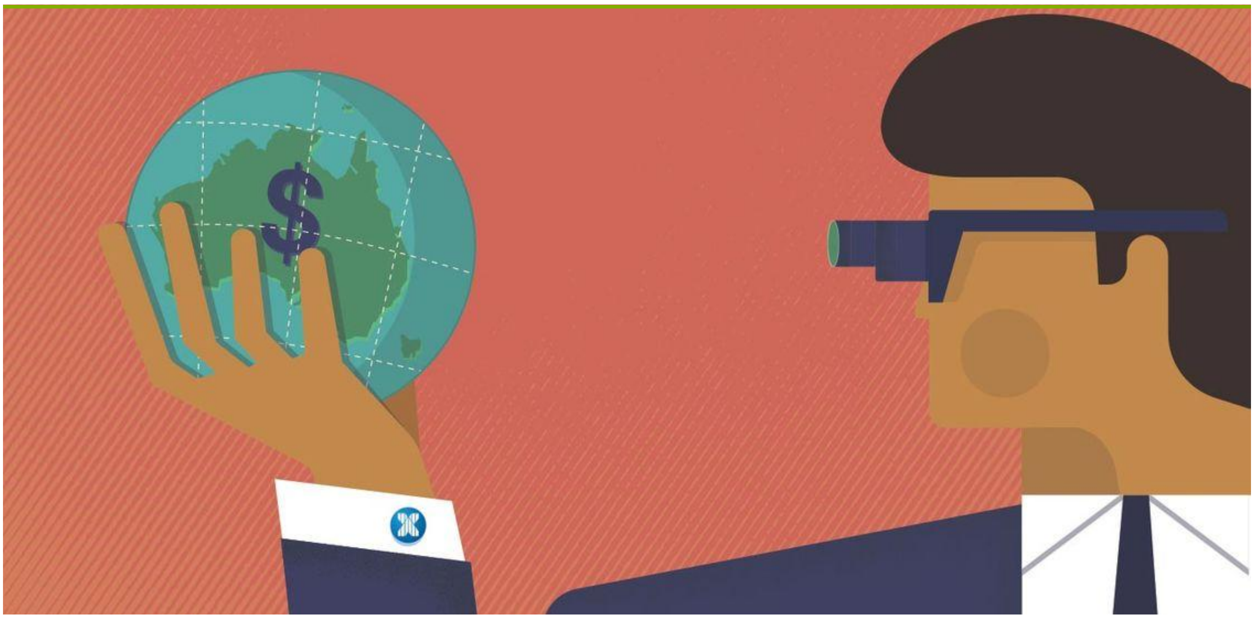
Mining Journal

Viewpoint > From-the-capital

BHP Gold could be among next radical mining moves

A future reshaping of Australia's mining industry could involve the likes of BHP, Rio Tinto and the largest ASX listed gold miners as well as newly emerging producers.

John Robertson*



24 September 2020

I have previously highlighted the potential for a change in the mining investment landscape in coming years as technology changes and geopolitical pressures underpin diversification in the industry's commodity exposures.

At the same time, new exploration insights are boosting the discovery potential in previously neglected regions, adding to the array of fresh investment choices.

The reshaping of Australia's mining industry has been a continual process. Iron ore, coal and gold accounted for 78% of the value of Australia's mining industry exports in the year ended June 2020. Thirty years ago, gold was more important than iron ore. Coal exports were twice the value of the iron ore trade.

At the turn of the century, less than half the industry's export value came from the gold-iron ore-coal combination. By 2009, iron ore export values had risen sixfold within five years. In 2019/20, iron ore export values were nearly four times those of gold and twice the size of the coal contribution.

Further change is already underway. The Australian government's Department of Industry identified 145 mining projects at the feasibility stage in its most recent compilation of major projects, an increase of 39 from five years earlier.

Three quarters of the increased number of projects were in the "other commodities" category, made up of everything outside iron ore, coal, gold, base metals and uranium. The "other commodities" category accounted for estimated investment of up to A$24 billion at the end of 2019 out of a total anticipated industry spend of A$126 billion. The same category of commodities amounted to A$9 billion out of

A$99 billion in the 2014 major project compilation.

The industry's strongest growth is set to come from beyond the commodity segments which have dominated the past 20 years and which have the strongest representation in today's investment market indices.

If history is any guide, investors should also anticipate asset rearrangements nearer the top end of the market.

“ **The project longevity which BHP is uniquely positioned to offer investors would give the company a superior valuation for gold assets it might assemble.**

Thirty years ago, for example, Newcrest was bequeathed its sector leading status through the purchase of BHP Gold Mines by Newmont Australia.

Ten years later, Newmont Mining Corporation outbid AngloGold to take over Normandy Mining and its 2.4 million ounces of annual production.

More recently, Northern Star Resources has parlayed a market capitalisation of just A$5 million into a $10 billion valuation through a rapid sequence of acquisitions starting with the fortuitous purchase of the Paulsens gold mine from Intrepid Mines in 2010.

The decennial top of the table reorganisation of the gold industry is now due. Gold market conditions are encouraging bold action.

Output peaked seven to 10 years after gold price rises in the late 1970s and mid 1980s. Australian gold production is set for a long-run expansion. Exploration results pointing to new areas of geological interest will also support more investment.

Higher gold prices permitting lower cut-off grades for mine planning and justifying deeper drilling will raise exploration productivity, encourage longer term planning and boost underlying valuations. At the same time, funding costs have never been cheaper.

Industry conditions are inviting the participation of larger scale operators. The industry is ripe for another aggregation foray.

Australia's largest listed miner is a conspicuous absentee from a gold mining landscape which is likely to become a more important part of the nation's mining industry.

The gold market is closing in on BHP's preferred financial scale. At a US$2,500/oz gold price, for example, the revenue of the four largest ASX listed gold producers would exceed BHP's 2019/20 copper revenue and profit contributions.

BHP's financial clout, ability to marshal exploration expertise, experience in negotiating complex regulatory frameworks and likely willingness to push into localities that had previously been neglected should give it an advantage in converting a cottage industry into a more sustainable industrial enterprise.

The project longevity which BHP is uniquely positioned to offer investors would give the company a superior valuation for gold assets it might assemble.

Within any five-to-seven-year timeframe BHP will usually have undergone a strategic redesign amid one or two chief executive transitions. Pressures to use capital more efficiently, improve growth profiles and put more emphasis on sustainability will remain.

Coordinated development of the Pilbara iron ore resources held by BHP and Rio Tinto must be on the cards again. A decade ago, the two companies valued the benefits at more than US$10 billion. A similarly compelling case could be made today although, for Rio Tinto, the pressures to deal are less intense than they were in the aftermath of its ill-timed Alcan takeover.

After having their earlier merger attempt rejected by regulators, sharply higher sales to Chinese steel producers helped salve the disappointment. A more mature Chinese investment cycle acting as a drag on financial momentum now requires new sources of earnings growth.

Greater operational efficiency through more emphasis on automation, sophisticated data analysis, energy conservation and manpower management practices will play a role. But many of these trends are already taken for granted. Pressure to dust off bolder industry initiatives will mount. It always does.

China's inevitable objections to an operational merger of Pilbara assets will be given less weight. The Asian giant has already shown its willingness to use its buying power to hit back at Australian government criticisms of its behaviour. The Australian government might see merit in a financially strengthened local industry better able to cope with an unpredictably belligerent Chinese regime.

Once the COVID-19 dust has settled, international regulators may also take a different view about the trade-off between competition and securing sustainable businesses not relying on Chinese good humour.

Whatever the result, any ten year period is bound to throw up radical strategic changes among the sector leaders as they respond to investor demands, real or imagined, for something new to help sustain the growth potential of their businesses.

**John Robertson is the chief investment strategist for PortfolioDirect, an Australia-based equity research and resource stock rating group. He has worked as a policy economist, business strategist and investment professional for nearly 30 years, after starting his career as a federal treasury economist in Canberra, Australia*