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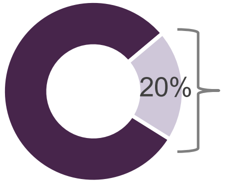
Impact of COVID-19

Mining Industry – April 13, 2020

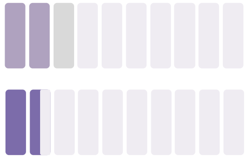
An overarching view of the impact and implications, with short- to mid-term outlook

Mining Industry: Impact of COVID-19 changed from moderate to high within March 2020

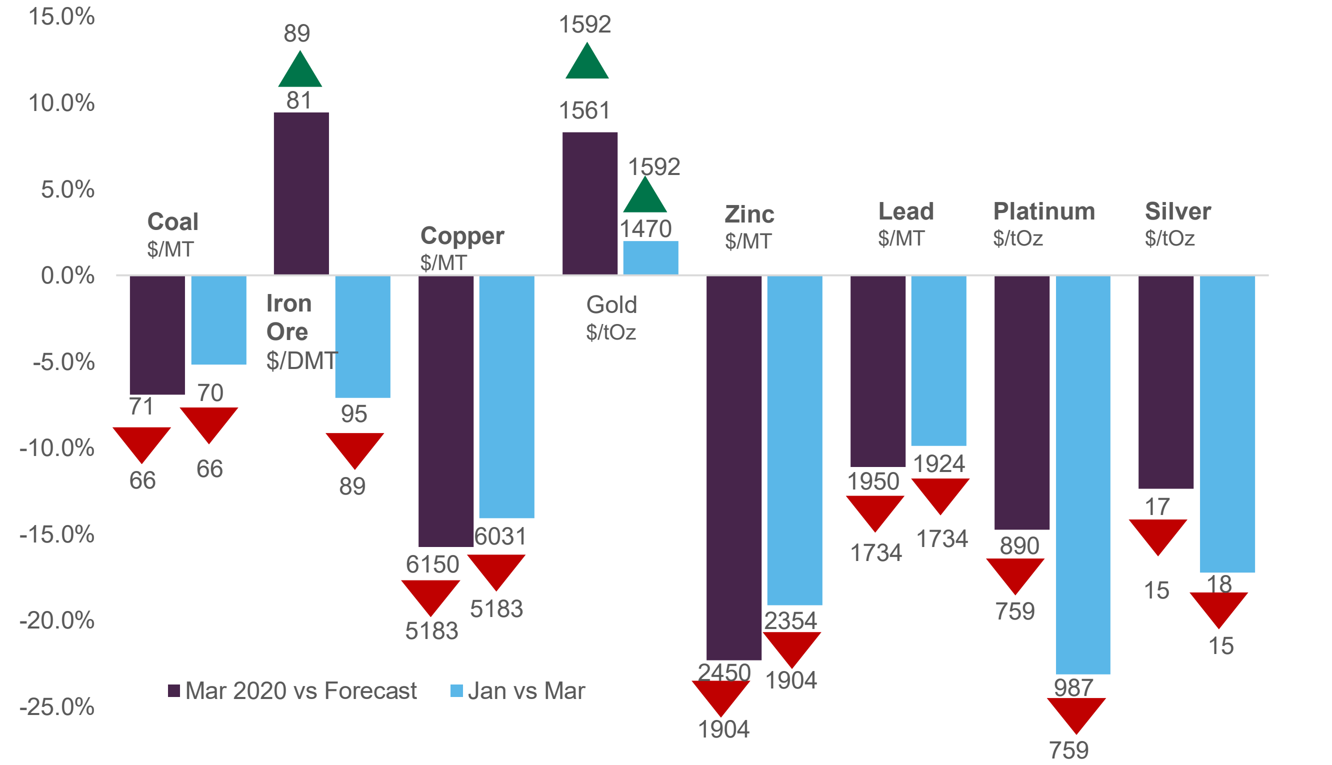


Supply cuts affecting about a fifth of global mining industry

Mines are going offline or operating at reduced capacity



Variation in Commodity Prices in Jan–Mar 2020 – Forecast vs Actual



Supply disruptions and reduced demand from end-user industries have led to a fall in the price of metals and minerals. But, as prices slumped, **investors rushed to purchase gold**, creating **an upward price rally**. Fall in iron ore prices remained subdued, largely due to reduced supply from Brazil.

- **Moderate to High Sector Impact:** For mining, the effect of COVID-19 has changed from moderate in early March to high in early April. Mining majors, such as BHP Billiton, Rio Tinto, and Anglo American, have so far reported partial shutdowns. While exploration and new investments are the most affected, smelters' beneficiation plants are operating at reduced capacity.
- **Gold Prices Rally; Industrial Minerals Slump:** Curtailment of manufacturing activity across major players, such as China, the US, and Germany, has led to a slump in metal and mineral prices. Prices of industrial minerals, such as iron ore, copper, coal, and zinc, fell by >5%, compared with the beginning of the year. Not surprisingly, gold prices rose ~8%, as investors shied away from riskier assets and started investing in the 'safe heaven' metal. Prices of precious metals were affected by supply disruptions due to border closures, etc.
- **Major Mining Economies Suffer:** Supply disruptions in China, along with the stalling of industrial activity, are creating ripples across the global economy. As consumer sentiment degrades, major mining economies (such as Australia, Brazil, Chile, the US, South Africa, and Peru) are feeling the heat. A drop in demand from various end-use industries is leading to a significant negative impact on these economies, which are heavily dependent on mineral and metal exports, with the mining sector contributing a significant portion of the GDP. With China resuming industrial activities, the impact could decline by Q4 2020.
- **Traders Likely to Benefit:** Owing to supply chain disruptions, mining companies are not operating at full capacity and are stockpiling. Smelters relying on imported raw materials may need to buy locally at higher prices or from traders such as Glencore. In these uncertain times, traders have higher bargaining power.

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Sources : Mining Technology, Financial Times, Big 4, UBS Analyst Reports, Major Mining Companies' press releases, Evalueserve Analysis, The World Bank

Companies are resorting to production slowdown, complete shutdown, demobilization of workforce, and shuttering / isolation of operations

While companies are not completely shutting down operations, due to the risks associated with such a move, they are adopting mitigation mechanisms by delaying projects (exploration and new), reducing scale of production, and reducing their workforce

Lockdowns Force Reduced Scale of Operations*

- With countries imposing lockdown, mining giants, such as Rio Tinto, BHP Billiton, and Anglo-American, have reported a slowdown in operations across South Africa, Columbia, Canada, and other countries.
- Uncertainty around the duration and impact of the pandemic is making it difficult for companies to quantify the impact on demand / supply and plan timely market recovery.
- To limit the spread of the virus, companies are shuttering / isolating operations and re-exercising their Fly-in fly-out (FIFO) employee roster, or temporarily relocating them.
- Supply chain disruption is causing delays across the industry.

Looming Economic Slowdown Poses Significant Downside Risk

- According to the World Bank, a severe pandemic could wipe away 5%, or more than $3 trillion, of the global GDP.
- With the industry starting to consider the aftermath of this pandemic and a likely economic recovery not expected until the end of 2020, commodity prices have started to tumble.
- The COVID-19 outbreak poses a significant downside risk to companies' 2020 guidance. For now, they maintain that their finacial guidance is the best approximation, until the true effects of the pandemic are calculated.
- Access to capital and credit markets, and planning for possible liquidity contraction will become major challenges for mining companies.

Likely Decline in Demand Sends Shockwaves across Industry – Majors Likely to Sustain

- The demand for metals and minerals spiraled down in Jan–Feb 2020, with the automotive and manufacturing sectors operating at low capacity and major manufacturing regions (such as China, Japan, and Germany) on lockdown.
- Majors, such as Rio Tinto and Anglo American, could sustain despite the impact of the outbreak, as they have several projects in hand and have easy access to finance.
- Small and medium miners are likely to face a major hit due to their reduced scale of operations, funding issues, and difficulty in getting new projects.

All companies are taking necessary measures aligned with the local government / agencies to safeguard the workforce

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Sources : Mining Technology, Financial Times, Big 4, Major Mining Companies' press releases, Evalueserve Analysis, The World Bank

Except for Gold, the majority of mining commodities are witnessing weaker prices

Base Metals

- **Copper:** Since Jan 2020, copper prices have dropped ~15% due to a decline in demand from various end-use sectors. However, with most smelters in China and the country slowly coming back to normalcy, copper demand and prices are expected to bounce back.
- **Zinc:** Prices were on a rally between 2015 and 2019, moving up by as much as 32%. Zinc prices are likely to hold back in the short term once the demand drops according to rising prices and production oversupply
  - On the plus side, Zinc-Bromine-based batteries are being viewed as an excellent alternative to Lithium-ion batteries – this could boost zinc prices
- **Nickel:** With global GDP growth expected to decline by 0.3% this year, compared with a ~3% rise in nickel demand, it is expected that about 10% global nickel supply could be accumulated
  - Before the COVID-19 pandemic, the Bank of America had warned about a potential nickel supply overhang emerging in an already lackluster stainless steel market.

Precious Metals

- **Gold:** An inverted yield curve indicates that there is a potential recession in the pipeline. Due to the COVID-19 outbreak, the fear of an economic slowdown has increased. This has compelled buyers to invest in safe heaven metals, making prices rally. Gold prices have thus increased by ~8% since the start of the year.
  - Forecasts suggest that Australia will supply 383 Mt of gold in 2021, overtaking China as the leading producer.
- **Platinum:** Prices have fallen by ~23%, compared with the start of the year.
  - South Africa, which accounts for >65% of the world's platinum production, is on lockdown. The country announced that while its production will be reduced, smelters will be operational and processing will continue.
- Although there has been a significant drop in the prices of precious metals, they are anticipated to recover as more investors look to lower their portfolio exposure to riskier assets.

Iron Ore and Coal

- **Iron Ore:** Prices were down by >5% vs the forecast for 2020 due to a decline in demand from the construction and automotive sectors.
  - The Chinese Manufacturing Index fell to 35.7 in February from 50 in January 2020 – effectively closing several industries, including construction. However, the big dip in demand was offset by tight supply from Brazil, which helped stabilize prices to some extent.
  - Most producers are now holding onto stocks, in anticipation of a rise in prices.
- **Coal:** Unlikely to experience major impact of COVID-19.
  - Stringent environmental regulations in Europe and North America were offset by coal demand for power generation from South East Asian countries.
  - Countries, such as Indonesia, Japan, China, and South Korea, are helping to maintain demand stability.
  - Prices are down by >5% since Jan 2020. However, they are expected to bounce back after industrial activity comes back to full capacity.

New Energy Metals

- **Lithium:** As COVID-19 has started to affect industrial manufacturing and the automotive sector, which are running at almost zero capacity in Asia, the demand for Lithium will likely stagnate in the short term. An alternative view is that the lower demand may fix the long-term issues – oversupply and falling prices – that the Lithium mining industry had been facing. Lithium prices have spiraled downward since 2018 and fell 70% (Mar 2020 vs Jan 2018), as Asian producers oversupplied the market.
  - Assuming the automotive sector is back to operating at full capacity by ~Q4-2020 and recession doesn't affect China, Lithium demand is set to reach >2MT by 2022
- **Cobalt:** Subdued demand from China and excessive stockpiling of the metal resulted in prices falling by as much as 9% since Jan 2020. Demand will be hit in the short term, as governments take action to contain COVID-19, further putting pressure on Cobalt prices.

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Sources : Major Mining Companies' press releases, Major Dailies, Evalueserve Analysis

Lower commodity prices could severely impact junior miners and force companies to revise their production numbers; majors could still pursue an inorganic route for growth, as well as explore automation opportunities

Expected support at current prices for Cu, Zn, Iron ore**:

- Supply cuts in major mining geographies, due to government mandated shutdowns is offset by the collapse in demand over the mid-term – thereby creating a support level for the current prices.

Social license

- As the industry evolves from the crisis, commitment and relationship with community and governments will remain a priority – especially in developing nations.

Amid uncertainty, mining companies could fast track automation

- The mining industry could fast track the uptake of automated solutions, such as autonomous trucks and remote operations centers.
- While companies opt for change in employment patterns and automation, they need to strike the right balance between employment generation and technology use.

Lower energy prices

- Energy accounts for 20–25% of miners' operating costs – a lower energy price scenario will benefit companies with unhedged positions.

Liquidity crunch

- Even before the crisis, liquidity was tight for junior mining companies – this is expected to continue, resulting in higher M&A activity or shutdowns.

Employment patterns to change dramatically

- The lockdowns and flying restrictions imposed by several countries have forced mining companies to temporarily reduce their contractual employees and FIFO experts.
- In the future, companies may be required to collaborate with unions globally.
- Keeping in mind the impact of COVID-19, mining companies could look for local talent (for remote locations) and prioritize training and upskilling of workforce, to ensure they are prepared for any future disruptions.

M&A strategies to change; more project delays expected

- Companies with stronger balance sheets could look to purchase assets that are available at a cheaper price. For example, BHP has hinted that it is in a good position to acquire cheaper assets.
- Mining companies could prefer collaboration / joint ventures to reduce their exposure to project risk and increase access to core technical capabilities.
- Cash preservation is expected to be the key, as exploration and new project financing could be delayed due to falling end-use demand.

Change in operational guidance on the cards

- At the Minerals Council South Africa meeting (held in South Africa), many mining companies stated that they are not too impacted by the COVID-19 situation.
- However, this is highly unlikely, as demand is not expected to bounce back before the end of 2020. The situation could force the companies to revise their operational and financial guidance.
- Resumption of industrial manufacturing in China would be a major demand driver.

** Gold prices are expected to witness volatility in the near future

Sources : Evalueserve Analysis