has increasingly looked to import higher-quality and less-polluting coal as part of its Clean Skies directive. That's put a squeeze on the seaborne market at the same time that many of the biggest producers start to turn their back on the fuel.

More than half of the respondents to our survey expect coal to be the most impacted commodity from China's continued policies to reduce pollution from its air. Rio Tinto has sold all its coal mines, while BHP and Anglo American have said the fuel will struggle to compete for capital against commodities such as copper. New entrants to the market are also constrained as banks and investors become warier of funding coal production. Lenders to the industry cut funding to US\$14.9 billion in 2017 from US\$22.5 billion in 2015, according to BankTrack, while at least 15 of the biggest banks have policies that prevent investing in coal projects.

This is a significant break from traditional commodity cycles, where sustained high prices often induce new supply. Yet, as the International Energy Agency confirmed in its annual report on coal in December, risks

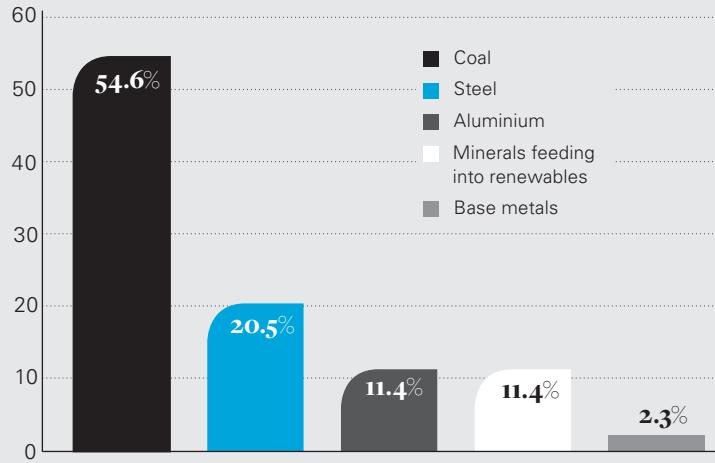


**US\$
14.9 bn**

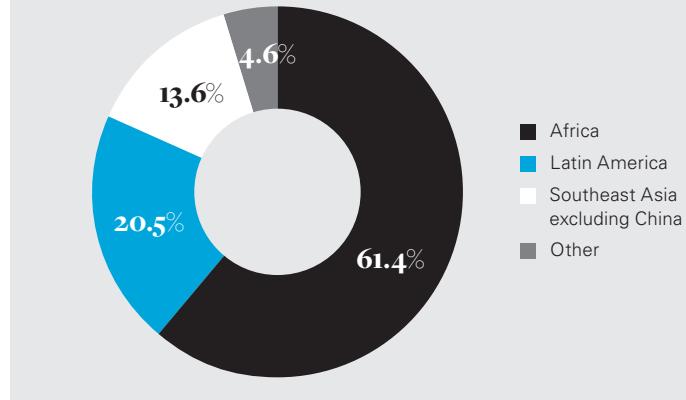
Lending to the mining industry in 2017, down from US\$22.5 billion in 2015

Source: BankTrack

China's Clean Skies policy will have the biggest impact on which commodity?

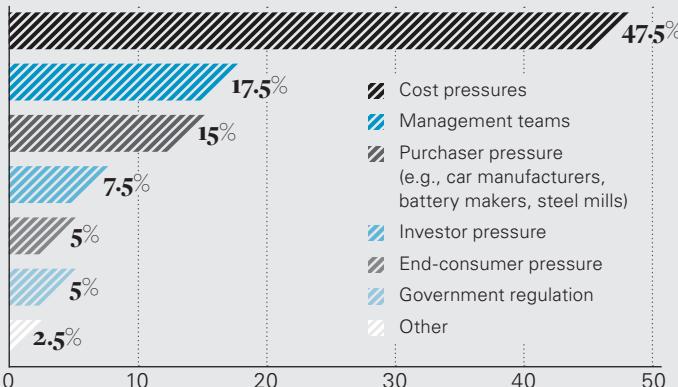


Which region do you see posing the biggest resource nationalism risk?



2018 was a quiet year for deals in the mining sector, with companies looking to offload unwanted assets rather than seek acquisitional growth, and M&A is likely to remain on the backburner for 2019

What will be the biggest driver of innovation in mining?



US\$
5,980

LME Copper
Official prices,
per tonne

Source: LME,
21 December 2018

associated with climate policies and local opposition continue to prevent significant new investment.

That's made it a very profitable space for those still mining thermal coal. Glencore is the only major miner that is increasing its coal footprint, having bought mines, along with Yancoal, from Rio. That's set to see its coal profits jump to US\$6.2 billion in 2019, eclipsing its copper earnings this year for the first time since listing in 2011, according to the company. Anglo, which still operates major coal mines, is also forecast by analysts to get more than 40 per cent of its 2018 profits from coal, despite the company's core assets being platinum, diamonds and copper.

National interests

Resource nationalism is a near constant theme in mining, and 2018 proved to be no different. A new mining code in the DRC became a political flashpoint as an alliance of miners, including Randgold, Ivanhoe and Glencore, sought to change the government's stance on raising taxes and royalties, while scrapping a ten-year standstill agreement. Tanzania and Zambia were also

more aggressive with some of their resident mining companies, using outstanding tax bills as a source of leverage. Indeed, one respondent expected government revenue collection pressures to be the most prevalent theme of 2019.

Our survey showed that while only about 8 per cent saw resource nationalism as the biggest risk for the sector, 61 per cent expected Africa to be the most risky jurisdiction. Ongoing elections in the DRC, where President Joseph Kabila's 18-year rule is set to end, will probably prove to be the main focus for investors. Elections are also set to be held in South Africa in the first half of the year. Given the country's work on a new mining charter, and importance to the industry, this will be a very closely watched vote.

Technological innovation gathers pace

While the mining industry has not traditionally been considered to be at the forefront of innovation, the sector continues to take steps that will ultimately revolutionise the impact it has on not only the environment, but also employment and productivity.

2018 was a big year in terms of automation, as the big Australian iron ore miners continued to drive forward in this space. Rio Tinto completed its first fully autonomous train delivery across Western Australia, moving 28,000 tonnes of ore 280 kilometres, all controlled from a tech hub in Perth. Resolute Mining is currently commissioning the first fully autonomous underground gold mine in Mali, while Anglo American unveiled its new FutureSmart Mining programme that has goals such as reducing water use by 20 per cent by 2020. More than 40 per cent of our respondents expect cost pressures to be the biggest driver of continued innovation in the sector. This is likely to gather pace as miners see rivals using automation, live data analytics and integrated supply chains to gain advantages, forcing them to follow suit if they want to hold positions on the cost curve.

Yet the industry is also making use of more fast-moving technologies such as blockchain. So far, the technology has been most developed in sectors where consumer confidence is key. De Beers, trying to combat concerns around supply chain traceability and the long shadow of conflict diamonds, is trialling a blockchain-based tracking programme that has gained support from some of the biggest retailers. There are also moves from the big technology companies and carmakers to use such innovations to assuage concerns about the cobalt supply chain. Still, it might be too early for this technology to be a game-changer for the wider commodity market. Just 3 per cent of our respondents expected a widespread rollout across the industry this year, while 20 per cent saw it gaining little immediate traction. Still, as more industry participants understand its potential benefits and as consumers and manufacturers become increasing aware of the need for supply chain transparency, it's likely to gain momentum.

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