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PRINCE MOPAI: Global growth recovery should favour SA's resource sector

A strong recovery, already under way, means that prospects for growth are high

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Pent-up demand and unprecedented amounts of monetary stimulus could bode well for SA's resource sector, the writer argues. Picture: SUPPLIED

This year could be a great year for the SA resource sector. Our view is motivated by a number of identifiable driving forces. There is a strong recovery in global growth under way and we think the deck is stacked for surprises to the upside.

Pent-up demand is set to be unleashed as developed economies reopen with some confidence thanks to their vaccine programmes. At the same time, unprecedented amounts of monetary and fiscal stimulus are still being dished out.

Incredibly, household savings across the G7 markets grew by 7% of GDP over the course of 2020, largely because of government support. Much of these savings literally sat on deposit waiting for lockdown rules to be lifted. If just a third of this cash is deployed this year the implication is the fastest rate of global GDP growth in over 50 years.

Global GDP in 2021 is expected to exceed 6.5% and the Chinese economy, which is key for resources, is expected to grow by 9%. Second, the supply of many resources is constrained. The global multinational resource companies have learnt from bitter experience in previous cycles about the pitfalls of over-investment, with the upshot that little fresh capacity has been added since 2015.

Supply constraints have been compounded by company specific problems. Production at Vale, the largest Brazilian iron ore producer, has not recovered from the tragic dam collapse of early 2019, and more recently water ingress into one of the largest nickel and palladium mines in the world at Norilsk in northern Russia has severely disrupted operations. As things stand, Norilsk has been unable to contain all of the underground flooding, leaving the outlook for palladium group metals supply uncertain.

In any event, the market was already undersupplied in palladium and rhodium (used to combat nitrogen emissions in internal combustion engines). This combination of strong demand and tight supply is an excellent recipe for higher average metal prices and continued upward momentum in resource sector earnings, cash flows and dividends.

Over and above the supply-demand dynamics, it’s worth noting that the stage is set for corporate activity in the resource sector. A number of global and local players have expressed the view that consolidation is desirable and likely. Management of these resource companies are well aware that the accelerating trend towards passive investing means that higher market capitalisations — resulting from M&A — equals larger weightings in key indices, thus attracting more flows from tracker funds.

Shareholders of companies that are acquired are likely to receive offers at handsome premiums to current prices. We believe the SA gold producers present good opportunity for potential takeovers by their global competitors. Our view is primarily motivated by attractive valuations coupled with good portfolio diversifications, reduced jurisdictional risk profiles and longer life assets. For instance, local players are now trading at 40% (enterprise value) discount to their global peers.

Additionally, we are already seeing some of the local players actively diversifying away from old, deep-level and high-cost SA gold mines to pursue longer life assets with sizeable and lower cost operations. Such efforts, we believe, should boost corporate activity and could prove to be value accretive for shareholders of companies that are acquired.

Our top picks are AngloGold Ashanti in the gold sector, Royal Bafokeng Platinum in the platinum sector and Anglo American in the diversified miners.

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