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Australia's new look mining industry

Australia's mining industry offers an increasingly diverse opportunity set for investors and unprecedented portfolio building flexibility.

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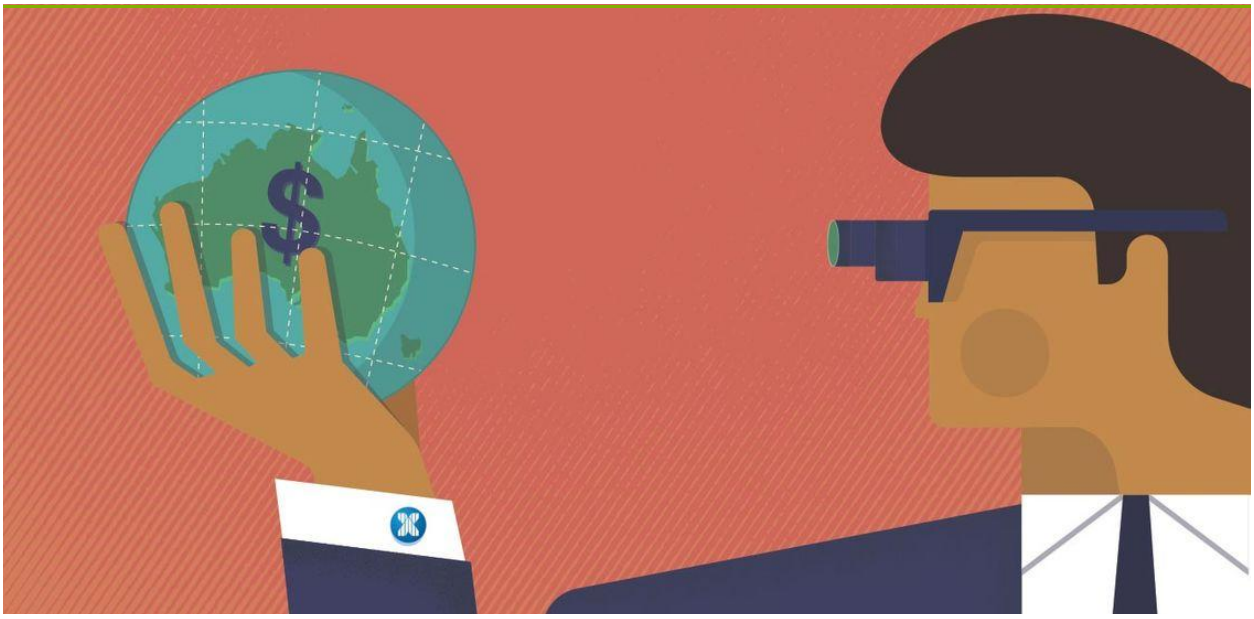

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Large-cap diversified producers and gold exposure has been the default setting for individual Australian resources industry investors. Private client advisors and institutional superannuation managers take their lead from sector indices. Only individuals eschewing advice can buck the trend.

The index of the leading ASX resources stocks remains dominated by exposure to iron ore, copper, gold and oil and gas. Little has changed over the past decade.

Of the 33 listed mining and oil and gas companies within the market's second-tier small resources share price index, the fortunes of 14 are tethered to gold. Five companies are tied to oil and gas, five rely on coal and iron ore and four have base metal exposure.

The gold component of the index will be further boosted next week. S&P Dow Jones Indices intends adding Alkane Resources, Capricorn Metals and De Grey Mining. One oil and gas stock is being removed.

Only five stocks in the index reflect the impact of emerging energy storage technologies.

Ideally, the small resources share price index should include the most dynamic stocks in the sector, leveraged to changing conditions and with the potential to become sector leaders. In practice, index composition is more often an indicator of unsustainable past performance.

Of the 96 mining and oil and gas stocks which were in the ASX small resources share price index 10 years ago, only 16 remain and only Beach Energy has since secured a position in the top-tier S&P/ASX 100.

Weak cyclical conditions have coincided with a decade in which investors have been more disposed to financial service innovators, drug and medical device pioneers, hospitality and lifestyle ventures and new ways to deliver goods and services to consumers.

> **Strong structural themes, and not simply cyclical influences, are underpinning a reorientation in the sources of industry value**

Returns from the small resources share price index have been 160 percentage points below the equivalent small industrials share price index since 2010.

The push into renewable energy generation and storage is changing the mining landscape. At the same time, the desire to break the stranglehold of China on supply chains is encouraging efforts to mine an array of commodities which might have otherwise been ignored.

High purity alumina (HPA) is an example of a fast-emerging mining segment unrepresented in the principal sector indices. HPA was little discussed in Australia prior to Altech Chemicals' plan to build a plant in Malaysia to process kaolin from a deposit near Meckering in Western Australia.

Subsequently, FYI Resources unveiled its intention to process kaolin from Cadoux at the emerging battery metals hub in Kwinana. Also working in this space is Gladstone-based Alpha HPA which intends using solvent extraction to make 99.99% pure alumina from bulk aluminium chemical feedstock. Pure Minerals, based in Townsville, is processing imported nickel ore to extract specialty chemical products, including HPA.

In related space, Andromeda Metals is seeking to tap a halloysite kaolin deposit in South Australia with the capacity to make HPA, although an initial focus on supplying the Chinese ceramics industry is planned.

Despite Australia's outstanding endowment, uranium is unrepresented directly in ASX sector indices. Vimy Resources chief executive Mike Young has raised the prospect of a 2023 production start at the company's Mulga Rock deposit in Western Australia. Other ASX beneficiaries likely to benefit from a stronger uranium contract market include Toro Energy, Marenica Energy and, outside Australia, Bannerman Resources, Deep Yellow and Peninsula Energy.

Also conspicuously absent from ASX indices are rare earth element exposures. Arafura Resources, seeking to develop its Nolans deposit in the Northern Territory, was a small resources index constituent 10 years ago. Rarex and Northern Minerals, both with projects in Western Australia, are also pursuing opportunities arising from the need for powerful magnets in wind turbines and electric vehicle batteries.

Vanadium is another metal with energy storage linkages although its role as a steel strengthening additive is currently its most important application. Vanadium Australia and Technology Metals Australia are both tapping mineralisation at Gabanintha in Western Australia.

Australia Silica Quartz Group and VRX Silica are seeking to develop silica sands deposits in Western Australia for glass making and foundry applications.

Tungsten, tin, cobalt and manganese are also largely absent from sector indices despite the growth opportunities for Australian-based ASX listed companies.

Fertiliser related products are linked to a growing global population and related pressures on land productivity. Several companies have significant overseas resources. Within Australia, Kalium Lakes, Australian Potash, Salt Lake Potash, Trigg Mining and Reward Minerals have potash production ambitions.

Strong structural themes, and not simply cyclical influences, are underpinning a reorientation in the sources of industry value.

Increasingly at the forefront of efforts to widen the production base have been state and federal governments. Geoscience Australia's focus on building databases to facilitate analysis of geological opportunities is paying dividends. Deployment of machine learning tools and sophisticated data analytics are removing barriers to a fuller understanding of Australia's geological makeup.

Helped by this effort, previously neglected or underexplored regions are being given more attention. The Pilbara and central Victoria for gold, the area surrounding Julimar in Western Australia for nickel and platinum group metals, the Lachlan Fold belt in New South Wales, western Victoria and the Fraser Range are home to some of the strongest investment propositions.

The number and spread of opportunities complicates decision making. That said, the burgeoning array of investments outside the coverage of existing indices also enables investors to construct their own thematic portfolios.

Picking isolated winners has long been a part of the industry's investment culture. The often binary nature of the high-risk, high-return trade-off attracts some but deters others. Compliance regimes, for example, prevent the vast bulk of private investment advisers from engaging with the sector in this way.

The industry itself should now think about how to take advantage of its new look to encourage portfolio approaches to investment which have not previously existed but which can extend its investment appeal.

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