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Macro Report

Trade Wars and Copper Miners

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Chinese Isolationism and Australian Copper

How China's trade wars will affect the Australian copper industry.

Though Trump is out of the White House his ghost lives on in Beijing. His isolationism has appeared to seep into Chinese Communist Party ideology. State officials have announced a ban on imported Australian copper. This is particularly interesting at a time when Australian government stimulus is expected to be concentrated on public work schemes. As China comprises 50% of the world's copper demand, this turn of events will have an impact on Australian mining M & A activity. The significant fall in copper exports will heavily outweigh any upside from Australian public works projects. Price compression will force mergers particularly among small cap copper miners.

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The 2020 Story so Far

Copper prices have increased by 50% since the dip in March. Increased demand stems from governments stockpiling copper in preparation for large public works projects to kickstart a post Covid recovery as well as increased demand for electric vehicles. Australian pure play copper miners are heavily exposed to China with mid tier operators such as Sandfire sending 93% of their product there. Without China they will have to pivot which is harder than it sounds considering their main competitors are comparatively low-cost and regulation free South American miners.

Opportunities

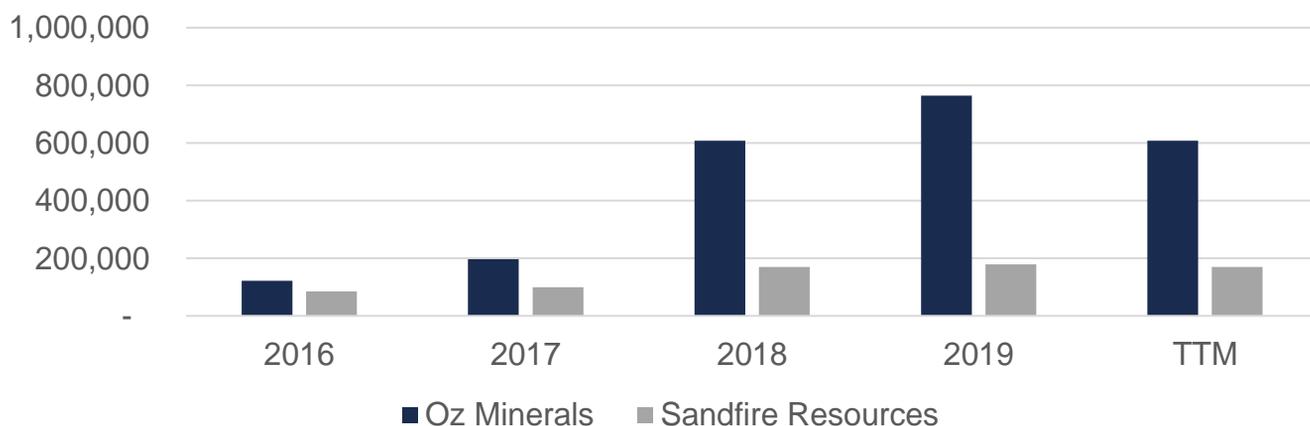
The pivot away from China will cause a temporary compression in revenue amidst what will continue to be a bull copper market. Despite this market, some Australian pure play copper miners such as Sandfire have been struggling as evidenced by its share price declining by 30% in the last year. The companies that have been succeeding are those like OZ Minerals, the result of a merger, whose share price has increased by 40% in the same period.

We expect companies like OZ, that invested almost \$770m on expansion last year to look at small cap poor performers like Sandfire and see significant room for increased cost efficiencies. Though OZ's net margin is only 4% higher than Sandfire's, their share prices tell wildly different stories. OZ has the human and financial capital necessary to acquire small caps and to create vastly increased value for shareholders.

Up to now, poor performers had acquisitions by Chinese miners as an alternative to bankruptcy. This life raft will never be available again as Sino-Australian tensions look set to increase over the coming decade. As ever, the reasoning for China's isolationist turn is unclear but it is likely linked to Australia's restrictions on Huawei.

If so, expect the restrictions to eventually encompass the entire Australian mining industry which is a curious thing as up until recently Chinese interest in acquiring even more Australian mines was soaring. It is likely whatever path Australian copper follows will define what happens in the entire Australian mining industry.

Investing Cash Flows (AUD)





Copper has been on a bull run since the trough in March.

Data source: Macrotrends

The Story Ahead

Copper prices are a key component of AUD value with a 70% correlation between them. Despite the sanctions, copper prices have continued to rise suggesting AUD will continue to strengthen. If this trend continues, Australian miners may seek value by making acquisitions abroad rather than focusing on domestics. Nonetheless, the story in 20/21 will be about scale. More generally, mining M & A has been particularly buoyant despite Covid. The most notable is the merger of the Australian Northern Star and Saracen companies creating a company worth \$11.5bn. Domestic appetite exists for mergers.

Such activity at the large cap end of the spectrum will put pressure on the remaining tiers to find value and we expect the next year to be a flurry of activity in Australian mining and copper miners will be the first domino to fall. However, this analysis is contingent on Covid vaccines being successful and returning the developed world to normality. Failing this, even more of the global demand will stem from China, a market Australia will not have access to. In such a scenario, the Australian copper mining industry will collapse in the absence of government support. However, we assign a low probability to such an outcome. Even if any vaccines underperform, there is a strong pipeline of vaccine trials that ensure a return to normality sooner than later.