Credit Benchmark®

Australian Mining: Trends and Credit Distributions

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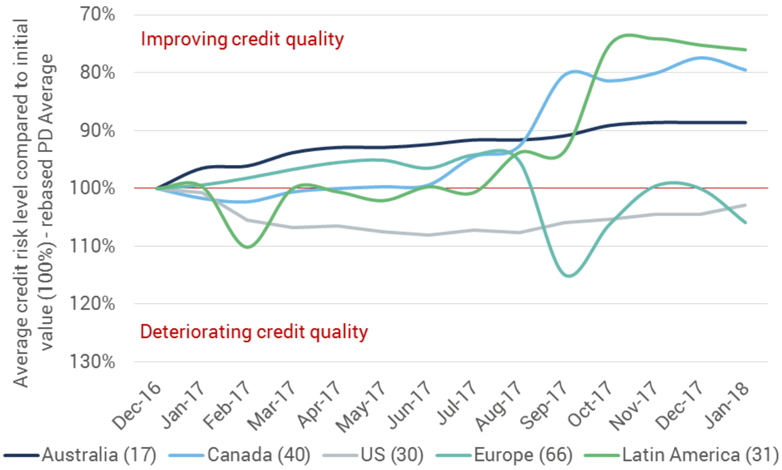
The past few years have been volatile for the global mining industry. According to a recent Deloitte study*, this "roller-coaster" is set to continue. Deloitte expect an extended bull run in a number of metals, but see disruptive new entrants and new technologies as posing a significant challenge to the established mining companies. They also identify a number of trends that are specific to the impact and image of mining as an industry: employee relations, environmental issues, and corporate governance.

Yields are declining as existing ore bodies are worked out, which is constraining supply. At the same time, battery-driven demand for "tech metals" – nickel, lithium, vanadium, cobalt, graphite and a range of rare earths – is set to accelerate. This is mainly due to the wider global adoption of electric vehicles, solar cells and mobile phones; as well as the broader technology need to store electricity from renewable sources.

The current trend towards protectionism has encouraged Australian mining companies to review their position in the value-add chain. Some of their iron-ore and coal exports are subsequently re-imported (e.g. from China) in modified form; Australian miners now see scope to extend and expand the revenue from future booms by taking more of the value-added manufacturing onshore.

Exhibit 1 plots the 2017 credit trends for 17 Australian and 167 International companies in the General and Gold mining sectors.

Exhibit 1: Gold & General Mining: Australian and International Credit Trends



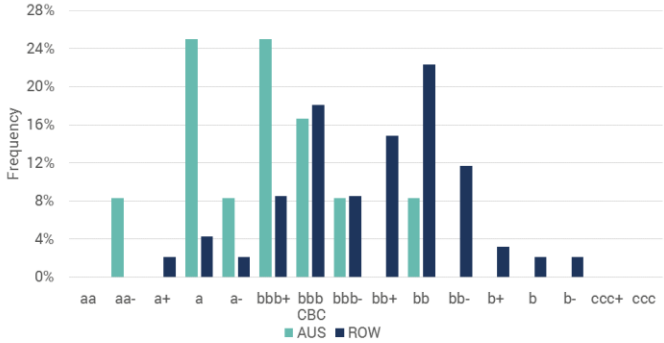
This shows that the credit quality of Australian mining companies steadily improved during 2017. Canada and Latin America have also improved, especially in the final quarter of the year. Europe has been very volatile (partly a reflection of the large but diverse sample of companies in the index), while the US is showing a slight recovery after a decline in the first half of the year.

* https://www2.deloitte.com/ca/en/pages/energy-and-resources/articles/tracking-the-trends.html

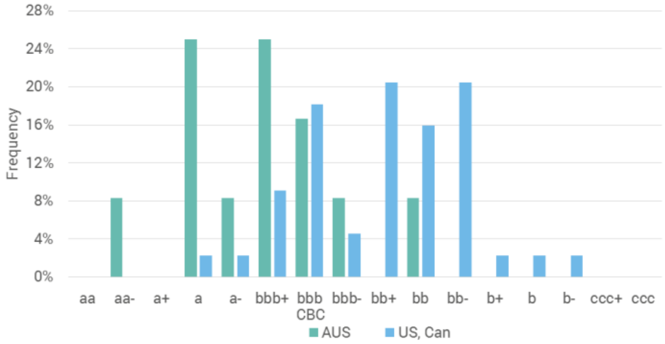
Exhibit 2 shows the distribution of Mining companies according to their Credit Benchmark Consensus ("CBC"**) ratings. Australian companies are shown as a separate series.

Exhibit 2: Australian and Global Mining: Comparison of credit distributions

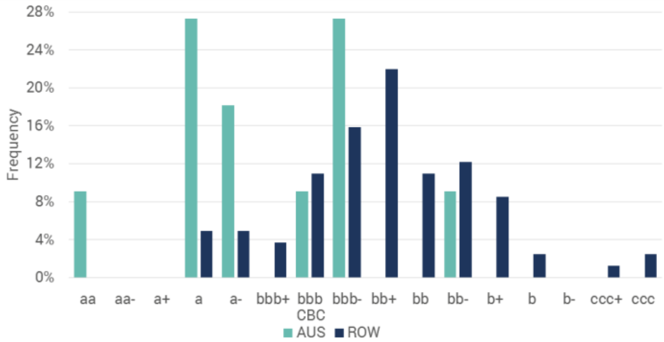
Australia and Rest of World – Latest



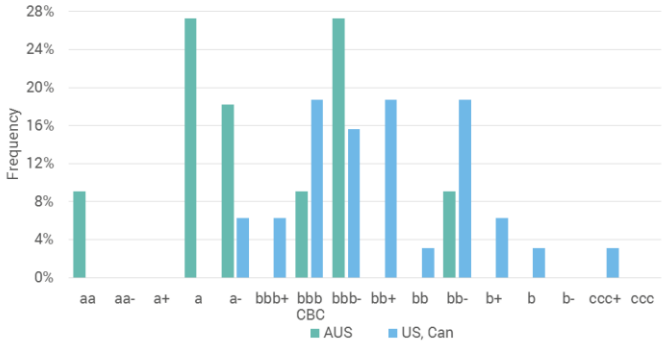
Australia and US/Canada – Latest



Australia and Rest of World – End 2016



Australia and US/Canada – End 2016



Source: Credit Benchmark. Sample sizes: Australia = 12, US/Canada = 44 Rest of World (incl Canada/US) = 94

These charts show that the credit risk of Australian mining companies is significantly better than the Rest of the World, and shows a similar result in a specific comparison with mining companies in US and Canada. The average CBC for Australian mining companies is comfortably within the Investment Grade range; but the average for the Rest of World is much closer to non-investment grade.

The lower set of charts show that these distributions are broadly similar over the past 12 months. However, over the past year, the average credit risks for all of these company subsets have improved; by 0.16 of a notch for Australia and by 0.4 of a notch for the Rest of the World. On average, US and Canadian companies are unchanged.

The changing dynamics of mining and global trade are likely to require significant investment. From a credit perspective, Australian mining companies are well-positioned for this new environment.

*** Credit Benchmark Consensus ("CBC"): this is a 21-category alphameric scale based on bank-sourced one-year probability of default estimates. It is similar to the scale used by the main credit rating agencies, so that a CBC of **bbb** is approximately equivalent to BBB reported by S&P and Fitch, and Baa2 reported by Moody's.*