Perfect storm for copper

Mining News.Net – March 31st, 2020
Kristie Batten

Major copper producing countries Chile and Peru have called a state of emergency, with mines forced into suspension for at least 15 days.
WoodMac said a 15-day shutdown of copper mines in those countries would see 1.5% of supply removed from the market this year.

"However, we believe there is a significant risk that disruptions will escalate, and breach 5% this year," WoodMac research director Nick Pickens said.
WoodMac stressed that was a worst-case scenario and would have "catastrophic consequences" for mine supply.

The copper price has fallen from over US$6000 per tonne earlier this year to about $4700/t currently. WoodMac said the current price was below the 90th centile of the industry cost curve, which could make shutdowns more permanent.

"Our mark-to market analysis suggests that at current market oil prices and exchange rates, the 90th centile of the C1 plus capex cost curve will fall by nearly 25c/lb when compared to 2019," Pickens said.

"Furthermore, a prolonged period of lower average oil prices will have a more extensive deflationary influence for other raw material costs, and the impact could be more significant."
The coronavirus is also hampering construction of new projects.

Anglo American has significantly slowed construction of its Quellaveco copper project in Peru, and withdrawn workers and contractors, while Teck Resources has temporarily suspended construction activities at its Quebrada Blanca Phase 2 (QB2) project in Chile, impacting 15,000 workers.

Rio Tinto has also warned the Oyu Tolgoi underground expansion could further be delayed.

"Combined, these projects account for a third of the total net growth expected over the next three years," Pickens said.

WoodMac said the current supply side outlook was analogous to the market in 2008-09.

"At the start of 2008, there was healthy pipeline of near-term projects, in our probable and highly probable (now included in our base case) categories," Pickens said.

"But a severe demand shock, brought about by the GFC, triggered project delays.

"During the 12 months between Q3 2008 and Q3 2009, we estimate the mining industry deferred up to 2.2Mtpa of new copper supply. While projects eventually hit the market, they were later than expected. "This undoubtedly contributed to the tighter market and high prices experienced in 2010 and 2011, once the market recovered."

UK investment bank Jefferies last week said "an unprecedented supply shock could be developing just as Chinese demand is recovering".

Jefferies suggested prices were still too high for producers to consider voluntary mine closures. Although copper prices have slumped in recent weeks to just over $2/lb, Jefferies said they would need to fall by more than 20% to around $1.67/lb "before sizable production cuts would happen based on economics". WoodMac believes the copper price will be well-supported at $4850/t, or $2.20/lb for the remainder of the year, but could dip below $2/lb for periods.

Unlike offshore peers, both listed Australian mid-tier producers OZ Minerals and Sandfire Resources have reported business as usual on the production fronts.

However, both have fallen significantly this year with OZ down 30% and Sandfire down 45% since January.

RBC Capital Markets said on its base case, there was upside for OZ and Sandfire on a 12-month view. "This is mainly predicated on an increasing copper price in the long term - required to incentivise new supply from 2025 (RBCe long-term price $3/lb real, versus spot at $2.20/lb)," it said, but added both stocks were pricing in sustained lower copper prices.

RBC said Sandfire exhibited greater downside given OZ was planning to process gold-rich stockpiles as the price was at a record, providing greater defensive cashflow.

"Sandfire's positive free cashflow position (RBCe) weakens significantly in FY21 under our bearish copper scenarios, and this excludes capital requirement at Black Butte (nearing completion of the EIS and record of decision)," analysts said.

"Despite this, we do not estimate any balance sheet risks given Sandfire's strong position currently (A$200 million cash, no debt).

"We expect OZ will be free cashflow negative through 2020, though this will revert once Carrapateena starts hitting its straps in 2021.

"Whilst we expect OZL will need to draw down on its $300 million revolver facility in 2020, we do not estimate any balance sheet concerns given its strong cashflows from 2021."

RBC upgraded OZ from underperform to sector perform and retained a sector perform recommendation for Sandfire.

Its price target for OZ is $8.50, against yesterday's $7.22 close, while it has a $6.25 price target for Sandfire, well above Monday's close of $3.22.