LionAnalyst

Most Significant Events in a Decade of Mining

Topics this edition

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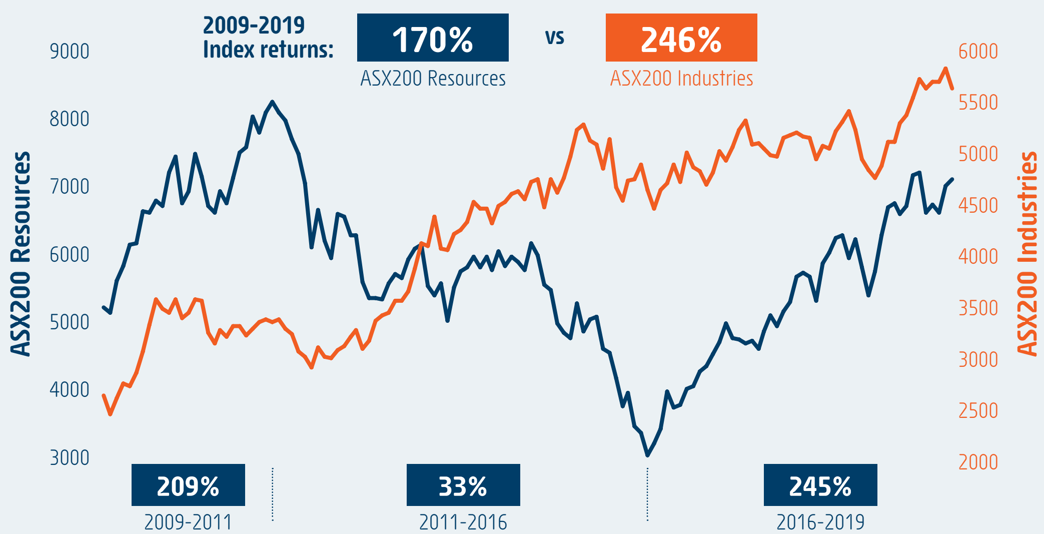
It was in 2009 that the first of 'The Hangover' movies hit the silver screen. Other than setting the scene of just how long ago 2009 was, it contains interesting parallels[1] to the experiences of the mining industry in the last decade.

Anyone wanting to know what a hangover looks like in a market sense need look no further than the performance of miners from 2011 to 2015 – the longest and deepest mining bust in living memory, against a broader market that posted a decade of almost uninterrupted gains. This certainly suggests there had been a long and wild party in the mining dorm at the start of the period. Whilst the analogy is far from highbrow, it seems strangely appropriate. Ultimately, the main characters of The Hangover look back to try to piece together what has happened to them. This may well be a worthwhile reflection for mining, but spanning a full decade, to piece together how miners fell so significantly from grace and then recovered the market's favour again.

The clearest events of significance for miners in the last decade are the turning points for mining equities – the top of the market in 2011, and then the bottom in early 2016. There is a clear linkage between mineral commodities and mining equities, the trading patterns are closely aligned over the decade including the respective turning points. This correlation makes it easy to overlook the significance of major events that contributed to, or directly caused, substantial changes in investor sentiment and occurred uncannily close to the market turning points.

Less obviously, but extremely significant for what it means for the future, has been a change in the pecking order of the industry brought about by the emergence of a new breed of mid-tier miners in Australia. These companies have grown into the space vacated after a major consolidation which was driven by major miners up to the 00's, that left the industry with a poorly populated mid-tier. The historical significance relates to how this group emerged, and the global status they have been bestowed with and the growth appetite which partially stems from this. This sets the scene for a new paradigm of industry leadership and may well lead to further emergence of new mining champions on the global stage.

Figure 1 >
Comparative performances: ASX 200 Resources versus ASX 200 Industrials, 2009-2019



Note

1. Probably totally unintentional.

The Five Most Significant Events in the Last Decade of Mining

In order of importance, not chronology

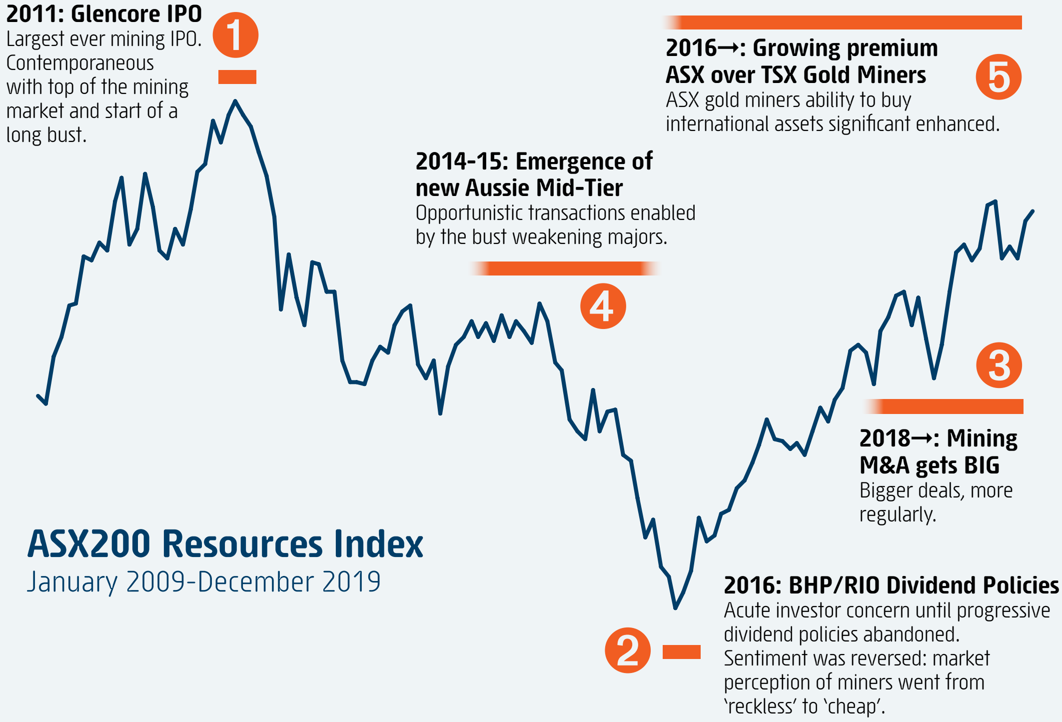


Figure 2 ›
Most significant events in the last decade of mining annotated on price performance of the ASX200 Resources Index, 2009-2019

One

Initial Public Offering and listing of Glencore onto the London Stock Exchange

US$11B, May 2011

> ***"Comparison is the thief of joy"***
>
> Theodore Roosevelt

Really large IPO's are only possible at the peak of the mining market, because that is the only time the necessary liquidity exists. But large IPO's also have a high capacity to disrupt sentiment, especially if their promotional push, liquidity drain, and comparative pricing help the penny drop on the actual state of the sector.

Anyone who got a bit flush from a large disposable wage in the mining boom and bought a Chevrolet Camaro ZL1 undoubtedly enjoyed the noise, acceleration and capacity to burn rubber the vehicle offers. At some point they might have realised that for the price there is a startling lack of safety features and setting aside sensibility, for roughly two thirds of the money a hot Mustang does all the same things. Big purchase – perhaps frivolous, certainly poor value. If buyer's remorse had not initially appeared, this realisation may well bring it on. For good reason, not many cars like this sell when disposable incomes are low. Similarly, large mining IPO's are only possible when the market is extremely liquid, they consume a lot of the prevailing market liquidity, and then invite a general assessment of the market as investors begin to wonder if what they bought was a genuine bargain or just a heavily made up pig.

History and outlook tend to be encapsulated in the market price of listed companies. But in IPO's, the sellers usually know far more about the company than the new buyers. There is room for severe mispricing, even in a bookbuild process because an equilibrium in understanding usually takes place well after money changes hands. Many things were significant about the Glencore IPO: previously secretive Glencore became subject to public market disclosure, it added a new name to the ranks of listed major mining houses, and provided a currency for growth – listed paper, which was used in short order to acquire Xstrata. But above all of that it was the largest mining IPO ever, and it happened at the very top of the market.

During 2011 miners were priced for perfection but delivering mediocrity. This is not to say mediocrity silently crept in during early 2011 – far from it, this was the peak year because this was when the penny dropped. The ASX200 Resources index peaked on 11 April 2011. Key mineral commodities variously found their peaks between January and September. Glencore raised £6.2B (US$11B), having marketed heavily through April and May, to list on LSE and HKSE on 19 May 2011.

Two

Revision of dividend policies of major miners BHP Billiton and Rio Tinto

January & February 2016

"Discontent is the catalyst for change"

Mike Murdock

There is only one way to make the front pages of major newspapers and its not via tremendous success. The likes of kicking the winning goal in a grand final are back page news, and a footballer is more likely to make the front page for a social scandal than football achievements.

In 2015 BHP Billiton and Rio Tinto received plenty of front-page news, much of which was focussed on their progressive dividend policies[2]. The investment community and media were literally at loggerheads with the two largest miners over their rigid adherence to such policies, which was seen as high folly on the tail end of roughly five years of commodity price weakening, reinforcing the belief that miners were financially reckless and irresponsible.

Mineral commodity markets began to bottom out between very late 2015 and early 2016 although this was far from obvious at the time, in fact many commentators and even the miners saw 'prolonged weakness' rather than imminent recovery. Standard & Poors downgraded BHP's credit rating on 2 February and indicated that a further adjustment may be necessary if commodity price weakness persisted and the progressive dividend policy was maintained. Rio Tinto abandoned its progressive dividend policy on 11 February 2016 in the announcement of its half year results, BHP followed suit on 23 February, both adopting new dividend policies that better reflected year to year financial performance.

With the weight of concern lifted the miners were relegated back to the business pages and the market was able to assess fundamentals in a fresh light, which led to the view 'miners are cheap'. BHP has gone up 2.8x and Rio Tinto 2.7x from their turning points in January 2016. Whilst a turnaround of mineral commodity prices has undoubtedly led mining equities higher, these changes of dividend policies were crucial to the complete reversal of investor sentiment toward miners.

Three

Commencement of large scale (US$1B+) M&A

circa September 2018

"If a little is great, and a lot is better, then way too much is just about right"

Mae West

Anyone who has experienced a fresh, warm cinnamon donut understands the temptation of a second. Crispy on the outside, soft on the inside and covered in spiced sugar. Maybe you have another straight away[3], maybe it's the next time you pass the shop. In Mergers and Acquisitions (M&A) a small first acquisition success often leads to a second deal. Unlike donuts, the second bite of M&A is often an upscaled serving.

M&A trends provide a strong indication of the growth appetite of the mining industry, and also what temperament their owners have toward company growth. If shareholders are worried about cash flows and expenditures, an acquisition of just about any kind will probably be a hard sell.

The character of M&A also provides a great insight to how the industry feels about the future. Over recent years there have been many instances of established producers investing in or buying juniors: this tells us the industry sees value and is prepared to invest, although the scale of this expenditure is roughly analogous to exploration budgets and probably provides similar growth opportunity – Incremental and longer term. Takeovers, or project acquisitions well into the $100's of millions are instantaneous step changes to becoming a larger company, which often attracts larger investors and better trading valuations. One swallow does not make a summer, and it follows that one big deal does not make an M&A trend – but we have seen a steady increase in the tempo of deal making over the last 18 months which corresponds with increasing average deal size.

Based on numbers out of Macquarie[4], aggregate M&A within the gold sector for deals over US$100m during 2015, 2016 and 2017 totalled between US$10B and US$12B per year. There were some sizeable deals, but few greater than US$250m. In 2018 the tally jumped to over US$15B – an increase year on year of circa 40%, followed by a 60% increase into 2019 which tallies over US$24B. The change in pace and aggregate size of announced deals was marked by the Barrick-Randgold merger (US$6B) announced in September 2018.

M&A is unlikely to remain constrained to the gold sector: in December 2019 the Australian newspaper reported that BHP is hiring an internal M&A team [5] – To a man with a hammer, everything looks like a nail. BHP has already been active in reasonably small scale (compared to the size of their business) investment across several promising juniors, but it is doubtful BHP is hiring a whole team for a continuation of this activity – this is a signal that large scale M&A is becoming an industry wide phenomenon.

The M&A trend we are seeing is the strongest indication the industry can give that it is interested in growth and will deal for scale. There is a strong motivation – company size is a critical factor to many investors. Therefore, scale will be the arena for competing for these investors attentions, where future share price growth will be fought out.

Notes

2. Progressive dividend policies provided for year on year dividend per share increases irrespective of underlying financial performance
3. Which is no doubt why the French Bakehouse in Kalgoorlie sells fresh cinnamon donuts in packets of five, not one.
4. Macqaurie Bank Gold Monthly, November 2019.
5. 'BHP recruiting M&A staff as it enters Mike Henry era', 2 Dec 2019. https://www.theaustralian.com.au/business/dataroom/bhp-recruiting-ma-staff-as-it-enters-mike-henry-era/news-story/00464d8c1825972e5b6208825557c0fb

Emergence of new Australian Mid-tier Miners
2014-2015

"From little things, big things grow"
Paul Kelly

Four

The structure of the mining market changed dramatically between the 1990's and 2000's as many established mining houses which sat in the global mid-tier disappeared via an enormous consolidation push led by the major miners. The mid-tier was hollowed out, and the last decade has seen the gap filled. Many of today's Australian mid-tier have grown via plucky acquisitions made when the bust loosened assets at great prices from stressed sellers, followed by apparent asset transformation brought about by asset appropriate investment and operation.

Many of the companies that occupy this space were junior companies when the last boom peaked in 2011. Rome wasn't built in a day and neither were any of the fresh faced mid-tier, the most transformative period of their growth was from 2014 to 2015, which coincides with the period of greatest pain for many of the major miners who were asset vendors at the time. 2014 saw Northern Star acquire Kundana/Kanowna and Jundee, Saracen purchased Thunderbox which was not a large transaction but has gone on to become a cornerstone asset. In 2015, Evolution acquired Mungari and Cowal, IGO took over Sirius, and South 32 was listed on ASX as a spin out of BHP Billiton. None of these were particularly large transactions in the sense of money raised or changing hands. Where an asset was acquired it enabled the junior buyer to move from one or few to multiple producing assets, and the deals in this period are the ones that made them into mid-tier companies today.

It's not to say that every transaction was universally accepted, most received some initial scepticism, but in the end a market crying out for mid-tier miners has been supportive and cornerstone assets bought cheaply have rerated their new owners.

The fresh face of the Australian mid-tier includes Evolution, IGO, Northern Star, Regis, Resolute, South32, Saracen and St Barbara (new incumbents / multiple producing asset base/market cap > A$1B). All are now well known but in mid-2011 were either junior companies or did not exist. Their combined market capitalisation in mid-2011 was A$3.8B but had become over A$42B by mid-2019.

The significance of the emergence of this group is more than just filling out a space in the market:

- None are bound by tradition. Most have relatively short corporate histories and retain their original central leadership so whatever mantra successfully catalysed their success is still intact
- Still (reasonably) nimble decision makers. They can act rapidly and opportunistically
- Most are now ideally poised to grow further, partially owing to their decision-making cultures, but also robust cash flow which covers meaningful exploration and capital investment budgets.
- There is no secret about intent to grow from this group but the manner in which these companies wish to grow is important – shareholder value creation is prominent, and this is an important example to set for their peers and the market.

ASX gold miners achieving a premium valuation over TSX gold miners

"He just smiled and gave me a vegemite sandwich"
Men at Work

Five

For 132 years straight, the New York Yacht Club held the prestigious America's Cup which some describe as the pinnacle of world yachting. In 1983, Australia II defeated Liberty in a best of seven races to end one of the longest single club dominances in world sport. The New York Yacht Club has not won the event since. In fact, since 1983 only four American boats have been victorious, and the trophy has only been successfully defended on five occasions.

For as long as most people in the gold market can remember, North American domiciled gold companies had richer premiums than their Australian domiciled contemporaries. But since 2016, Australian listed gold companies have eaten into and overtaken their North American peers and now have the strongest premiums. This is as significant as the win for Australia II in the 1983 America's Cup in dislodging a long-term incumbent.

Australia II sported a winged keel, an innovation which provided a major manoeuvrability advantage. The winged keel of Australian gold miners has not been nearly as controversial or closely guarded, in fact the common source of success has been far more about "back to basics", with a central focus on managing costs and producing sustainable return on investments. This has been a key factor in making silk purses of assets discarded as sows' ears by larger companies. The reward has been Australian gold miners trading at higher premiums to their Net Asset Values than their global peers.

When companies that trade at a high premium purchase assets / companies at a low premium, value is created for shareholders. North American gold miners used their premium paper to grow their asset bases over several decades, including acquiring many Australian gold mines. Australian domiciled gold miners are now positioned to assume the mantle of consolidator, and if recent M&A transactions are anything to go by, some already are.

2020 Vision

"The only function of Economic Forecasting is to make astrology look respectable"

John Kenneth Galbraith

What lays in store in the decade to come? When people who go by all three of their names say something poignant it's best to pay stern attention, so forecasts will be avoided at all costs. Hopefully the follow on from the 2010's decade follows a different formula to movie sequels. Most viewers would be well aware the more recent instalments of The Hangover followed the same basic formula, but the gags became more cringeworthy. Rather than forecasting, there are some logical observations can be made, even at this early stage.

Size: Continued growth of Australia's mid-tier, led by gold companies (and perhaps, emergence of a new gold major?)

The consolidation within the mining sector through the 1990's and 2000's was one of the most major adjustments to asset ownership to take place in multiple decades in mining. Combining events 3, 4 and 5 above may well prove to have been the next most significant reshuffle to asset ownership.

Meanwhile, this trend of increasing capitalisation of miners is unlikely to be universal, in fact company size may well become a barrier. Equity markets are becoming more stratified, with many large pools of money now utilizing structures such as Exchange Traded Funds (ETFs) to obtain desired exposure across individual market sectors, where they might previously have held equities directly. Whilst they might not ordinarily have taken on holdings in very small companies like junior miners or explorers because of the liquidity and outcome risks typically associated with that size and stage of company, it was nevertheless possible for them to make an exception. Using ETFs there is no possibility of that money funding junior companies anymore. The question is how much this will exaggerate the difference between junior miners and / exploration companies versus established producers, and potentially create a segregation of classes: the funded versus the unfundable.

Mineral Discoveries

There has been no lack of commentary around the declining success rate of mineral exploration globally. Exploration success requires a sustained effort which combines funding with an iterative scientific effort, and the balance of these were disrupted by the cleaning out of the mid-tier and funding crises such as the Global Financial Crisis and 2011-2015 mining bust.

Several of the new mid-tier have led the way in deploying exploration budgets that have helped invigorate appetite for others to do the same. These companies are now ideally sized and structured to incubate the necessary scientific thought, at the same level or very close to company decision makers.

Add to this, since 2015 there have been a number of discoveries which are not only successes in their own right but have invigorated investors to fund juniors in nearology and lookalike plays. The discovery of extremely high-grade gold at Fosterville in Victoria has seen possibly the largest investment rush for Victorian gold exploration since the 1850's. Rio Tinto's discovery of Winu in the north of Western Australia has also seen a flurry of pegging and exploring, and the eyes of the market are firmly focussed on Stavely Minerals with their Thursdays Gossan discovery in Western Victoria and Legend Minerals Shackleton discovery in Southern Western Australia. These are just a few examples – they have all added encouragement to a fledgling risk appetite in the market which is slowly recovering and provoking interest in early stage investment both from the market and within the industry.

Battery Minerals

Battery commodities have played a significant part in invigorating risk appetite, and no doubt some would argue have been a significant development of the past decade. Once commodities such as graphite, lithium, and cobalt became valuable, many previously known occurrences of things like pegmatites and graphitic schists became significant. Discoveries, some globally significant were soon to follow. But it is unlikely the battery minerals sector will be a thing of just the 2010's, and likely much more a part of the next decade. Many of the discovered projects are yet to be developed, and the respective commodity markets are expected to grow, stabilise and diversify along with the widespread maturation and future evolution of electrification and energy storage themes which underpin their demand.