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Miners face altered obligations

Might the COVID-19 pandemic force entirely different commercial models onto the mining industry?

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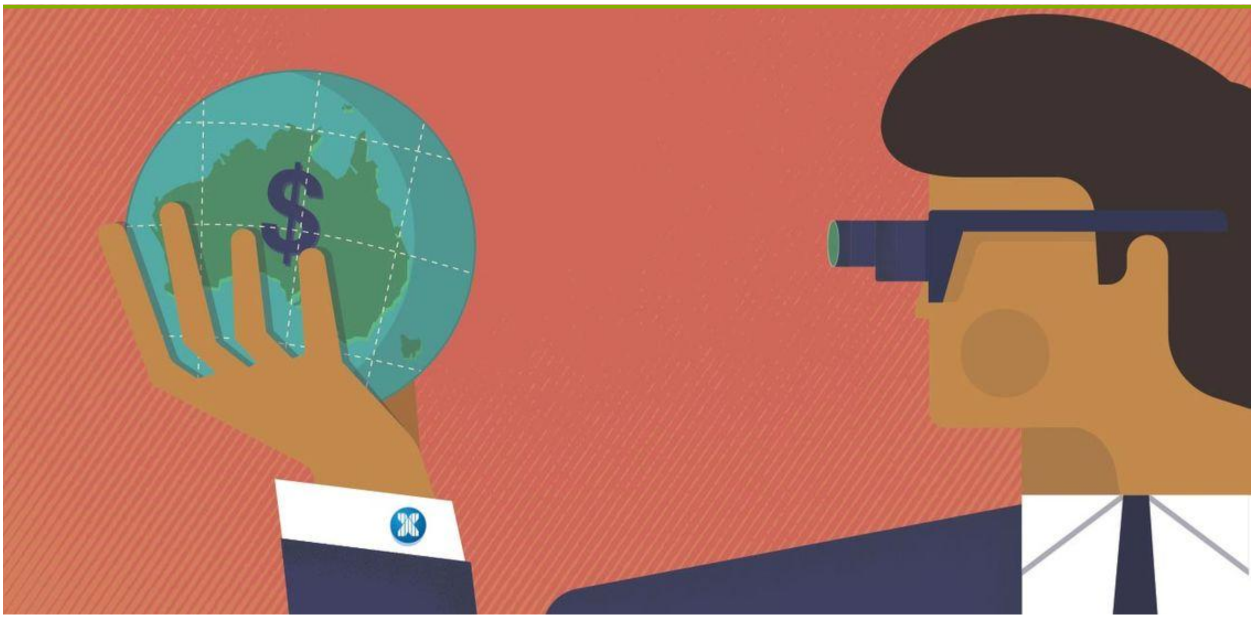

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Within barely a few weeks, even some hitherto fervent small-government adherents have turned full circle on the future roles of government and business.

Politicians nominally on the right of the political spectrum in Europe, North America and Australia have openly contemplated widespread public ownership of business as anti-coronavirus public health policies shutter more firms.

Survival risk is at the heart of the newfound willingness to redesign economic relationships. Ironically, a disease threat originating in China may be forcing the rest of the world into state-ownership of enterprises.

Large retailers are being directed to collaborate with suppliers to keep goods on shelves. Drug researchers and medical device manufacturers are being told to join forces. Anti-trust rules are being ripped up.

Social licences to operate are being radically rejigged as businesses are offered a financial cushion in return for unprecedentedly strict expectations of future behaviour.

Businesses as disparate as global airlines and neighbourhood pizza restaurants are at risk of falling into government hands or, at least, owing their survival to public funding. Consumer-facing businesses relying on discretionary spending, whatever their size, are wondering about their viability in a post-coronavirus world.

For the time being, at least, the relative physical isolation of the mining industry is proving an advantage. Community reliance on depleting mineral resources also helps guarantee a future for the mining industry others cannot assume.

Being relatively better placed does not mean being unaffected by future changes to how governments interact with business. In assessing the impact of the evolving relationship between business and government, it is worthwhile thinking of the mining industry as falling into four broad categories.

A handful of companies operating the biggest mines in the world and accounting for a disproportionate amount of capital invested and output make up the first category. They will survive largely intact but will be called on to do more to validate their social licences.

> “ **Governments in mineral-rich jurisdictions will be under pressure to improve rates of discovery**

The second group, made up of smaller single mine operators, is highly leveraged to changes in short-term economic conditions. They tend to have little financial cushion to alleviate the effects of a near-term loss of sales. They are most endangered.

The third category includes those companies not yet producing but seeking to develop new mines. Even before the coronavirus market slump, many had little chance of producing an economic return, whatever their feasibility studies might have said. Their predicaments have worsened considerably.

The rise from 11% as recently as February to 20% this week in the ICE Bank of America CCC-rated bond yield index is one measure of the plight facing the most capital-hungry parts of the industry.

The fourth and by far the largest group is made up of minerals explorers. Most have to periodically tap capital markets to pay for drill rigs and assays. Their primary sources of funds are in jeopardy.

Companies had budgeted to spend US$9.8 billion on exploration in 2019 after a $10.1 billion spend in 2018, according to S&P Global Market Intelligence (‘World Exploration Trends 2019'). Capital raised primarily for exploration has averaged $2.9 billion in the past three years. Among the 1,708 active explorers out of more than 3,300 identifiable exploration companies, the median exploration budget had decreased to $1.1 million in 2019.

The last major commodity price cycle spawned hundreds of newly-listed exploration companies. As the industry's compliance overheads proliferated, the proportion of new equity going to exploration has shrunk. As both expenditure in the field and industry expertise have been spread more thinly, success rates have fallen.

Granting hundreds of perennially undercapitalised explorers access to public lands implicitly relied on private investors tapping their superannuation savings and using superior gains from non-mining investments to subsidise the industry's efforts.

An already failing model now risks collapse. At the same time, governments in mineral-rich jurisdictions will be under pressure to improve rates of discovery to hasten much needed employment and investment opportunities.

The likes of BHP, Rio Tinto and Glencore, whose corporate acquisitions have underpinned a history of exploration spending cuts, could be directed to participate more wholeheartedly in future exploration efforts.

The coronavirus pandemic has pulled the rug from under expectations of tight metal-market balances, buoying sentiment toward the sector. Even a quick public health resolution seems likely to leave miners facing price-sapping metal inventory accumulations. Only sector leaders volunteering large production cuts might avert this outcome.

Of course, followers of the industry will most likely point to far better prospects in the longer term, not least for those companies finding and producing battery metals. But those greener pastures require them to first survive multiple existential threats.

Governments will become more directly involved in capital deployment decisions in the next few months, whatever their philosophical disposition, as they seek to mitigate the effects of COVID-19 on their disease ravaged economies.

The mining industry will not escape the effects of the heightened involvement of government in deciding how capital is best used.

The US Federal Reserve decision this week to buy corporate debt already excludes those higher risk bonds that are more closely connected to the availability of finance for the mining industry. Recognition of more urgent needs elsewhere is already damaging the industry's competitive position in capital markets.

As governments and companies look to renovate broken supply chains, sourcing raw materials will be scrutinised. Already financially stretched car manufacturers, needing to meet nationally imposed carbon-emission standards, will urge governments to consider alternative ways of sourcing raw materials.

A new model in which end users take control of how much metal is produced and how it is priced could easily eventuate if car makers, and others in need of industrial raw materials, insist they need greater financial clarity, assurances of supply and cheaper inputs.

In the post-coronavirus world, appeals to the spirit of free enterprise to protect historically accepted practices and occasional super profits will fall on deaf ears.

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