INTUITION

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Mining: a constant ebb and flow

Last Thursday, markets were greeted by the news that BHP had made a bid for Anglo American. Unthinkable? Cheeky? It might appear so at first glance. Anglo American is so synonymous with corporate life in SA that it is hard to imagine a future without it. Yet BHP's bid has let the genie out of the bottle and highlighted a stark truth facing the global economy – namely that the corporate world is vastly ill-equipped to meet the demands of the transition to a cleaner future. There is much water still to flow under this particular bridge before any deal may be concluded, but we analyse the deal, its implications, and take a trip down memory lane in the process.

Michael Porter

SPEED READ

- **BHP Group has made a bid for the core of Anglo American, shaking up the domestic mining sector.**
- **Ultimately, the merger is all about copper. The world is chronically short of the necessary amount of copper for both the energy transition and now the wider implications of AI on data centres and electricity demand.**
- **It is widely believed that the current bid undervalues Anglo's suite of assets. We expect competing bids to emerge now that the genie is out of the bottle.**
- **One of the implications may be the relisting of De Beers, 23 years after it was taken private. The ebb and flow of the mining cycle is as predictable as that of the waves in the ocean..**

It might seem unthinkable that one of SA's largest companies, and one so synonymous with corporate life in this country, could be about to disappear. But that is a distinct possibility following BHP's cheeky bid for Anglo American last week.

Life is full of cycles. I am writing this watching the ocean on a trip to the Cape. The waves and tides ebb and flow. So too does the commodity cycle, and so too does the cycle of corporate activity. Mining is a cyclical industry. Boom times are fantastic, but the troughs can be deep and painful. The strongest not only survive, but thrive, whilst smaller rivals become victims of weak balance sheets and shareholder impatience.

The last down cycle ended in 2016. Having boomed for years thanks to China's insatiable demand for commodities, demand dried up resulting in excess capacity. Consequently, commodity prices tanked, and share prices followed closely behind. The trough occurred in Q1 2016, when the share prices of Anglo and BHP Billiton (as it was then known) reached R53 and R125 per share respectively. Fast forward six years to 2022. The mining industry was espousing shareholder returns, prioritizing dividends and buybacks over (normally) value-destructive mergers and acquisitions. Despite Covid, strong demand and tight supply pushed commodity prices significantly higher, especially iron ore, which was compounded by accidents and other idiosyncratic factors. Welcome back to the boom days. The share prices for Anglo and BHP peaked at R830 (March '22) and R636 (December '23) per share – providing shareholders with handsome returns.

The past eighteen months have proved far more tricky for the industry. Interest rates have risen fast, putting pressure on both cash flows and commodity prices, due to the expectation of weaker growth. For Anglo in particular, this downcycle has been compounded by weak PGM prices (due to the rising popularity of electric cars and excess supply out of Russia as they discount metal to fund their war) and weak diamond prices due to overstocking. That has caused Anglo to significantly underperform its peer group. It therefore comes as little surprise that suitors are swirling.

The deal

As it stands, BHP has proposed an all-share deal for Anglo, offering Anglo shareholders 0.71 BHP shares for every Anglo share owned. This offer is conditional upon Anglo first unbundling all its shares in Anglo Platinum and Kumba

Iron Ore to shareholders. The value of the unbundled shares is equivalent to $13 billion for Anglo shareholders. The implied value of the "rump" (what remains in Anglo and what BHP wants to buy) is $26 billion. Anglo's market capitalization before the bid was $34 billion, versus a peak valuation in 2022 of $67 billion. You can see why BHP have chosen this point to pounce.

The rationale

The world has been mesmerized by AI for the past 18 months. Ever since OpenAI (and Microsoft) unveiled ChatGPT to the world in December 2022, there has been little other topic of conversation. Company reports are dominated by executives espousing the advantages of AI and how they are using it to become more efficient.

More recently, investors have started to think more broadly and woken up to some of the wider impacts of AI. Key amongst them is the demand for electricity infrastructure. Data centres are expected to consume 4% of the world's electricity in 2026, up from 2% today. And as we all know, copper lies at the core of the electricity ecosystem. This demand is in addition to the demand from the transition to electric vehicles and other renewable / clean energy solutions. It is very clear that barring a major technological innovation, the world is desperately short of copper. Given permitting, red tape and construction times, it can take up to 16 years to bring a new mine into production. Anglo has recently commissioned their new copper mine in Peru (Quellaveco), one of the largest new mines to come into production in recent times. There are a handful of new mines coming into production over the next year or two, but nothing of any significance after 2026. Annual copper production is approximately 25 million tons per year. Combined, BHP and Anglo would produce about 10% of the world's total. For mining companies with ambitions in copper, its far easier to buy existing mines than build new ones. The scramble for copper assets is well and truly underway.

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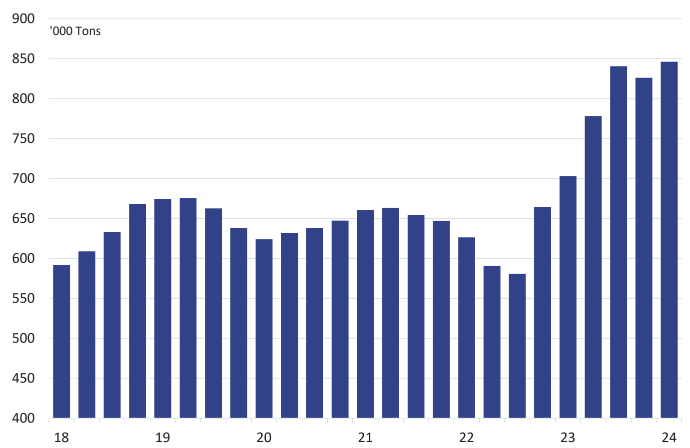
The deal has interesting implications. Firstly, BHP has made its intentions clear that it doesn't want any SA exposure. Anglo Platinum is understandable, as BHP has never been involved with PGMs. It is harder to gloss over them spurning Kumba Iron Ore as this would be a natural fit within the bigger Group, given that BHP is dominant in the global iron ore industry. One doesn't have to look much further than Transnet for a reason. In Australia, BHP controls the rail and harbours that export iron ore. They can optimize and gain efficiencies all the time. That is not the case here. Enough said.

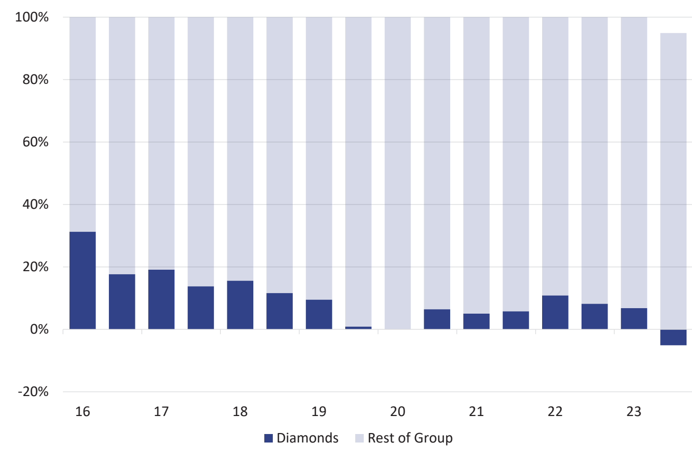
The other interesting implication is the possible return to the market of De Beers. Those investors with a few grey hairs might remember the day in 2001 when Anglo American and De Beers collapsed their joint cross shareholdings in each other – and De Beers was delisted. That was a significant even in the history of corporate SA. Diamonds have become more and more irrelevant to Anglo over the years, a consequence of a weak market, and pressure from producer countries like Botswana to get a greater share of the spoils.

ANGLO AMERICAN COPPER PRODUCTION



Anglo has recently commissioned its Quellaveco mine in Peru, adding significantly to its production profile.

PROPORTION OF EBITDA FROM DIAMONDS



Despite the strong heritage, diamonds have become more and more irrelevant to the wider Anglo Group. This deal may prompt the separation and relisting of De Beers. The corporate life cycle would have turned full circle.

Consequently, Anglo has come under increasing pressure to decide the future of De Beers. This may speed up that process. There is a reasonable chance that De Beers may in fact be relisted separately. The corporate cycle would have truly turned full circle.

There is no doubt that much water still must flow under this bridge before a deal is consummated. However, the genie is out of the bottle. There is a high probability of competing offers from other suitors and BHP themselves may be forced to cough up to get shareholders over the line. It makes for interesting times. Like the waves in the ocean, the mining cycle has come full circle – mergers and acquisitions are all the rage again. But equally importantly, it highlights that Big Tech are not the only beneficiaries of AI. In my early days, I was fortunate to have lunch with Brian Gilbertson, the then CEO of Gencor and Billiton. It was the late 1990s and the Dot.com bubble was all the rage. Mining was struggling to find relevance amongst investors.

Anglo is one of the world's largest mining groups with assets across the globe.

He quietly reminded us that cell phones, computers (and every gadget since) are made with his nickel, copper, iron ore and gold. That remains as true today as it was in 1998.

The ebb and flow of the mining cycle: a quick trip down Memory Lane.

The bid for Anglo has reminded me of the ebb and flow of the mining cycle, and the companies that dominate the industry. What is fashionable one day is not the next. I thought it might be interesting to briefly recap some of the major transactions over the past twenty five years that have shaped the companies we know today.

- *In 2001, Iscor split into two companies, Iscor Steel and Kumba Resources. Kumba Resources itself was later separated into two companies, Exxaro (coal assets) and Kumba Iron Ore (the iron ore assets.) Anglo acquired a stake in Kumba Resources in 2003.*
- *In the 1990s, Billiton was created when Royal Dutch Shell split off their mining assets from their oil operations.*
- *Gencor (which housed such SA icons as Ingwe Coal, Impala Platinum, Samancor, Gold Fields, and the aluminium smelters amongst others) acquired Billiton in 1994 to form Billiton International and moved its listing to London.*
- *In 2001, BHP and Billiton merged to form BHP Billiton. Fourteen years later, BHP Billiton demerged the majority of its coal, manganese, aluminium and other base metal operations to form South 32, which is now listed separately on the JSE and Australian markets.*
- *More recently, BHP demerged their oil interests and energy coal operations to become the focused miner they are today – largely iron ore and copper.*
- *In 1998, Anglo American consolidated all their various gold interests into Anglogold, which later became Anglogold Ashanti. Anglo sold its last remaining stake in Anglogold in 2009, marking the end of its journey with gold.*
- *A year later, Anglo American merged with its sister company, Minorco, to combine their global mining interests. This coincided with the moving of their listing to London. In 2001, Anglo and De Beers unwound their cross-shareholding, resulting in Anglo owing 45% of De Beers. The Oppenheimers and the Botswana government owned the balance.*
- *In 2020, Anglo buys the Woodsmith project in the UK, which will produce high-quality fertiliser when operation. Simultaneously, BHP is developing the giant potash mine in Canada. These would be a good fit in a future combined entity.*

By the time of our next Insight seminar, our election will be out of the way. We will take the opportunity to review market performance for the first five months of the year, and look ahead to what the second half might hold.

Please note that we will be hosting both a morning and evening presentation in Cape Town. The venues will be communicated once finalised.

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Topic:	**Taking Stock: Mid Year Update**
Natal Midlands	
Date:	20 June, 2024
Venue:	Christ Church Howick, 23 Mare Street, Howick
Morning Time:	10am for 10.30am
Evening Time:	5.30pm for 6pm
Johannesburg	
Date:	11 June, 2024
Venue:	Rosebank Union Church, Cnr William Nichol and St Andrews Road, Hurlingham
Time:	7am for 7.30am
Cape Town	
Date:	13 June, 2024
Venue:	ABRU Motor Studio, Lourensford Wine Estate, Somerset West
Time:	5.30pm for 6pm

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