

Mining: Enjoying the tailwinds

One of the sectors to have seen the sharpest recovery since the lows reached in March 2020 has been Resources. The latest bout of results being released by the heavyweight global diversified miners as well as single commodity producers shows a vast improvement in earnings, and share prices reaching multi-year highs. Encouragingly, dividends are rising just as fast.



Roy
Lamb

It is hard to believe the rate at which commodity counters have recovered from the pandemic lows seen in March last year.

The rebound has been spurred by the promise of government stimulus, under-investment in new mine supply and continued strong demand out of China.

Performance of Selected Metals

Commodity	19-March 2020	19-February 2021	Change
Platinum (\$/oz)	586	1264	116%
Palladium (\$/oz)	966	2354	144%
Rhodium (\$/oz)	7000	23400	234%
Gold (\$/oz)	1472	1809	23%
Iron Ore (\$/t)	90	171	90%
Copper (\$/kg)	4685	8806	88%
Zinc (\$/t)	1880	2864	52%
Aluminium (\$/t)	1581	2135	35%

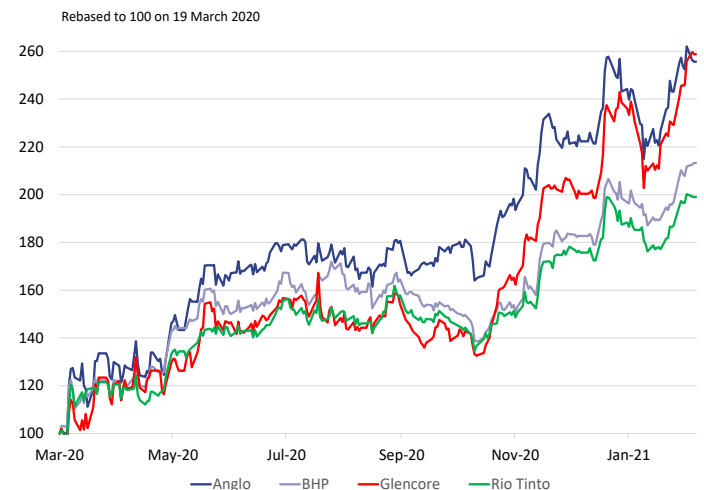
The Boom has been broad based across precious metals, base metals and bulk commodities.

The market seemed to under-estimate the rate at which governments would support economies by turning the money printing presses (quantitative easing or QE) up

SPEED READ

- The market is starting to speculate about another super-cycle in the commodity sector.
- Strong demand from China, coupled with supply constraints, is adding to the tailwind.
- The outlook for the commodities market is strong according to the CEO of BHP Group, as more of the global economy rebounds from Covid-19.

PERFORMANCE OF THE DIVERSIFIED MINERS



Despite the differences in their portfolios, global miners have all moved higher in tandem.

even more aggressively to stimulate job growth. Supply disruptions in some of the key producing areas - whether iron ore, copper or precious metals - together with a lack of investment in new projects following the last commodity boom between 2011 and 2013 (and subsequent bust in 2015/16 which saw debt levels rise to crippling levels and which in turn prompted a period of consolidation and

austerity seems to have helped fuel the rampant moves higher.

With debt now under control for most of the diversified miners and capital expenditure generally at multiples lower than at the previous peak in the cycle, it has become a lot more palatable being an investor in a mining operation due to the return of cash to shareholders. The longer that spot commodity prices remain at these elevated levels and provided that companies resist the temptation to pay exorbitant prices for underperforming acquisitions, then the chances improve significantly for further shareholder distributions.

Mike Henry, the CEO of BHP Group, had a very constructive outlook for the commodities market, and commented that “The energy transition that will occur will also be commodity intensive.” (referring to the energy transition to decarbonize the world). This is becoming increasingly evident from all the miners – namely the need for additional supply over the medium term and the intense competition for resources as the world shifts rapidly to new technologies.

BHP Group reported earnings of \$14.7 billion for the first half of their 2021 financial year, an improvement of 21% year-on-year and 47% over the prior six months. 70% (or just over \$10 billion) of the profits were derived from iron ore and a further 25% (or \$3.7 billion) from copper. The balance of 5% came from coal, nickel and petroleum combined. During the last boom cycle, BHP spent almost \$60 billion on capital expenditure, a stark contrast to the

\$16 billion that they are expected to spend during this cycle. That alone signals the change in approach that mining companies have undergone in the past few years. Owing to booming commodity prices, earnings are expected to peak at \$34 billion – lower than the \$39 billion reached in 2011. But these earnings have been generated off a leaner, smaller, and more efficient base, with a substantially lower debt profile. Undoubtedly though, the standout of these results was the 55% increase in the dividend to \$1.01 per share – a payout ratio of 80% of earnings.

“Both the diversified and specialised miners are expected to return their exceptional cashflows back to shareholders.”

Glencore is another diversified miner who has benefitted from the commodity price rally, given its exposure to a broad basket of base metals, coal and a marketing division (metals and agricultural). Revenues are split roughly as follows: copper (25%), zinc (14%), nickel (5%), coal (30%), oil (2%), and the balance of 23%

coming from the marketing division. They also joined the de-gearing trend by reducing their net debt to \$15.8 billion versus debt of \$19.7 billion just six months earlier. If one was super optimistic and assumed that current prices would persist for the entire year, then debt could drop as low as \$10 billion by December. Admittedly there are a lot of assumptions to this forecast, but it does highlight how a leveraged operator can swing around should tailwinds persist. Finally, a resumption of dividends (\$0.12/share) was also welcomed by the market, considering the last dividend was paid in September 2019.

Rio Tinto, the London-listed diversified miner and global leader in iron ore supply, also released a strong set of 2020



Miners have entered a better period and may benefit from green technology and an effort to lower carbon emissions.

results with a final dividend of \$4.02 (an increase of 74% over the prior year). Together with the interim dividend, that equates to a full year dividend of \$5.57, implying a dividend yield of almost 7% on the current share price. Earnings are heavily weighted towards iron ore (77%), with aluminium (5%), copper & diamonds (4%) and energy & minerals (7.5%) making up the balance. Whilst few analysts expect iron ore prices to remain at the lofty current levels of \$171, production costs are expected to average about \$16.5/ton, so margins will remain exceptionally healthy. That in turn will drive exceptional cash generation and additional shareholder returns.

The last of the diversified miners to report their results was Anglo American. They released their best second-half performance since 2011 with full-year 2020 earnings of \$9.8 billion (-2% on the previous year) and earnings per share of \$2.53 (-8%). Dividends were also a touch lower at \$1 for the year versus \$1.09 in 2019, but all these numbers were better than what the market were forecasting. With diamonds and platinum being the differentiators in Anglo's suite of minerals versus BHP and Glencore, these divisions had an extremely tough time during its first half of the year due to lockdown and plant failure. Fortunately, the strong metals prices in the later part of its financial year help offset this weakness - the diversification of the business showing its benefits. The CEO also made the following comment: "Our business is increasingly positioned to supply those

products that are fundamental to enabling a low carbon economy and catering to global consumer demand trends."

The four divisions across the business include Diamonds (\$0.4 billion of earnings for the 2020 year), Copper (\$1.9 billion), Platinum Group Metals (includes nickel, rhodium, palladium, \$2.6 billion) and Bulks (includes thermal/metallurgical coal and iron ore, \$5.1 billion). The production outlook for all key divisions for the years ahead (2021-2023) all look set to improve or hold steady, and De Beers has already raised prices 3 times this year, highlighting the strong recovery in demand. Another pleasing trend in this result was the decline in net debt from \$7.6 billion in June to \$5.6 billion at the end of December. The overall ratio of net debt to earnings remains less than 1.5x which is at the bottom of management's range. With earnings margins currently between 45% - 50%, the company remains highly cash generative, so there is room for debt to fall further and for shareholders to benefit as well.

With an absence of any major new projects in which to deploy capital and given the consolidation that has already taken place across the sector after the last boom period, both the diversified and specialized miners are expected to return their exceptional cashflows back to shareholders. This is most welcome given the gradual recovery in dividends from the rest of the market.



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Topic: N/A

Natal Midlands

Date:	N/A
Venue:	Fernhill Hotel Midmar / Tweedie Road (almost opposite entrance to Midmar)
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm

Johannesburg

Date:	N/A
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am

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