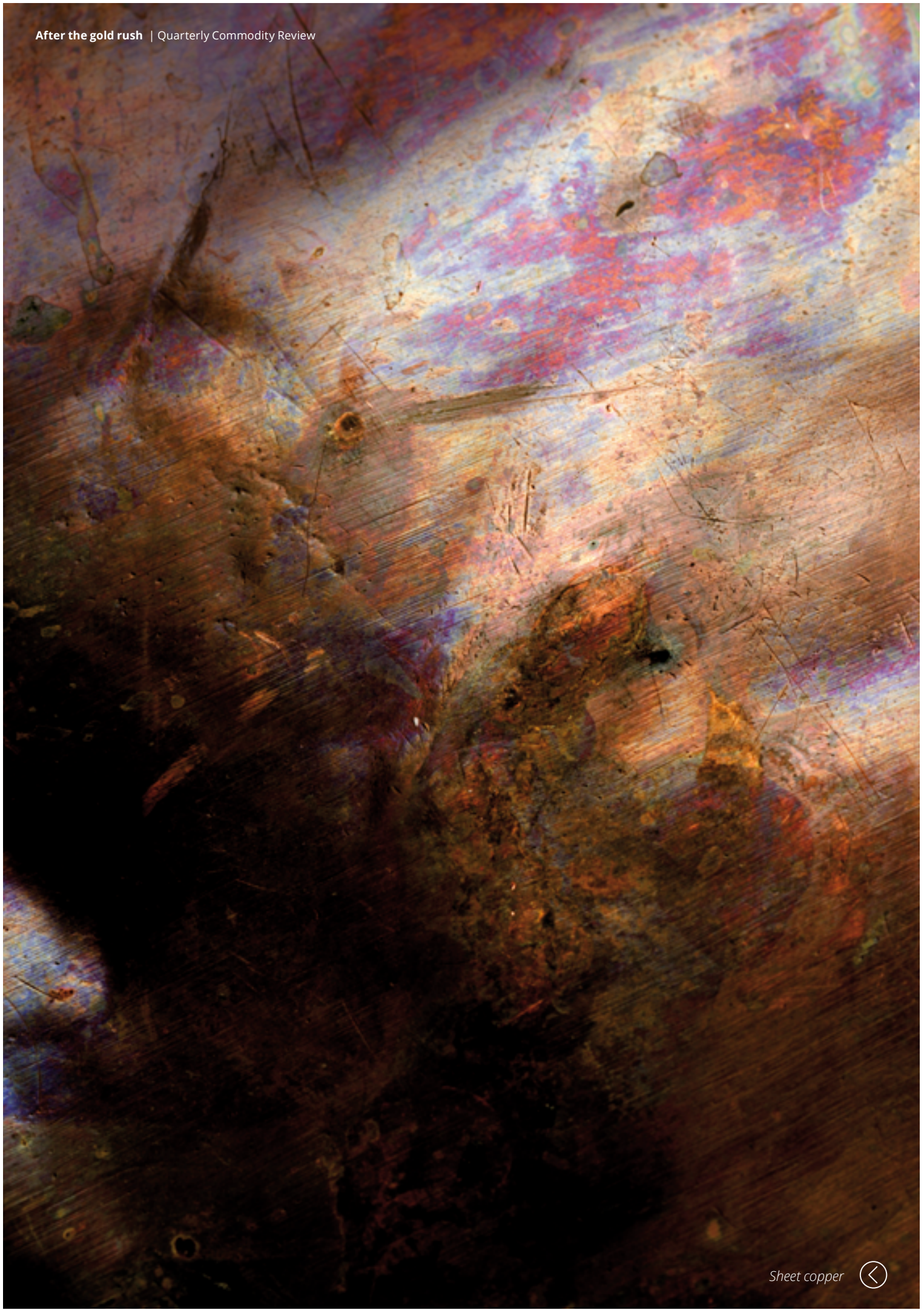


# Introduction

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Dear mining community of Australia,

Welcome to the first edition of the *Quarterly Commodity Review*.

My name is Ian Sanders and I lead Deloitte's Australian mining practice.

When I first joined Deloitte as a cadet, I earned the moniker 'Colonel Sanders' thanks to my surname. Some 30 years on, the nickname has shortened 'Colonel', while my focus on serving Australia's mining community holds strong.

In this publication, my team and I will be looking to share our observations of the commodity markets and insights into the Australian mining market.

As this is our first edition, we would welcome feedback as to the themes and trends that you would like featured in our Quarterly Commodity Review going forward.

A handwritten signature in black ink, appearing to read 'Ian Sanders' in a cursive style.

**Ian Sanders (Colonel)**  
**National Mining Lead Partner**  
**Deloitte**



# State of play

## My top three observations

### 01 What will drive commodity markets in 2019?

This was a key question heading into the new year.

Will adverse macroeconomic 'shocks' – a slowing Chinese economy, reduced international trade levels, weaker global industrial activity, heightened risk of a European recession, emerging market volatility – continue to exert an influence on commodity markets? Last year we saw adverse macro trends trigger a broad commodity sell-off with trade tensions, concerns about a slowing Chinese economy and general market volatility all dampening investor appetite for commodities.

These global macro headwinds deflected attention from an almost universally strong set of commodity fundamentals. Structural supply constraints, slowing global mine supply growth and attractive long-term demand prospects all provide confidence that the current commodity price cycle will be sustained.

What trend will dominate in 2019? Will fundamentals reassert themselves and override a bearish macro backdrop? My sense is that while the underlying fundamentals for commodities are undoubtedly solid, the relentless twists and turns in the global economy will test price resistance levels. Brace yourself for another rollercoaster ride!

### 02 Stars are aligning for precious metals

Cometh the hour for the precious metals.

After a challenging 2018, there is a strong sense of momentum building in the precious metals space. We are in perfect storm territory with a number of supportive price drivers. Strong investment demand (Exchange Traded Funds, Central Banks) and a confluence of supportive macro trends suggests 2019 could be a good year for precious metals producers and investors.

Keep an eye out for the mid-cap ASX listed gold producers too. With low levels of debt, healthy cash flows and considerable earnings firepower, we expect a number of Australian gold producers to be on the hunt for acquisitions this year.

Another commodity making a big splash is palladium, the best performing metal for the past two years. China's tougher emissions standards are pushing car manufacturers to use greater amounts of palladium in catalytic converters. With a strong demand narrative and reported supply shortages, palladium is a deficit market with decent price upside for 2019.

What about the other commodity groups? Iron ore's outstanding recent price performance notwithstanding, I sense more confidence in the mid to long-term price outlook for base metals than the bulk commodities. Steel exposed commodities face a challenging outlook in light of China's slowing economic growth and shifting steel/property sector dynamics.

### 03 New markets, new opportunities

Exciting mega-trends like developing world urbanisation, electrification and industrialisation are supportive for long-term commodity demand. As these developing world economies mature, they will need huge amounts of 'building block' commodities. Supportive indicators for steelmaking commodities like iron ore and met coal as well as classic industrial commodities like copper, aluminium and zinc.

It is more than just a developing economy growth story. The likes of 'New Energy', Smart Cities and Electric Vehicles are opening the door for the so-called 'tech metals'. Cobalt, lithium, graphite and rare earths are all integral to the battery revolution. The challenge facing producers is timing and the need for discipline. These are embryonic markets. Too much supply too soon will weigh on commodity prices and disrupt project economics.

The tech space is also generating new customer markets for more established industrial metals like copper, tin and nickel. It will potentially trigger structural change in how these commodities are priced. 'Premium' commodity products will find their own price and market.

There are tremendous opportunities for Australia here – not just as a producer and exporter of high-grade battery commodities but also as an investment 'hub' and centre of mining excellence. Western Australia's plans to be a global lithium hub is potentially the tip of an iceberg.

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**'Solid price fundamentals and macroeconomics will compete for dominance in 2019. The one certainty is further volatility in the commodity markets this year'**

Colonel

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# Macroeconomic outlook, darkening skies ahead

China, US and Europe all expected to see lower growth in 2019

## Global economic outlook darkens

- Undoubtedly a more challenging global economic outlook in 2019. Tighter financing conditions, lower international trade volumes, moderating industrial production growth and higher debt service costs all weighing on economic growth.
- Net impact expected to be negative for commodities, particularly trade exposed industrial metals. Fears of a return to a 2014/15 style demand recession weighing on risk appetite for commodities.
- In its Jan-19 economic update, the World Bank forecasted global GDP growth to 'ease' to ~ 2.8% by 2020.

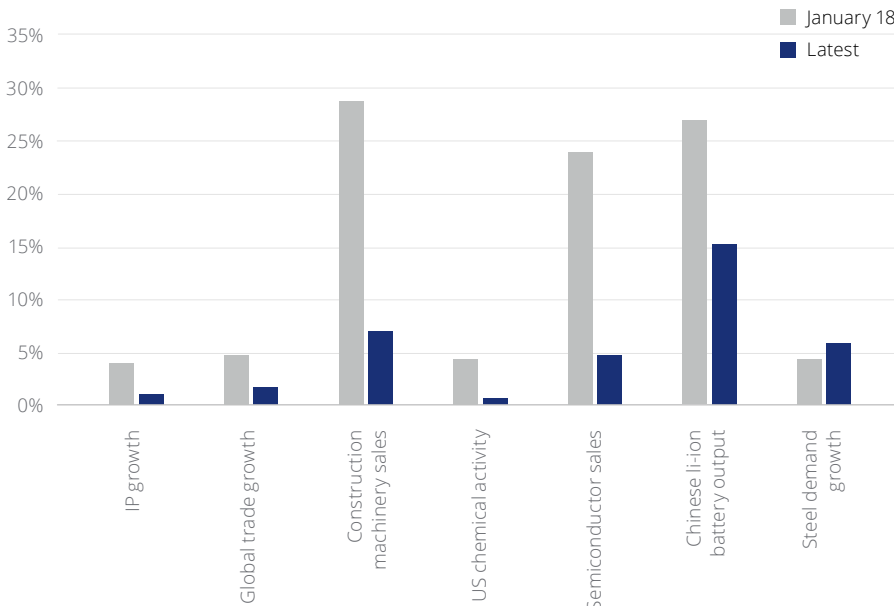
Advanced economies are expected to experience a number of economic headwinds and lower growth in 2019. More volatility is expected for emerging market economies and greater proportion of low Income Countries to experience debt distress as advanced economies withdraw monetary accommodation.

- The International Money Fund (IMF) are more upbeat, forecasting global growth is of 3.7% for 2019. That said, slower growth expected for US and China at 2.5% and 6.2%.
- China's economic slowdown is expected to have a broad impact on major trading partners. Asia's economic growth expected to slow in 2019.

- Economic headwinds in the US and Europe. The IMF are likely to continue to shrink its balance sheet and withdraw liquidity from the US economy and global financial system. The positive growth impact of Trump's tax cuts is now waning and US corporate profit growth is slowing. Europe's economic growth is also slowing with another pullback in liquidity. The European Central Bank (ECB) has ended bond and mortgage buying. The fact the US Federal Reserve and central banks globally are pausing rate hike programs suggests near-term stability is higher priority than deleveraging and other structural economic reforms.

## Global Industrial Economy Indicators

Y-on-Y % growth



Source: Bloomberg, Reuters, BMO Capital Markets

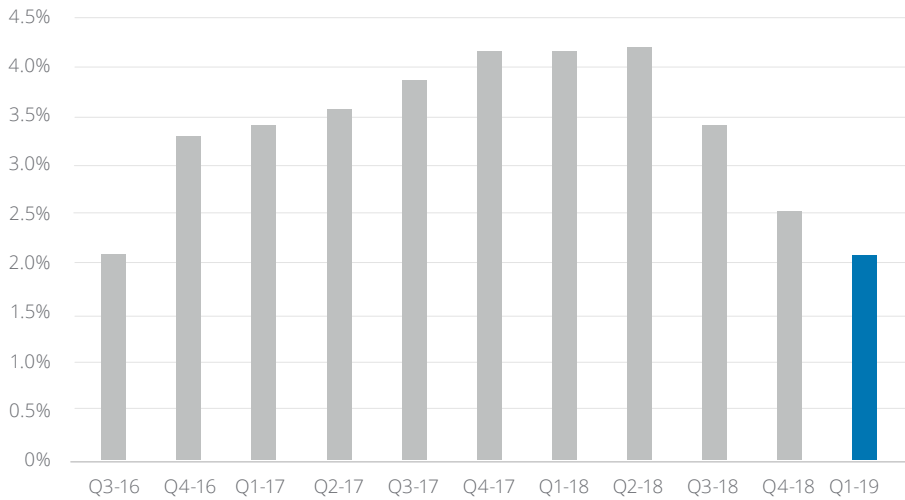
'Undoubtedly a more challenging global economic outlook in 2019.'

Colonel



### Global Industrial Production Growth

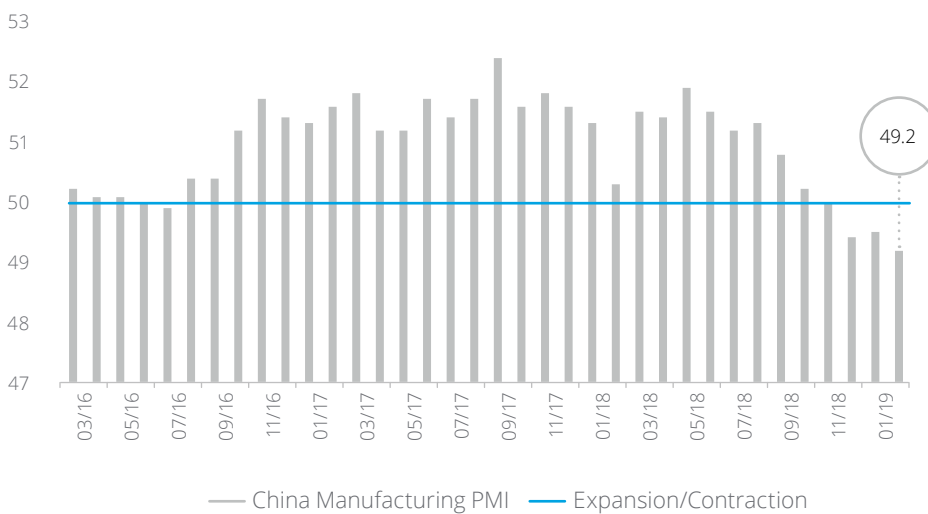
Y-on-Y % growth



Source: Bloomberg, Reuters, BMO Capital Markets

### China's slowing manufacturing sector

Percentage growth and quarter



— China Manufacturing PMI — Expansion/Contraction

Source: Datastream

### China's economy is unambiguously slowing.

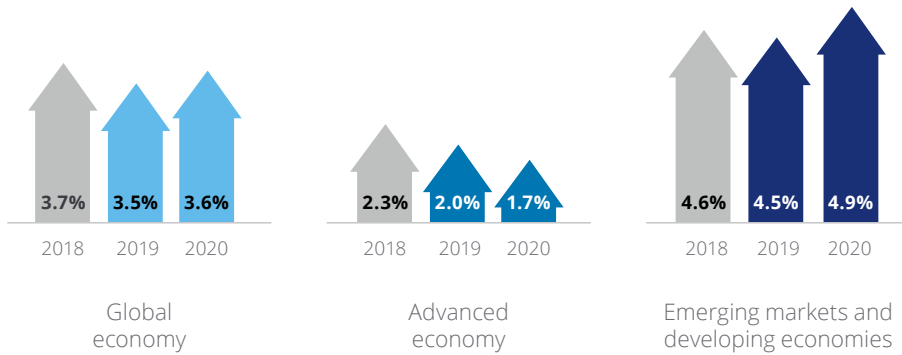
- Recent economic data points to the weakest growth in 3 decades. At 6.6%, China's 2018 economic growth was the lowest since 1990 and Q4-18 growth slowed to 6.4%.
- Key economic indicators are struggling. China's manufacturing PMI contracted in December, as did retail sales.
- December trade data was especially worrying. China customs reports imports falling 7.6% y-on-y when analysts had predicted a 5% increase and a 4.4% decline in exports (also against expectation). US tariffs have weighed on Chinese exports in recent months, disrupting supply chains and dragging down business and consumer confidence.
- Once again, it's stimulus to the rescue. The latest People's Bank of China (PBOC) cash injection of US\$83b is largest open market operation on record. PBOC also reducing amount of cash banks need to hold as reserves. Effectively frees up ~ \$120b of 'new credit'.
- Tax cuts and infrastructure investment program focused on transport. Big hike in rail investment. National Rail Operator announces plans to build 6,800 km of new track this year, a 40% y-on-y uplift. Will flow through increased demand for steel, iron ore, copper and coal.
- Is there need for more aggressive policy measures to turn China's economy around?



**World economic outlook update**

January 21 2019

*Growth projections  
A weakening global expansion*



International Monetary Fund [www.IMF.org](http://www.IMF.org)

**China's falling passenger vehicle sales**



Source: Datastream, y axis is number of passenger vehicle sales

'Elevated global economic risks have undoubtedly clouded the demand outlook for commodities.'

Colonel

**Trade - Resolution, Truce or War?**

- The jury is out.
- 2019 started with some optimism that China and US can resolve differences and broker a mutually beneficial trade deal.
- Following recent talks, there is more optimism of a successful resolution. However, there are still complex structural issues in China's economy suggesting it will be no easy, quick fix. The 'truce' looks fragile. With so many unresolved details and complications, it is unlikely we will get a full trade deal in the near-term.
- Elevated global economic risks have undoubtedly clouded the demand outlook for commodities, especially trade exposed base metals.



# What's hot... quarterly commodity price performance\*

\*3 month price % to March 31 2019


## OVERALL VIEW

It's been a positive quarter for screen traded LME base metals and the precious metals complex. A mix of supportive factors – falling exchange inventories, supply disruptions, a weakening US Dollar and growing investor confidence in a resolution to the China-US trade

dispute – have all played a role. A more dovish Fed putting policy rates on hold notionally for the next 2 years and accepting of higher inflation is clearly positive for miners and commodity prices given the likely impact this will have on the US Dollar. Looking ahead, the key

uncertainty in the near-term will be the ability of industrial metals to withstand all of the current headwinds impacting the global economy. The IMF, OECD and World Bank have all downgraded their 2019 global GDP growth forecasts in response to weak economic data.



5% 

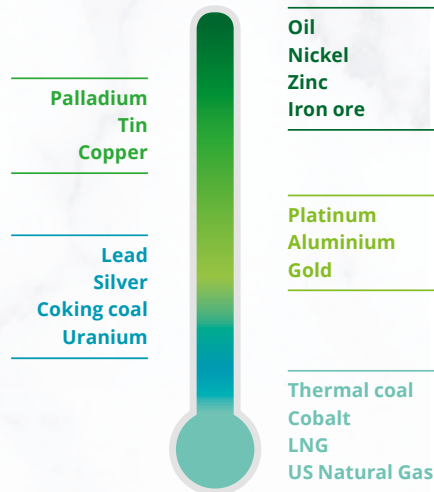


1 month increase copper price

## THE BULL

- **China stimulus** – tax cuts, OMO, transport infrastructure, credit growth
- **Weaker USD** – growing expectations of a US interest rate cut in 2020
- Cost inflation. Shifts the entire cost curve higher, raising the equilibrium price
- Equity market turmoil – increased risk-off trading supportive for some commodities
- **Supply disruptions and falling inventories** – copper, zinc, iron ore, aluminium, PGMs
- New energy, EVs and battery storage – new customer markets for copper, nickel, aluminium etc
- China's One Belt One Road (OBOR), which is focused on infrastructure development and will be highly metals intensive.
- India's commodity intensive rate of urbanisation
- China's economic and environmental reforms and industry rationalisation (i.e. reducing overcapacity)
- Structural supply issues – falling ore grades, input constraints, slowing mine supply growth
- Global deficits in several industrial commodities – copper, nickel, palladium.

## Heroes and zeroes



### THE BEAR

- **Trade tariffs and import restrictions** – reduced trade volumes, impact on commodity demand and economic growth
- **Sharp decline in freight rates**
- **Increased market volatility and risks to global economic growth** – outlook for world economy is darkening
- **Synchronised growth becomes divergent growth**
- Emerging Markets growth outlook – debt service costs rising, volatility ahead
- **China's economic slowdown** – Fixed Asset Investment (FAI), Industrial

Production (IP), Purchasing Managers Index (PMI), trade, retail sales.

- **Falling steel producer margins** – less demand for premium commodity products
- China's slowing property market – controls on house sales, lower credit and reduced land supply available for construction
- Geopolitical disturbances
- Higher US interest rates – a headwind for gold (increased opportunity cost), emerging markets (capital outflows, increased borrowing costs) and commodity markets (impact on USD)
- Decarbonisation policies.

### NICKEL

Nickel prices have retreated slightly on a m-on-m basis but it's still been a strong 2019 with the LME Nickel price up 17% since the start of 2019.

### ZINC

Supply tightness and investor capital inflows are pushing up zinc, one of the best performing base metals in the quarter. How sustainable is this? Much will depend how quickly anticipated supply comes online.

### IRON ORE

Seaborne iron ore prices are up almost 20% on a quarterly basis reflecting recent supply disruptions. An estimated 5% of seaborne supply has effectively been removed from the market following the tailings dam disaster in Brazil. There's not much spare capacity to quickly fill this supply gap with neither Chinese domestic nor major seaborne producers able to scale up quickly.

### PALLADIUM

Palladium has been the best performing metal for the past two years with another strong performance over the quarter. China's tougher emissions standards are pushing car makers to use greater amounts of palladium in catalytic converters. With a strong demand narrative and a deepening supply deficit, we may see further upside in palladium this year.

### PLATINUM

It's been a long time coming but we are now seeing the early seeds of a revival in platinum.

### GOLD

With increased volatility and geopolitical risk, macro asset allocation is becoming more gold positive again. Another positive is the likelihood of USD weakness, particularly as the Fed pauses its rate hikes.

### COBALT

It's a familiar tale of too much supply too soon weighing on the cobalt price. Despite a strong long-term demand outlook, cobalt oversupply is expected to cast a shadow over cobalt prices in 2019.

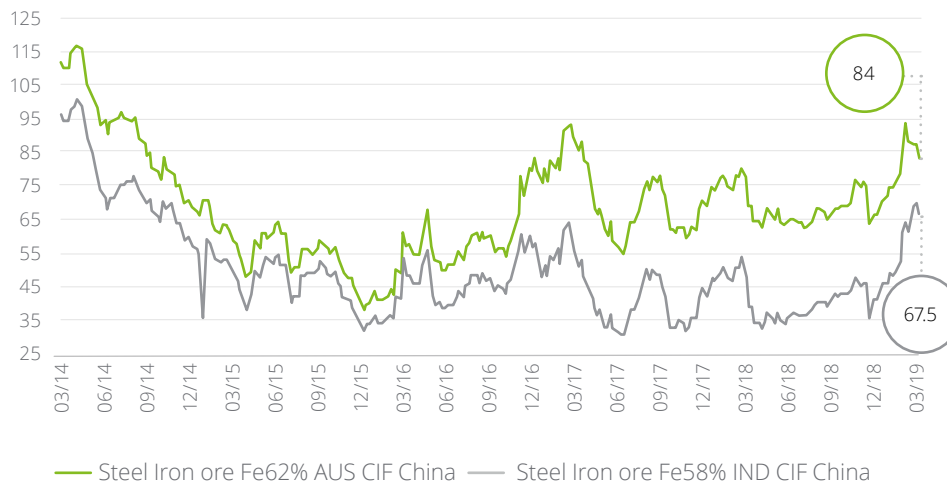


# Bulk and energy commodities

Of the three major commodity groups in our coverage, the outlook for bulk commodities is the most challenging. While trade issues and slower global economic growth outlook impact the broad industrial metals complex, the bulk commodities have weaker long-term supply/demand fundamentals. Steel exposed commodities are vulnerable to trends in China’s economy, not least a slowing property sector and the shift towards a more consumer and service orientated economic model.

## Has the iron ore rally peaked?

US\$/t



Source: Datastream

## IRON ORE

### State of play

Benchmark 62% Fe currently trading close to US\$90/t, up 16% in the past month alone. Despite bearish signals suggesting weakening market fundamentals – falling steel producer margins, weakening crude steel output, declining domestic steel prices, robust seaborne supply and weak Chinese trade data – iron ore continues to defy the odds. A number of trends in China’s steel sector – notably steel mill restocking, falling domestic iron ore production and rising scrap prices are driving seaborne iron ore demand and pricing.

### Outlook

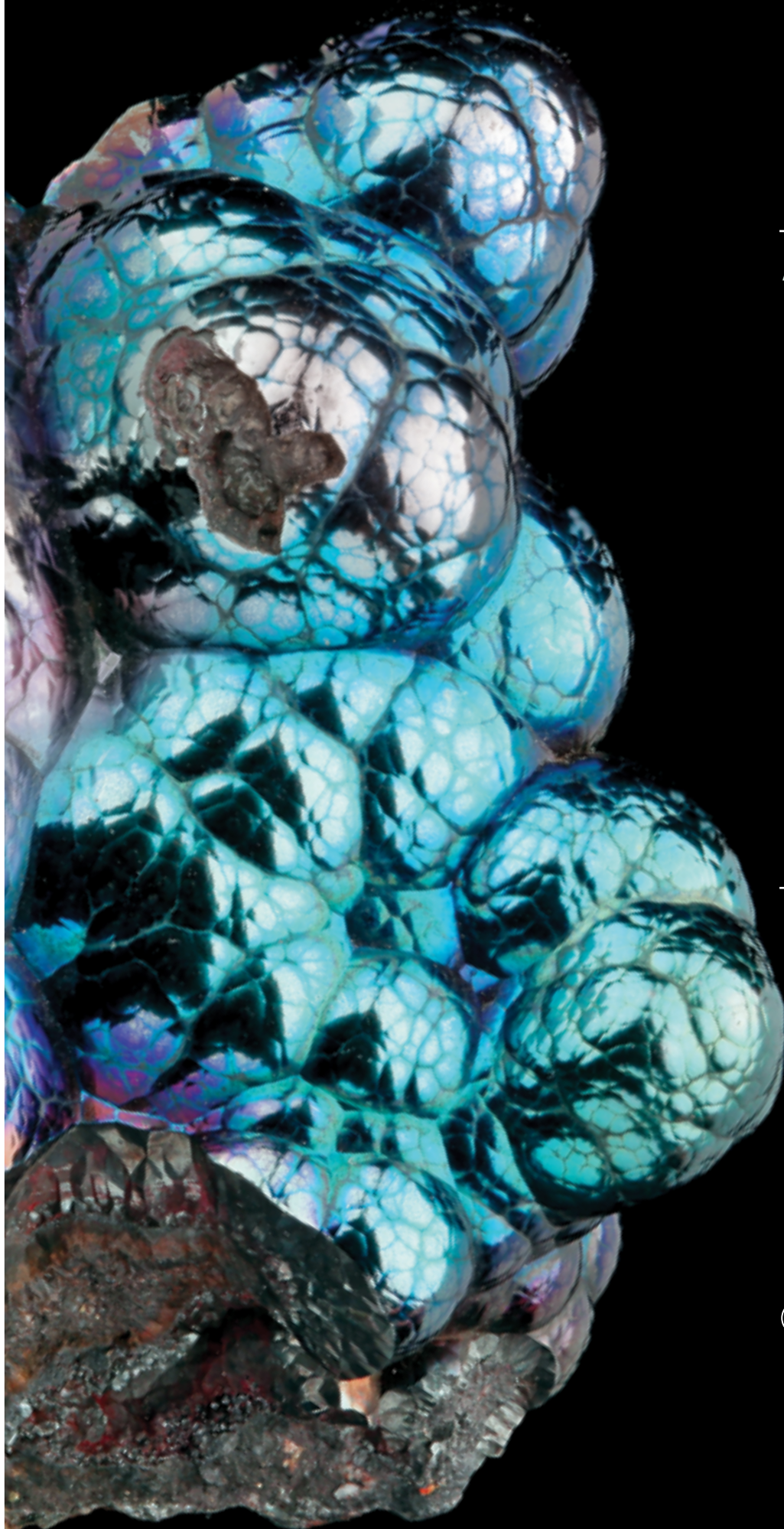
We expect a tougher year ahead for the steelmaking raw materials. There’s a darkening narrative underpinning the global steel industry of late, consistent with a weaker global economic outlook and worrying lead indicators pointing to trouble ahead for China’s economy. China’s steel industry – a critical export market for Australia’s iron ore and coking coal output – is going through a transition as China’s property sector and broader economy deleverages. Continued supply growth by the major iron ore producers is likely to push a finely balanced seaborne market into oversupply, applying downward pressure on the iron ore price in 2019. China’s approval of major steel intensive transport infrastructure projects may provide some temporary relief.

## Met coal prices primed to rise again

Premium Coking Coal CIF CH AUS \$/MT



Source: Datastream



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'The year ahead promises a more challenging bulk commodity price dynamic. Deterioration in China's steel sector fundamentals will weigh on iron ore and met coal. Asia's clean energy policies will likely dampen demand for thermal coal. We're also seeing supply headwinds across the whole complex with growth in seaborne iron ore and coal production expected to weigh on 2019 prices.'

Colonel

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➤ *Limonite is an iron ore consisting of a mixture of hydrated iron oxide-hydroxides in varying composition.*



### Flat China steel prices

Steel 5.75mm HR Coil Beijing CH/MT



Source: Datastream

### Thermal coal prices retreat



Source: Datastream

### COKING COAL

#### State of play

Coking coal prices have come off recent price highs with Australian Hanseatic Coal and Coke (HCC) trading just above US\$180/t. This reflects the return of Australia's met coal export industry to full operating capacity following weather related disruptions (Cyclone Debbie), various port/rail infrastructure upgrades and mine maintenance programs. The demand picture is also looking less secure than six months ago given the decline in China's steel production and falling producer margins.

#### Outlook

Similar dynamics to iron ore. The seaborne market is expected to return to balance in 2019, on rising supply from top producer Australia and weaker demand from China. Australian HCC shipments are reported to be at a three year high, a trend that if persists, will likely see the exit of marginal capacity from the industry. Ongoing producer supply discipline will be required to support met coal prices in 2019.

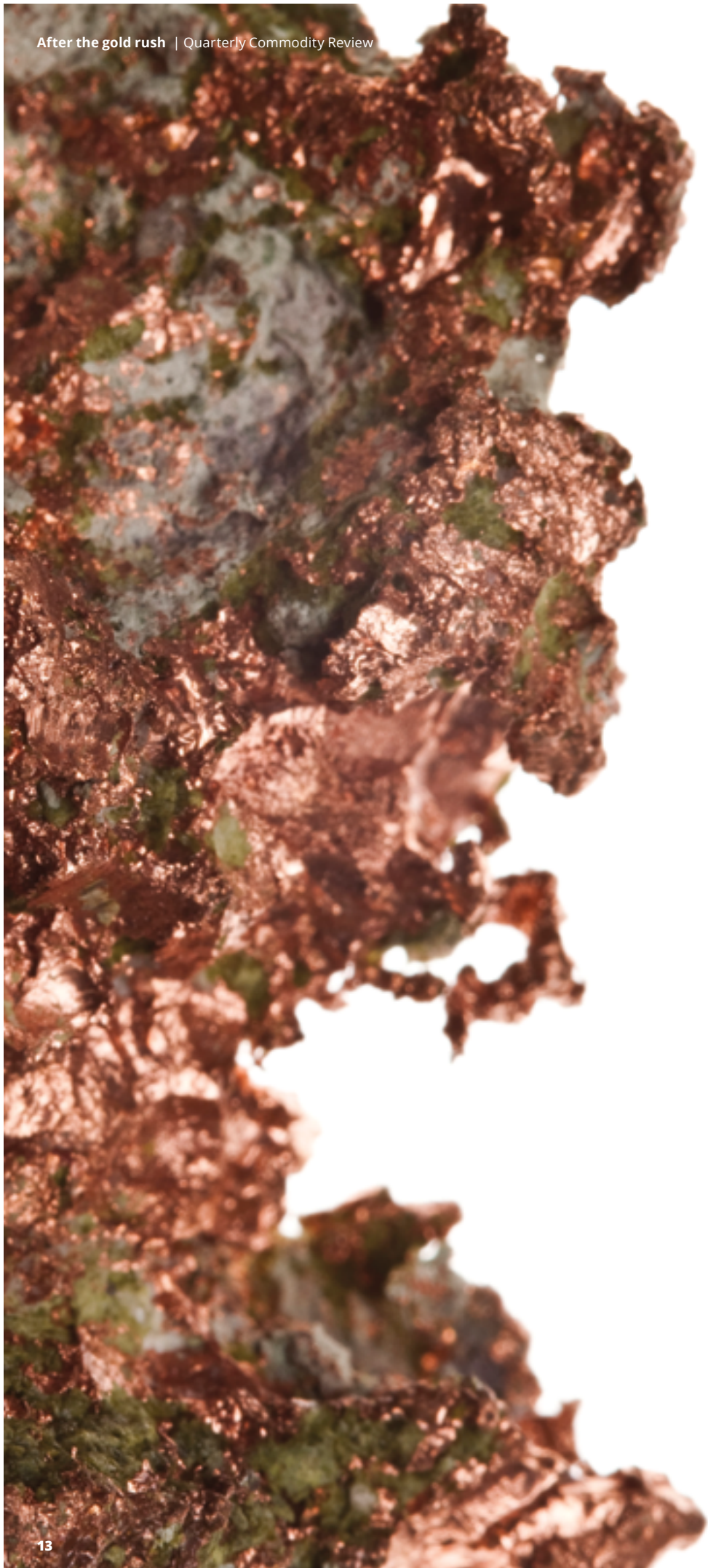
### THERMAL COAL

#### State of play

Thermal coal prices are falling across the board off the back of slowing seaborne demand, rising export shipments and high inventory. Australia's premium price benchmark - Newcastle - is now trading below AU\$100/t with further downside expected. ARA, the European thermal coal price benchmark, has experienced an even steeper decline.

#### Outlook

A challenging year ahead for thermal coal producers. Lower seaborne demand from key Asian utility customers (driven by clean energy policies) together with rising supply from Australia and Russia is expected to drive the overall seaborne market into surplus and put downward pressure on price. The Newcastle price benchmark is forecast to drift further down to \$88/t 2019 with steeper price declines expected for lower grade coal products.



## URANIUM

### State of play

Uranium is holding steady at ~ US\$29/lb with recent production creating a degree of price support. Still a long way to go before we hit those pre-Fukushima prices (~US\$70/lb).

### Outlook

Uranium is a commodity that splits the market. Bulls point to growing demand from Japanese nuclear restarts, developing Asia's appetite for clean energy and ongoing producer supply discipline via curtailments. A more sober view rests on conservative nuclear energy demand forecasts, the closure of ageing reactors, the slow pace of new builds, increased competition from low-cost renewables and the risk of low-cost uranium supply from Kazakhstan flooding the market.

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'With a declining nuclear fleet in the US, Japan, and other parts of the world, the speed and momentum of China's nuclear new build program will be critical to uranium demand.'

Colonel

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Copper nugget



# Base Metals

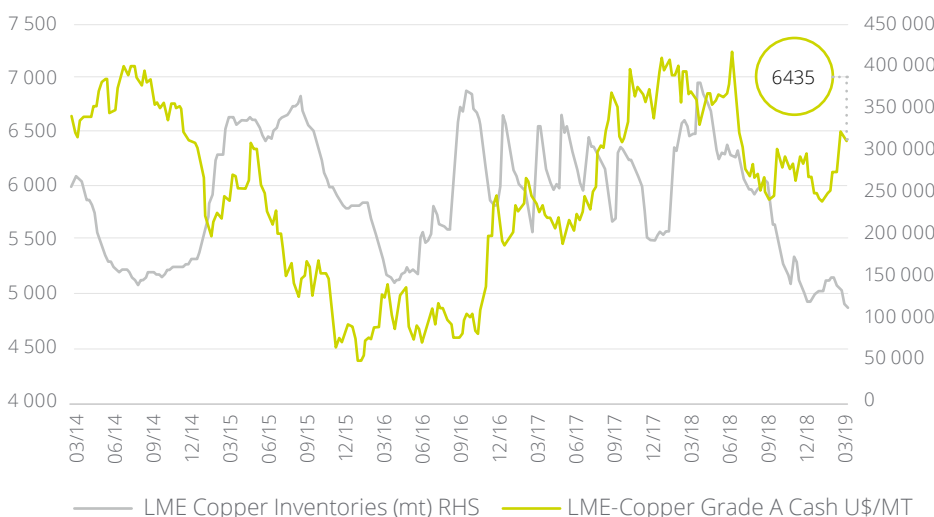
A bearish global economic backdrop and investor risk-off sentiment weighed on base metals complex in the second half of 2018. While macro headwinds remain, details of Beijing metals intensive stimulus and growing optimism that the China/US trade negotiations will reach a successful resolution have given several base metals a sentiment boost.

## Investors rethink zinc short strategies



Source: Datastream

## Copper roars back to life



Source: Datastream

## ZINC

### State of play

Like copper, zinc prices have also rallied, up 5% since the start of 2019. Here the catalyst is more supply related with reported London Metal Exchange (LME) zinc inventories falling to their lowest level in over a decade.

### Outlook

Zinc's long-term price fundamentals are more challenging. You have the likelihood of significant supply growth with major new zinc mines entering production, recovering zinc output from China and growth from countries like Peru. There is potential demand weakness coming from a slowing global auto sector, steel industry consolidation and China's environmental policies.

## COPPER

### State of play

Following a strong first-half in 2018, copper dropped off sharply off the back of a slowing Chinese economy (China accounts for 50% of global copper usage), trade anxiety (copper one of the more visibly impacted metals) and signs of an economic slowdown in US and Europe. 2019 has seen LME copper prices rebound by 6.5%. Solid supply and demand fundamentals have shrugged off ongoing volatility in the global economy.

### Outlook

Macro headwinds aside, the underlying narrative for copper is compelling. On the supply-side, you have limited mine supply growth and structural supply disruptions (labour unrest, power/water shortages and grade declines). Global demand for refined copper is expected to grow 2.6% this year. Based on a flat supply growth scenario and a strong demand environment, the consensus view is for a + US\$7/000/t copper price by 2021. Quality copper assets are highly valued by the market.



## LEAD

### State of play

Better times for lead prices after a tough 2018. China's efforts to green its economy has been a lifeline via its impact on the local lead supply chain. Falling domestic production has pushed up local prices, opening the door to increased import demand. Globally, we are seeing supply tightness re-emerge with several new lead mines failing to deliver expected volumes.

### Outlook

While the demand backdrop is reasonably positive, particularly for lead intensive vehicle batteries, overall sentiment for lead has deteriorated recently. This is due to a combination of supply growth and adverse macro factors. Uncertainty over the US-China tariff deal and global growth worries are weighing on the lead price outlook.

## TIN

### State of play

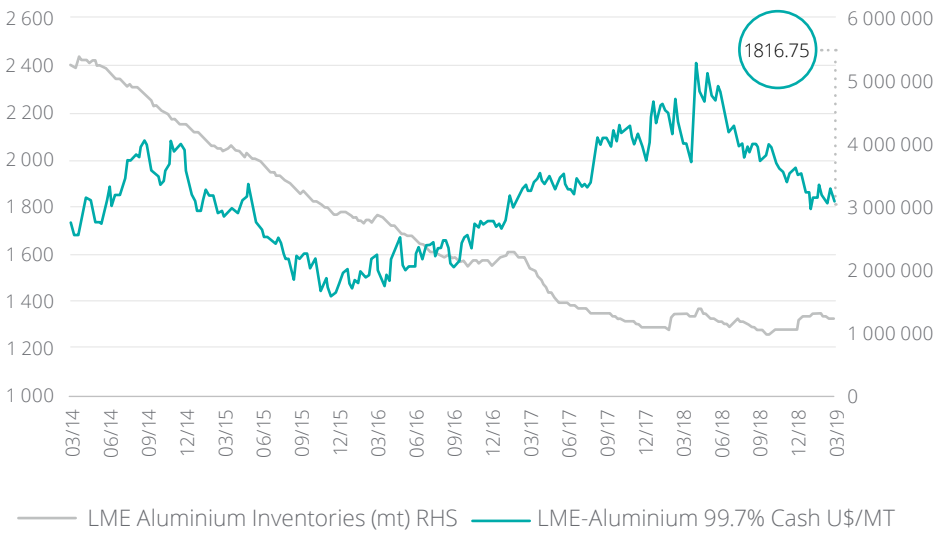
Tin has been a surprise package, retaining its value while other base metals experienced significant volatility. An emerging EV narrative is breathing new life with reported supply constraints also supporting prices.

### Outlook

The market's pricing upside for tin prices off the back of supply shortages and an increasingly compelling demand story (Electric vehicles, energy storage, electronics).

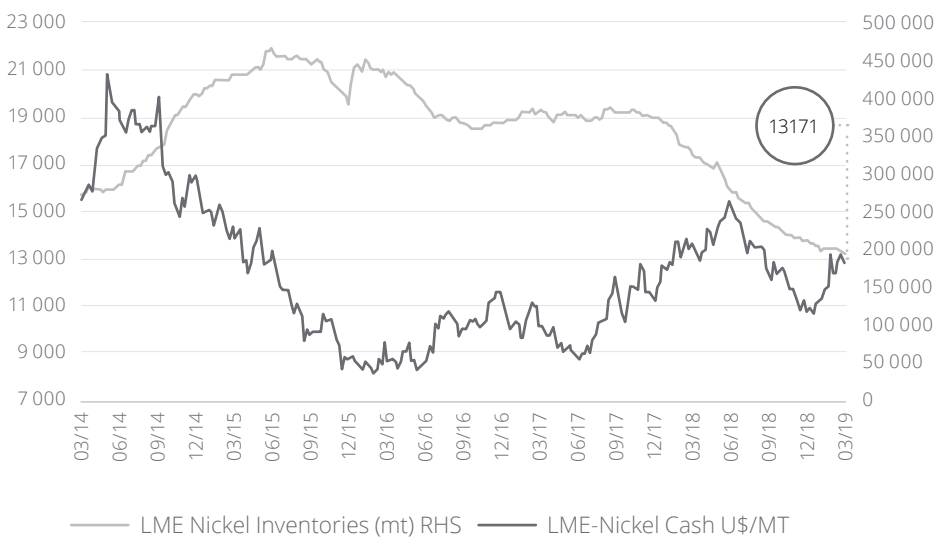


**Aluminium steadies the ship**



Source: Datastream

**Strong start to the year from Nickel**



Source: Datastream

**ALUMINIUM**

**State of play**

After peaking in April last year, the LME Al price has fallen almost 30%. A weakening automotive sector, lifting of sanctions on Russian alumina producer Rusal, falling alumina prices and ongoing macro headwinds have all dragged on Aluminium prices.

**Outlook**

The market is pricing in upside for Al, largely on the back of evolving supply dynamics. At current spot prices, close to 50% of smelters globally are loss making. China has announced some extended maintenance closures. I think we will see some sizable production curtailments in 2019, which should give aluminium prices a degree of support.

**NICKEL**

**State of play**

An exceptionally strong start to 2019 for Nickel with prices up 16%. Consistent with the low inventory trend playing out across the base metal space, nickel stockpiles in exchange warehouses are near multi-year lows. How much this reflects strong demand, produce destocking or a deeper structural deficit is open to debate.

**Outlook**

We are likely to see the evolution of two distinct Ni price mechanisms. 'Class 1' or battery grade Ni for EVs and lower purity 'class 2' for stainless steel production. They will trade at very different price points due to their divergent supply and customer dynamics. China's ability to produce high-grade nickel at significantly lower capital costs will be a significant test for nickel prices.

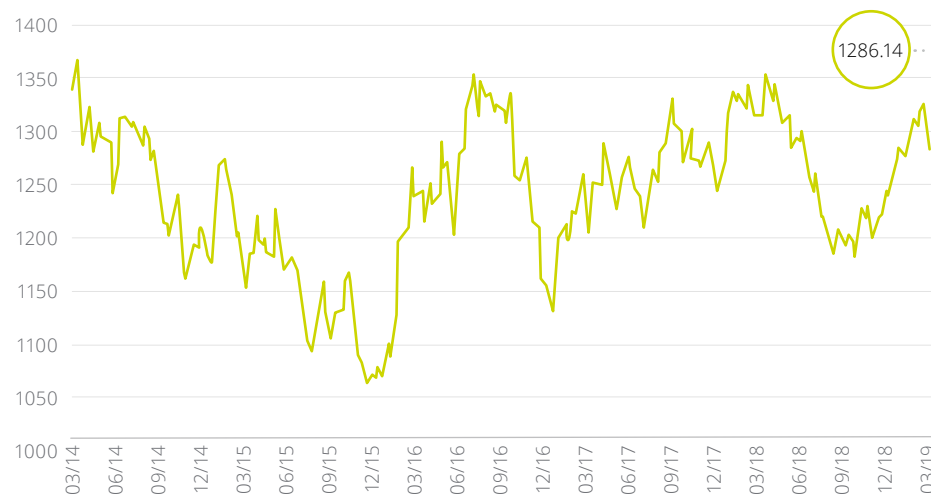
# Precious metals

After a patchy 2018, the stars are beginning to align for the precious metals complex. For good reason too. While an uncertain global economic outlook is a bearish indicator for industrial metals, it is generally supportive for precious metals, often used as a safe haven investment option as investors seek to protect the value of their portfolios in an increasingly volatile world.



## Safe haven investors return to gold

Gold Bullion LBM \$/t oz



Source: Datastream

## GOLD

### State of play

The gold price has been steadily rising since October, driven by strong safe haven buying as the global economic climate becomes more uncertain. There is also healthy investment demand, reflected in net ETF inflows increased gold purchases from the Central Banks. The Federal Reserve's decision to 'pause' its rate hike program is also a positive for a zero yield asset like gold.

### Outlook

Increasingly supportive macroeconomic conditions are expected to lift gold prices through 2019 and beyond. This a commodity seeing the confluence of several strong positive price drivers ... increased risks in the global economic outlook, a weaker USD, the pause in the Federal Reserve rate hike program and rising inflation. There is also an emerging supply-side narrative for gold. It is becoming more challenging to develop new supply with global mine supply growth slowing.



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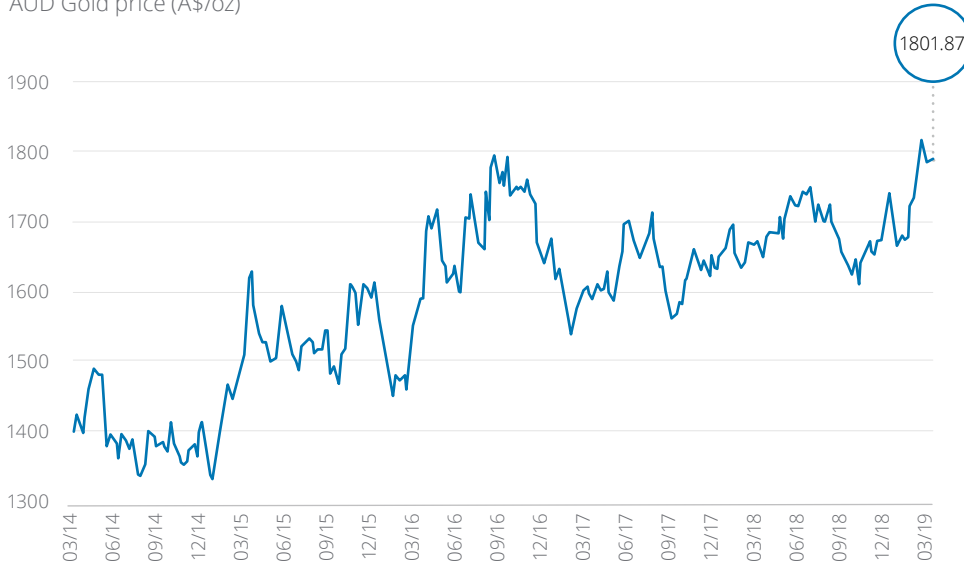
'Of the main commodity groups, probably the best pick in terms of short-term price momentum is precious metals. Commodities like gold typically do well during times of economic uncertainty. The shift in narrative from synchronised global economic growth to one of a slowing and deleveraging China, tighter Fed liquidity, rising global protectionism, emerging market volatility and elevated risks to the global economic outlook are a perfect storm for safe haven assets'

Colonel

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**Good time to be an ASX gold producer**

AUD Gold price (A\$/oz)



Source: Datastream

**Silver moves with gold**

Silver, Handy&Harman (NY) U\$/Troy OZ



Source: Datastream

**SILVER**

**State of play**

Like gold, silver is having a decent run, responding positively to the elevated geopolitical risk climate. The silver price has appreciated 3% since the start of the year with potential for further upside given reported supply constraints.

**Outlook**

Long seen by investors as an undervalued commodity, 2019 could be the year where silver comes out of the shadows. Consensus forecasts point to a gradual appreciation in the silver price, with a long-term silver price in the US\$19/oz. ballpark. Silver's greater exposure to the industrial cycle via fabrication demand differentiates it from a more investor-based commodity like gold.



### Palladium continues to scale the heights

Palladium US\$/Troy Oz



Source: Datastream

### PALLADIUM

#### State of play

Scarcely believable a few years ago, palladium is now a more valuable commodity than gold. It has been one of the best performing commodities for the past two years. Europe's diesel emissions scandal has been hugely beneficial for a commodity whose primary application is in the exhaust systems of cars. After hitting a 12-month low in August, palladium prices have increased by more than 70% since then.

#### Outlook

With catalytic converter demand showing little signs of abating in the clean energy policy environment and an industry supply response struggling to keep pace, the near-term price outlook is positive for palladium. Any marked slowdown in global industrial activity is a headwind. Palladium is the most industrial metal of the precious metals complex, with autocat and electronics demand accounting for 90% of total consumption.



### Flat platinum pricing

London Platinum Free Market US\$/Troy oz



Source: Datastream

### PLATINUM

#### State of play

Relatively soft demand and an ongoing lack of supply discipline from the major platinum producers is keeping the platinum market in surplus and capping price upside.

#### Outlook

Platinum is the clear outlier of the PM group with unattractive fundamentals (excess supply, tepid demand) weighing on the near-term price outlook. Such is the scale of the platinum surplus, scheduled production cuts are not expected to have a price impact for at least 12-18 months. Is this the time for investors to return to platinum? Platinum ETFs have seen considerable net inflows in 2019 with holdings rising 22% year-to-date to 2.8moz. With the global platinum market slowly but surely returning to balance, investors see upside potential.



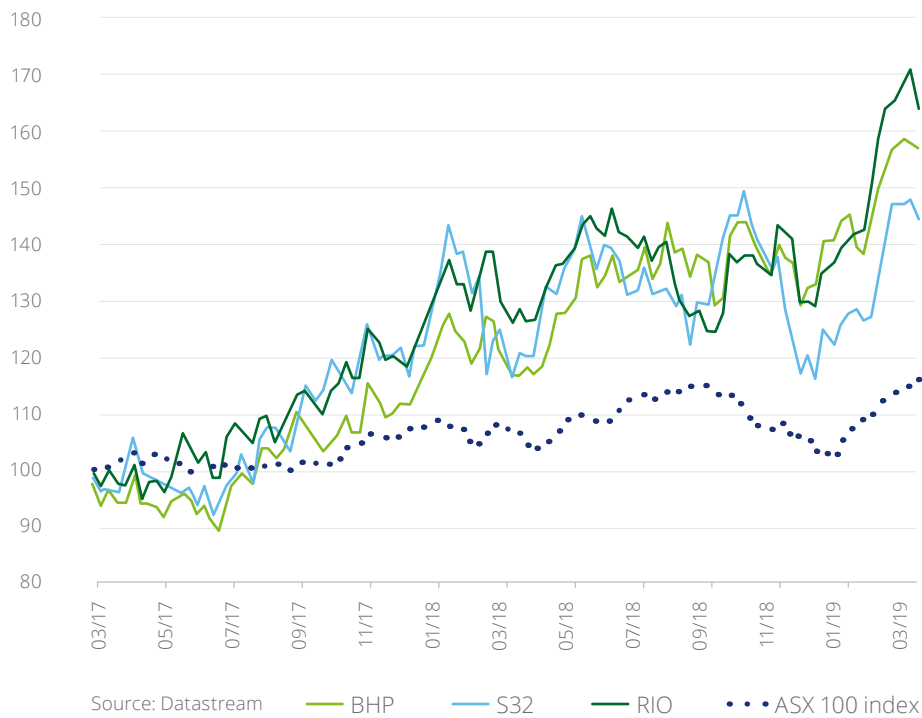


# Australia Mining Indicators – Corporate

AUS mining valuations holding up despite global macroeconomic headwinds

## Diversified miners outperform

2 year rebased total returns

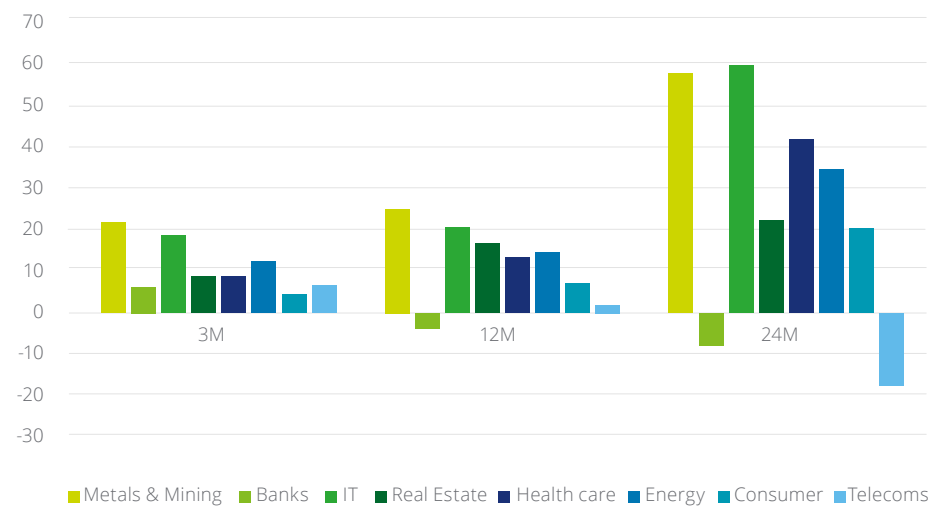


All of the big three diversified miners are comfortably outperforming broad equity markets on a two year total returns basis.



### ASX 300 sector comparisons

Total shareholder returns growth (%)



Source: Datastream

What is behind this outperformance? The recovery in commodity prices has given miners the financial headroom to repair stretched balance sheets and become the catalyst driving corporate earnings, cash flows and valuations. We are also seeing some macro support

for valuations. There is growing optimism that the protracted trade negotiations between China and the US are one-step closer to a successful resolution. Beijing's stimulus on metals intensive infrastructure projects is also a positive earnings driver.

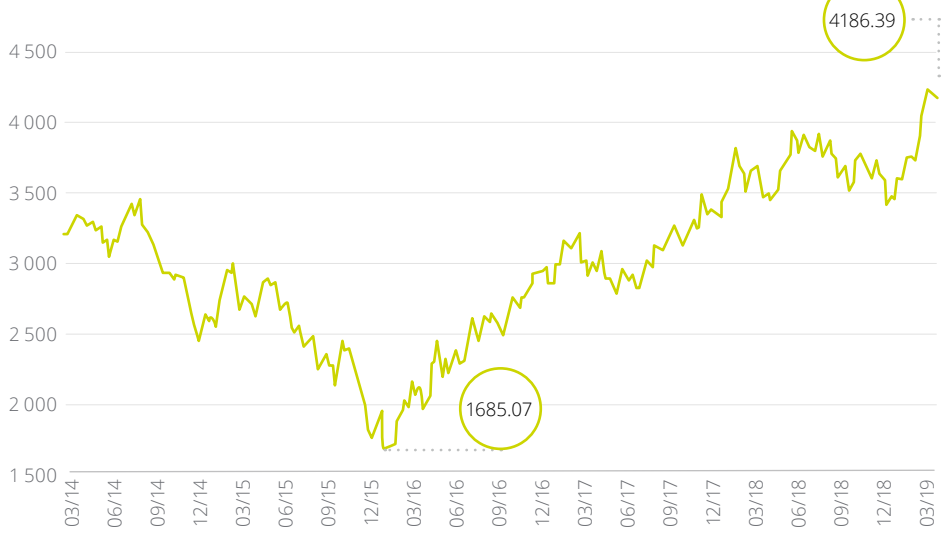
ASX mining stocks outperformed broad equity indices over the quarter, reflective of a strong reporting season. Favourable commodity prices, strong operating metrics, internal productivity programs, the divestment of non-core assets and cash generative tier one assets all helped to boost underlying earnings for the top miners. Rio Tinto's ASX share is trading at a 52 week high following an exceptionally strong FY18 result that delivered \$13.5b of cash returns. BHP's share price is up almost 30% y-on-y off the back of H1-19 EBITDA of 10.5bn. South32 is also having a good run with the ASX share price up 17% in the past quarter, driven by a strong first half result that came ahead of analyst expectations.

Valuation metrics for the big three ASX diversified miners look compelling from a cash flow perspective in the near-term with FY19 FCF yields of 7-8%, EV/EBITDA multiples of 5-6x and dividend yields trading north of 5%. A growth strategy based on disciplined capital management is being well received by the market. Investors continue to look for disciplined capital allocation including buybacks and dividends. Several large cap miners have announced significant share buybacks in recent quarters.





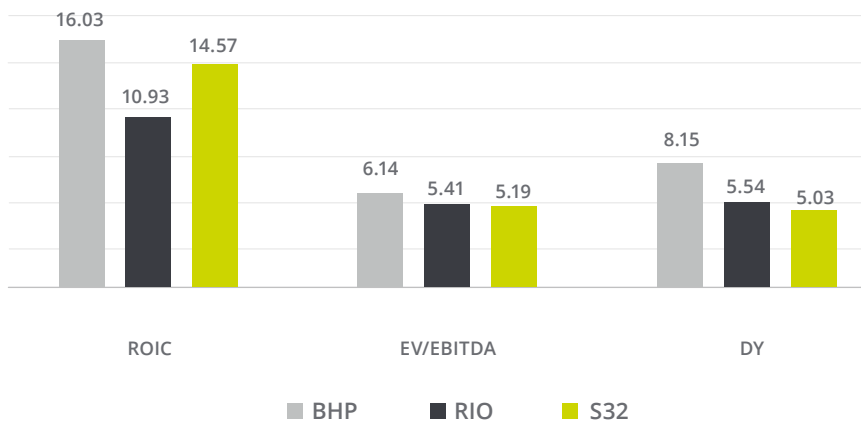
**S7P/ASX 300 Metals and Mining price index**



When it comes to delivery of returns to shareholders, miners have consistently outperformed other sectors too. ASX Miners are generating superior shareholder returns relative to broad equity indices (i.e. ASX 200) and individual sectors.

Source: Datastream

**Attactive FY19 valuation metrics**



There are real pockets of value outside the big three diversified miners. ASX gold producers are performing strongly with cash generative assets and debt free balance sheets driving valuations. Elevated global economic growth risks and trade tensions are boosting investor sentiment for gold stocks as a diversification option. It is not only gold producers trading at attractive multiples. ASX 100 Iron ore producer FMG has seen its share price appreciate by 55% in the past quarter, driven by a 61% uptick in the 58% Fe price over the same period. Another sector doing well is the asset services space. Australian mining service companies are generating double-digit revenue growth following a notable improvement in underlying business conditions.

Source: Thomson Reuters Eikon

# Spotlight on M&A



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Looking at the trends playing out in the commodity markets gives a good sense of future M&A deal activity. The past few years have seen a recovery in announced Australian mining M&A, consistent with the broad recovery in the commodity markets and uplift in corporate earnings. While there is still caution in the market – safeguarding cash flows and protecting balance sheets is still priority – we expect M&A to be a key channel to growth for Australian miners in 2019. The mid-market space will be especially acquisitive in 2019 with the ‘buy over build’ mantra driving corporate growth strategies. Several mid-caps will be attractive targets for overseas suitors too.

There are several commodities where we expect increased deal activity in 2019.

With compelling long-term supply dynamics and price fundamentals, there is naturally a lot of interest in high quality copper assets. Slowing global mine supply compounded by a shortage of world class copper deposits is encouraging miners to seek copper assets to buy. The challenge is finding the right assets at the right price. In this market dynamic, relatively few copper assets are available to buy and any high quality copper asset for sale will attract significant interest. Bidders will need to balance their desire for high-quality copper projects against the risk of overpaying.

In terms of global M&A, gold is one of the most dynamic sectors right now, with a number of deals announced in the past six months. It is a particularly good time to be an Australian gold miner. A market environment of rising gold prices, benign cost inflation, healthy producer cash margins and global consolidation is creating tremendous growth opportunities for several of the mid-cap ASX listed gold producers.

With the two biggest announced mining M&A deals both in the gold space (Newmont and Goldcorp; Barrick and Randgold) and both likely to generate divestments, there is great opportunity for cashed-up ASX gold producers to add scale and move to the next level. There is also plenty of overseas interest in Australian gold assets, particularly from North America. With the turbulence in the world economy and the ongoing China-US trade talks, Australia is a stable place to do business and a potential hedge against the volatility felt elsewhere.

Outside of copper and gold, there is plenty of interest in the so-called battery metals space too. Positioning for the ‘new energy’ revolution, miners are keen to get exposure to what they see as a long-term earnings growth opportunity. Lithium has been an M&A hotspot in recent years and there is every indication that more deals will follow in 2019. Battery-grade nickel deposits will also command a high level of interest. While increased supply has put downward pressure on short to medium-term prices for lithium, nickel and cobalt, the strong long-term fundamentals of battery metals will continue to drive activity. Navigating the timing of market and short-term pricing versus long-term opportunity will be the challenge.

We may see more activity in the coal space too. Increasing shareholder activism is continuing to cause majors to consider their positions on coal, while consolidation may be attractive for mid-tier coal producers focusing on reducing costs and improving efficiency.



# Latest insights



## Tracking the trends 2019

Now in its 11th year, the 2019 Tracking the trends reveals the top 10 trends that should be on every mining companies' agenda. Our global mining professionals once again share insights that miners can leverage in their ongoing pursuit for productivity, capital discipline, strategy development, and sustainable growth.

**Download the report to find out what's in-store for miners this year**

[www2.deloitte.com/au/en/pages/energy-and-resources/articles/tracking-the-trends.html](http://www2.deloitte.com/au/en/pages/energy-and-resources/articles/tracking-the-trends.html)



## Culture, Customer, Purpose Key recommendations and impacts of the Hayne Royal Commission

The Hayne Royal Commission final report means different things to the industry, to regulators, to customers and to communities. The overarching theme of the report is balance. Commissioner Hayne has kept one eye on structurally reforming the system, while not rocking Australia's economic boat. His unequivocal message to all was that the principles that underpin the rules for the industry should be clear, obeyed, and enforced.

**Download the report**

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