Anglo American – Baby out with the Bathwater

Corporate theory these days is driven by the grand gesture. Just as in the good days we saw overblown acquisitions because small deals just didn't "move the dial", now in the reverse phase the baby goes out with the bathwater.

Latest candidate for the grand gesture is Anglo-American which is throwing out bath as well as bathwater and baby.

Some History

I am an unalloyed fan of demergers. If the asset does not fit in the corporate family then demerge it to the shareholders and let them makes their own choice what to do. So many times we have seen companies vend core assets to just have the money vanish into the black hole or "corporate expenses" or "restructuring charges " or "debt reduction".

The concept of demergers is not unknown at Anglo-American as last decade (in July 2007) it spun-out Mondi, its international packaging and paper division. Employing around 25,000 people across more than 30 countries. Our key operations are located in central Europe, Russia, North America and South Africa. Mondi is fully integrated across the packaging and paper value chain – from managing forests and producing pulp, paper and compound plastics, to developing effective and innovative industrial and consumer packaging solutions. In 2014, Mondi had revenues of €6.4 billion and a return on capital employed of 17.2%.

With this in its history its surprising that Anglo American have not been more skillful as slicing and dicing their own product mix to create different companies that might whether this current storm better. A demerger of the De Beers entity with its stellar brand name and potential to trade as a luxury goods stock (with attendant ritzy ratings) rather than as a miner seems like the elephant in the room. Obviously some shibboleths are too touchy to even be considered. Pushing it out the door with a goodly chunk of debt attached to it would lighten the load on the mainstream mining business and seems like a win-win outcome.

Likewise the iron ore business, Minas Rio, should be a candidate to go in a demerger. We always marveled during the go-go days of the BOVESPA as to why more foreign miners did not go for a Sao Paulo listing from their Brazilian assets to capitalise on the Carnival atmosphere while it lasted. Too late now to spin it out with a premium rating but still NOT having iron ore in one's asset mix these days is better than having this mineral around emitting a noxious vibe guaranteed to scare investors away.

I reiterate my thesis that while base metals, and even precious metals, might see better days in the near to medium term, the massive oversupply of iron ore and the end of the Chinese steel boom is likely to leave iron ore in the doghouse for a decade.

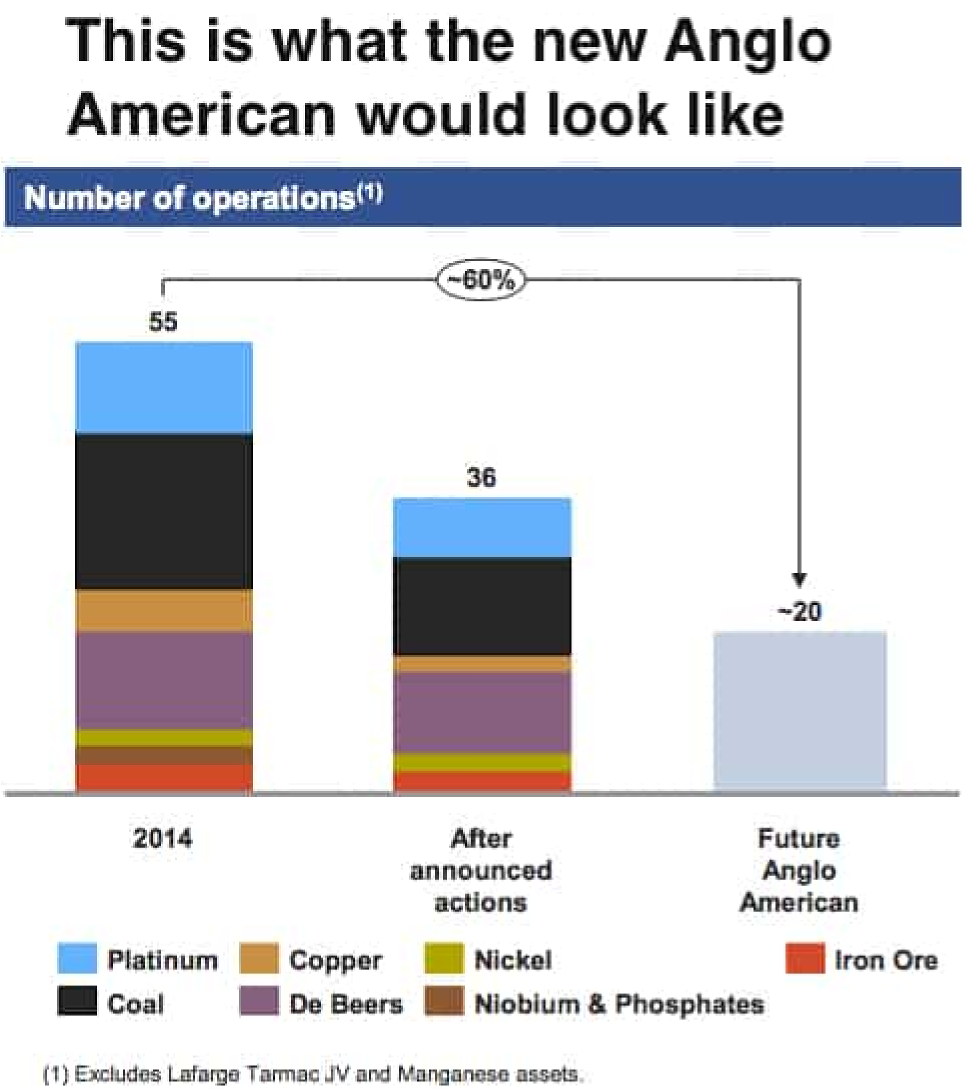
Niobium

As we have covered Niobium here in the past it is useful to note that Anglo American is one of the world's top three

Niobium producers with its Catalao mine in Brazil.

Company & Deposit		Reserve	Grade of Nb	Existing Production	Expanded Production
CBMM - Araxa	Brazil	800-900 MT M&I	2.50%		150,000
Magris Resources - Niobec	Quebec	450 MT M&I	0.42%	4,500	13,500
Anglo-American - Catalao	Brazil	33 MT M&I	1.24%	4,000	6,500

There had been talk about selling this asset early in the current decade but in March 2011 it abandoned these plans. However the latest presentation (which accompanied the massive shrinkage announcement) published this chart which by a process of deduction shows Niobium no longer in the mix.



First you see it, now you don’t. This raises some questions as to who the likely buyer would be. Does Magris want it? Probably yes but as a fledgling fund does it really want to be that overweight in Niobium, which is linked with the troubled steel industry, after having already shelled out $500mn for Niobec? CBMM buying the asset would bring a whole raft of anti-trust problems at the international level, though the Brazilian government probably would not care.

That leaves two other names to conjure with, and both include Mark Smith. These are Largo Resources, which is already positioned in Brazil and Niocorp which has Niobium as its specific brief. Might we ponder a merger of the two listed entities, and then buying Catalao, with Anglo accepting stock in the new combined entity? We can only suppose at this point but it does have an interesting logic.

Down She Goes

Below can be seen the stock price performance since 2010. While we all know mining has not been the happiest of places since 2011, it appears the rot set in early here as many majors managed to hold up as they had a better mix of metals than your average one-trick pony miner and because they had cash-flow. In addition Anglo American owns De Beers and while diamonds are not exactly sparkling at the current time they have not been as dire or as undisciplined as the rest of the mining industry.

However, at Anglo American the mood has been almost unrelievedly downbeat (downhill?). It's no wonder that shareholders want blood.

Conclusion

While big caps like Anglo American are not the usual fodder for my musings on Investorintel this case strikes a chord because it is yet another example of a trend that not too many have applied logical thinking to. In the past we have noted that there was a horde of gold juniors thinking that a handful of majors were going to buy their properties to which our response was "they can't buy all your projects" and in fact since the (many) debacles of Kinross, the majors have been buying hardly any properties from juniors. Now the boot is on the other foot, somewhat, with a bunch of cash-strapped majors (Anglo, Glencore etc) trying to divest assets to companies lower down the mining totem-pole. So far precious few deals have been done. The very largest of the first tier have mines that are so large and (in theory) so valuable and thus with such big ticket price tags that how can one imagine that everything that is on the "for sale" rack is going to be picked up. Who are the buyers supposed to be? How many cash-rich minor majors are there? And in any case even in the smaller majors bought one or two of Anglo's cast-offs then who is going to buy the rest. There is a fundamental mismatch between the number of foreseeable buyers and the number of assets being cleared out.

Majors are showing themselves to be just as wedded to outdated paradigms as juniors with their "put it for sale and they will come" attitude. While much criticism is made of BHP these days, we can't help but think that its spin-out of South32 at the beginning of this year was one of the smartest deals of 2015. It allowed some unwanted assets to find their one way in life without having to resort to a Filene's Basement-style "automatic markdown" policy. Still we have the suspicion that both Glencore and Anglo-American are creating the "assets for sale" lists to pander to bankers and institutional investors that want to see managements in full fire-fighting mode and yet the companies are probably just hoping for a turnaround in metals fortunes and then hanging onto the assets they never wanted to dispose of in the first place!