Metals and mining outlook: Uncertainty presents opportunities

By Johann Pretorius

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The Covid-19 outbreak presents significant challenges and is likely to have a materially negative impact on the global economy, in our view. We believe commodity prices could fall closer to trough levels in the near term and make significant cuts to mining companies' earnings forecasts.

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Negative earnings momentum may outweigh long-term value and share prices may remain under pressure until news flow around global growth prospects improves. We believe diversified mining companies with strong balance sheets and low-cost, long-life assets may outperform in this environment.

It may be too early to call the bottom, but the mining sector now offers attractive value for value investors.

Negative momentum as economy slows

The coronavirus pandemic is causing supply disruptions and demand shocks, which will have a significant negative impact on the global economy the scale of which is yet to be estimated. Falling asset prices against the backdrop of high debt to GDP in many countries pose additional risks.

Falling equity markets have already provided a warning of slower global growth expectations. Every time over the past 33 years that the MSCI Global Index dropped more than 15%, it was followed by a significant slowdown in the global economy.

Slowing demand for commodities could cause commodity prices to fall closer to trough levels, which are around or below the levels we saw during 2015. Thus, we have reduced our commodity price forecasts closer to trough levels for 2020 and 2021.

Mining companies best positioned for falling commodity prices

Most mining companies under our coverage have deleveraged significantly since 2015, which reduces financial risk in an economic downturn and provides financial flexibility to take advantage of acquisition opportunities. More appropriate dividend policies, limited growth capex commitments and a sector-wide value-over-volume approach should also preserve balance sheets. Defensive diversified mining companies with strong balance sheets, low-cost, long-life assets and defensive earnings streams may outperform in this environment. Miners with strong balance sheets may benefit from value-accretive acquisitions in a low-commodity-price environment. We believe high-quality, de-risked, producing assets are already trading well below replacement cost. We would steer clear of mining companies with high debt levels, high-cost, short-life assets or material greenfield projects.

Slowdown presents opportunities

The market may ignore long-term value while news flow and momentum remain negative. However, we believe this slowdown offers opportunities for value investors. Long-term fundamentals for the diversified miners remain positive. Lower oil prices and stimulus measures could support a demand recovery after the virus has peaked. Sector capex has been cut to a level that could result in supply deficits over the medium term. Cheaper equity valuations, strong balance sheets and low global interest rates favour sector consolidation over greenfield projects, in our view.

Source: Africa Oil Week/Mining Indaba.

ABOUT THE AUTHOR

Johann Pretorius is Renaissance Capital's head of research in Africa, and also head of metals and mining research team. He has almost 16 years of experience as a mining analyst. In 2019 he was top rated by Financial Mail's analyst ratings. Johann joined RenCap from Citigroup where he spent four years. He is a Chartered Accountant and graduated from the University of Johannesburg with a Bachelor of Commerce, Honours in Accounting.