

Anglo American: Time for Thungela to stand alone

Given that coal prices have recovered well off the lows reached in mid-2020, the timing could not have been better for Thungela Resources to be spun out of the Anglo American behemoth. The new company will receive substantial support from Anglo as it transitions to a stand-alone company. But the outlook is clouded by ESG concerns as sentiment turns increasingly negative towards coal.



Roy
Lamb

Thungela Resources: Some background

To give some context behind Anglo American's decision to demerge its South African thermal coal operations, the company has made numerous comments and strategic decisions showing that they are on a transformational journey with a clear leaning towards future-enabling products. Given that coal is such a contentious issue in the context

of social and environmental concerns, it is not surprising that it does not feature highly as one of Anglo's long-term commodities of choice.

The CEO of Anglo, Mark Cutifani, has referred to the 'healthy, but intense competition for capital across the group.' Coal is not high on their agenda and hence capital has ultimately been allocated to projects and minerals that enhance their future-enabling stance, namely copper, crop nutrients, platinum group metals and other positions across their portfolio. The contribution of thermal coal to Anglo's group revenue is a paltry 4% and coupled with the fact that having exposure to this commodity has actually been a deterrent for some investors added to their reasoning to hive off this division. This is not to say that the division does not have value but at 4% of the portfolio it is just not meaningful enough for those wanting pure exposure to coal. As Mark Cutifani stated, thermal coal remains at the '*back of the queue in terms of capital allocation*'.

Anglo is by no means leaving Thungela in the lurch, but rather laying a solid foundation which will enable it to stand on its own over time. This support comes in three key areas:

1. A capable management team have been appointed who have already proven themselves by transforming the business dramatically over the past few years for the better.

SPEED READ

- Anglo American is parting ways with their SA thermal coal operations. Consequently, Thungela Resources has been demerged from Anglo American. Shareholders in Anglo have received 1 Thungela share for every 10 Anglo held. The demerger took effect last Monday, 7th June.
- Anglo will provide a cash injection of R2.5 billion, as well as support over the next 18-months should an agreed upon coal price not be achieved.
- The outlook for Thungela is a tug-of-war between improving operating metrics and ESG concerns.

2. Anglo is also providing initial funding and capital which will eliminate the debt of the coal division entirely.
3. Finally, they will also help with the marketing of Thungela's export production whilst providing a guaranteed minimum price in order to give the business a buffer as it starts life as a standalone operation.

A closer look at Thungela Resources

Despite all the negative environmental connotations around coal, there is no disputing the fact that thermal coal will remain a significant part of the energy mix going forward in countries such as India (largest export market for SA thermal coal), China, Pakistan, Vietnam and others. Likewise, thermal coal will also remain important for South Africa's energy requirement for decades to come. Thermal coal was SA's single largest foreign currency earner in 2018 and it employs roughly 90 000 people, making up 20% of mining jobs locally. Recent research has indicated that South Africa is the fourth-largest producer of thermal coal globally. Consequently, Thungela is well positioned to cater for this growing demand from India and other developing countries in South Asia.

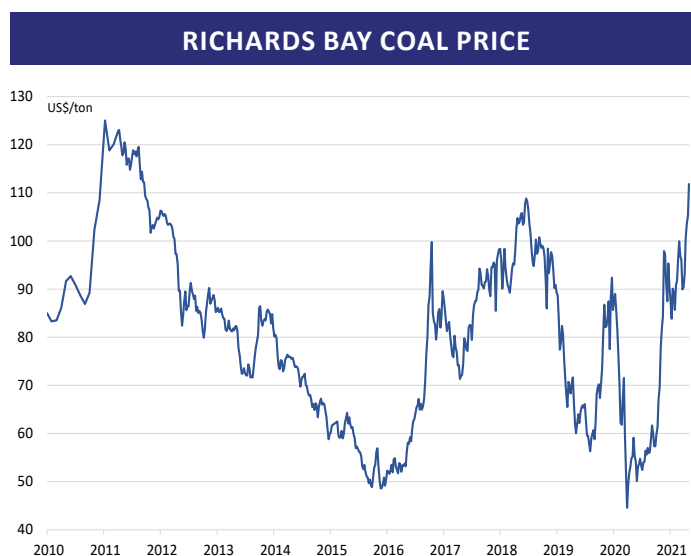
Viewed holistically, coal makes a significant contribution to our economy. Consequently, the business is highly aware of the sensitivity of the projects and mines that they operate and have committed to responsible environmental stewardship based on the efficient use of resources, climate risk management and promoting biodiversity which will also deliver significant benefits to their host communities. This includes closing mines in a responsible manner to enable sustainable future land use.

Some of the benefits to employees and the communities include each eligible employee receiving a minimum dividend of R4,000/annum, guaranteed until 2024, and a community partnership plan that will hold a 5% direct equity stake in the South African operations. This in turn will generate an annual dividend of R6 million/annum until 2024, which is available for reinvestment back into communal facilities.

From a business and operational point of view the portfolio of assets has been upgraded meaningfully over the past 5 years. In 2015, a high proportion of production was tied to supplying Eskom, whereas the current portfolio is largely export focused with a higher quality product. Current annual production is just over 30 million tons with over half of that being exported. Thungela have four opencast and three underground mines located in Mpumalanga with an experienced management team focused on delivering maximum cash flows from the respective assets and ensuring that each mine delivers on its ultimate potential whilst keeping a sharp eye on overall costs. The net result is that some of the high-cost production has been removed from the production mix whilst simultaneously improving the overall quality of the coal – which in turn receives a

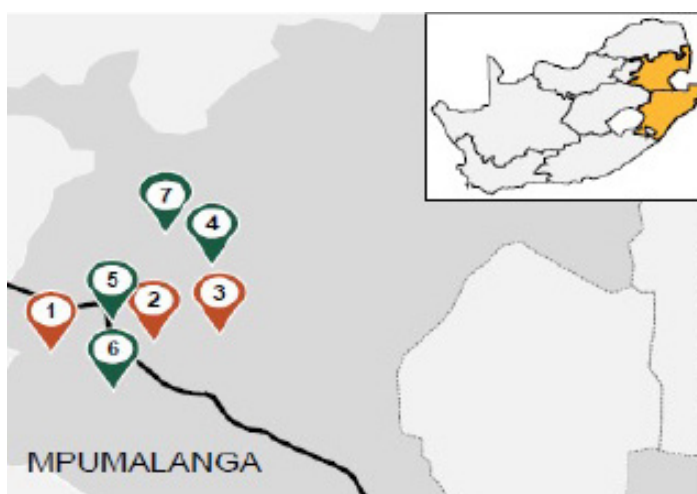
higher price on the global market.

Fortunately, Thungela’s asset base is found at the lower end of the industry cost curve relative to both its global and local peers, which bodes well for this ‘out of favour’ commodity. Spot coal prices having firmed recently (albeit somewhat offset by rand strength) giving the company increased flexibility for expansion and / or shareholder returns. Due to the structure of the demerger, Thungela shareholders are partially protected from an unexpected decline in coal prices by the inherited tax loss of R5 billion as well as the minimum floor price guaranteed by Anglo. Management also has sufficient flexibility to produce a lower quality coal should low prices persist.



The Dollar price of coal is at its highest level since 2011, although Rand strength has taken some of the shine off for domestic exporters such as Thungela.

THUNGELA’S MINE LOCATIONS



Thungela has three underground and four open-cast operations, producing 30 million tons of coal per annum. 54% of this is exported, 37% is used by domestic industrial customers, and the balance of 9% is sold to Eskom.

Coal may be a “sunset” industry, but that doesn’t necessarily imply a poor investment return. South African seaborne coal supply alone is forecast to decline by 30% over the next 15 years and globally by 25% over the next 10 years. Simultaneously, production capacity is expected to decline as existing mines are depleted and not replaced. Taken together, the outlook for coal prices is highly favourable. The investment case for Thungela is a tug-of-war between the relatively attractive operating metrics and potential high cash flows, offset against the environmental concerns of coal and the associated carbon footprint. Furthermore, given the small size of Thungela relative to the broader Anglo Group, the weighting in portfolios of Thungela will be negligible. Consequently, we expect the share to come under pressure in the first few months of trading as shareholders adjust their portfolios. Having been invested in these assets (through Anglo) we don’t feel that it is worth selling the shares indiscriminately – especially given vastly improving coal prices and operating metrics. Once the share has settled, we will reassess the investment case and make a further decision.



We are excited to have resumed our seminar program in April / May. Our next seminar is scheduled for June / July. The topic will be announced in due course.

Please save the date below. Please note that due to Covid protocols, numbers are strictly limited to 100 per session, and only drinks (no food) will be served. Booking is therefore essential.



[Harvard House is on Facebook](#)



[Harvard House is on YouTube](#)

Topic: Can you trust your first thought?

Natal Midlands

Date: 24th June 2021

Venue: Fernhill Hotel
Midmar / Tweedie Road
Howick

Morning Time: 10am for 10.30am

Evening Time: 5.30pm for 6pm

Johannesburg

Date: 08 July 2021

Venue: Rosebank Union Church, Cnr
William Nichol and St Andrews
Road, Hurlingham

Time: 7am for 7.30am

CONTACT DETAILS:

For more information on the range of products and services offered by Harvard House Investment Management and its associated companies (including Harvard House, Chartered Accountants), or for any financial advice, please contact the Company at:

HARVARD HOUSE GROUP



3 Harvard Street, Howick, 3290, South Africa



P.O. Box 235, Howick, 3290, South Africa



+27 (0) 33 330 2164



+27 (0) 33 330 2617



admin@hhgroup.co.za



www.hhgroup.co.za

The information contained in this newsletter comes from sources believed to be reliable, but Harvard House Investment Management (Pty) Ltd, Harvard House Financial Services Trust, Harvard House Insurance Brokers and Harvard House, Chartered Accountants (collectively known as the Harvard House Group), do not warrant its completeness or accuracy. Opinions, estimates and assumptions constitute our judgment as of the date hereof and are subject to change without notice. Past performance is not indicative of future results. This material is not intended as an offer or solicitation for the purchase or sale of any financial instrument. Any investor who wishes to invest with the Company should seek additional advice from an authorized representative of the firm. The Company accepts no liability whatsoever for any loss or damages whatsoever and howsoever incurred, or suffered, resulting, or arising, from the use of this newsletter. The contents of this newsletter does not constitute advice as contemplated in the Financial Advisory and Intermediary Services Act (FAIS) of 2002.

The Harvard House unit trusts are registered under the Boutique Collective Investments. Custodian: Standard Executors & Trustees: Tel (021) 007-1500. Collective Investments are generally medium to long term investments. The value of participating interests may go down as well as up and past performance is not necessarily a guide to the future. Collective Investments are traded at ruling prices and can engage in script lending. Forward pricing is used. Commission and incentives may be paid and if so, are included in the overall cost. This fund may be closed to new investors. Collective Investment prices are calculated on a Net Asset Value basis and auditor's fees, bank charges, trustee and RSC levies are levied against the portfolio. The portfolio manager may borrow up to 10% of portfolio NAV to bridge insufficient liquidity. Boutique Collective Investments (RF) Pty Ltd ("BCI") retains full legal responsibility for the third party named portfolio. Boutique Collective Investments is a member of ASISA and is an authorised Financial Services Provider. Should you have any further queries or complaints regarding the suite of units trusts offered by The Harvard House Group please contact: Boutique Collective Investments Call Centre, Tel: (021) 007-1500, Email: clientservices@bcis.co.za. For your information, the FAIS ombudsman provides an independent and objective advisory service. Should you not be satisfied with the outcome of a complaint handled by Boutique Collective Investments, please write to, The Ombudsman, PO Box 74571, Lynnwoodridge, 0040. Telephone (012) 470 9080/99. Fax (012) 348 3447. Email: info@faisombud.co.za

Performance figures quoted for the portfolio is from Morningstar, as at the date of this document for a lump sum investment, using NAV-NAV with income reinvested and do not take any upfront manager's charge into account. Income distributions are declared on the ex-dividend date. Actual investment performance will differ based on the initial fees charge applicable, the actual investment date, the date of reinvestment and dividend withholding tax. Performance fees do not apply to any funds managed by Harvard House. The manager does not provide any guarantee either with respect to the capital or return of the portfolio. A schedule of fees, charges, and maximum commissions are available on request from the manager.

Harvard House Investment Management (Pty) Ltd*, Licence no: 675 Harvard House Insurance Brokers*, License no. 44138

Harvard House Financial Services Trust*, Licence no: 7758 * Authorised financial service providers in terms of FAIS (2002)

Harvard House Investment Management (Pty) Ltd*, Licence no: 675

Harvard House Financial Services Trust*, Licence no: 7758

Harvard House Insurance Brokers*, License no. 44138

* Authorised financial service providers in terms of FAIS (2002)