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Miners' luck beats analytical skill

The world's leading miners are backing different commodities in response to the impending electric car revolution. Is at least one making a strategic error or does the choice not matter?

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The switch by car manufacturers to more planet- friendly electric powered vehicles opens new opportunities for the mining industry, according to the leaders of BHP, Rio Tinto and Glencore.

All three miners have copper exposure. In addition, BHP has decided to reverse its exit from the nickel business to take advantage of that metal's role in the production of batteries. Rio Tinto is heading down the lithium route. Glencore is putting its eggs in the cobalt basket.

BHP has revived a previously unloved nickel business acquired through the buyout of Western Mining in 2005. The head of BHP's Nickel West unit has been quoted recently as saying that BHP reviewed all the ways in which the company could involve itself in the battery supply chain and concluded that nickel offered the best avenue.

Speaking in London in July, BHP chief executive Andrew Mackenzie forecast "more than adequate supplies" of lithium and cobalt arising from the efforts of others.

Rio Tinto has gone down the lithium route via it Jadar deposit in Serbia, discovered in 2004. Jadar, estimated to contain some 2.5 million tonnes of lithium product, would require the world's first lithium-boron separation plant. It could be big enough to eliminate the imbalance many had foreseen in the lithium market through the latter 2020s, posing challenging market placement as well as technical issues.

Glencore's chief executive has said he had "zero interest" in lithium. Glencore's preferred cobalt platform is a by-product of copper and nickel from its mines in Africa, Australia and Canada.

As it happens, the three companies have adopted similar approaches to come to their differing conclusions. They have all turned to conveniently existing asset bases to exploit the opportunities which may emerge from the shift in car technology.

The companies would have been grappling with each of these development pathways whether electric drive vehicles were on the horizon or not.

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The fact that the companies each have an asset base around which they can wrap the electric vehicle narrative is a result of good fortune rather than considered planning.

BHP, the most obvious example of luck trumping analysis, has a nickel business today because there were no takers for its sale in 2014. Nor was it in sufficiently good shape to be included with the divestment of South32 assets in the following year.

BHP has shifted the emphasis from stainless steel to batteries with a nickel sulphate plant at Kwinana scheduled for completion within 12 months. Even so, as recently as August 2018 Mackenzie was reported in Mining Journal as saying "we are just finding the right time in the market to offload Nickel West".

Most predictions about the investment attractiveness of individual commodity markets are based on a prevailing consensus about future demand trends. And, yet, strong demand for lithium, cobalt and nickel stretching indefinitely into the future may have little correlation with the profitability of their mining or the adequacy of the return on capital invested.

The new battery metals of today have a parallel with aluminium, the emerging growth metal of its day 100 years ago. Battery metals analysts will be well pleased if the metals they follow can replicate the progress of aluminium from a 6,000-7,000 tonne production base in 1900 to a 64 million tonne annual rate of primary metal output today.

Over that spread of time, the economics of the industry has varied greatly. Since the very earliest years of its commercial life, aluminium producers have faced a declining real price trend. Along the way, previously unimaginable uses have emerged but large numbers of plants have had to close as unanticipated rises in energy costs hit hard.

Even this most successful commodity of the past century has had to weather continual changes to its business environment too complex to have been fully anticipated.

The aluminium experience is proof that growth in demand, the most frequently cited rationale for a commodity choice, may say nothing about margins being able to withstand changes in prices or cost structures to protect returns on capital.

New entrants count optimistically on the strength of demand being enough to absorb new supplies and keep upward pressure on prices. For simplicity and to keep hope alive, authors of feasibility studies use that as an unproven working assumption largely beyond the limits of their analytical skills.

Saying that luck trumps analytical skill and strategic wisdom may sound overly harsh but honestly and frankly recognising the importance of luck, and using it to advantage, may actually improve the chances of future success.

As products of sometimes haphazard corporate merger activity, BHP, Rio Tinto and, more recently, Glencore have defined a strategic model possibly peculiar to the mining industry.

Large portfolios containing a variety of asset qualities, geographic locations and commodity exposures have been assembled periodically then culled to leave more streamlined businesses which are then replenished organically or through acquisition. Excess assets are culled again and the process repeated.

With a sufficiently healthy balance sheet and a broad enough coverage of commodities, a company can hope to pluck one or two relatively strong financial contributors periodically, without knowing ahead of

time what they will be.

That is the real life model for the largest miners with sustainable investment propositions. Acknowledged or not, the model discounts the analytical value of forecasters in picking winners in favour of being well positioned to take advantage of a succession of shorter term market themes.

The company most prone to fail is probably the one expressing the greatest confidence in its ability to process and rank the likelihood of future events and prepared to eschew alternatives.

The most successful, on the other hand, is likely to be the company least certain about the future, recognising that luck is many times more powerful than analytical skill, and assembling its choices accordingly.

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