Industry Top Trends Update

Metals and Mining

Credit steadies after a big upswing

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What's changed?

Credit quality has strengthened after a round of upgrades. Consistent with the global theme, we've upgraded a remarkable 10%-15% of the portfolio in the last year. Even accounting for the sector's volatility, companies built a buffer over several years with restrained capital outlays and debt reduction.

Prices drop with clouds on the economic horizon. Record-high prices in early 2022 have dropped considerably but remain above their long-term averages and well above trough levels. As such, prices still have plenty of downside before hitting cash clearing costs, which could indicate a cyclical trough price in a serious downturn.

Issuers boost shareholder returns and corporate development after years of discipline. Most large distributions have been from excess cash, with many issuers embedding flexible returns into their capital allocation policies. Also, all-share transactions have helped bolster operating breadth with little debt overhang.

What to look out for?

Prices are volatile and unpredictable. In a downturn, trough prices often test the unit cash costs of high-cost producers, which have been pushed higher by declining ore grades in mining and higher raw material costs overall. On the other hand, steelmaking in the U.S. continues increasing modern capacity with lower-cost scrap inputs, while retiring higher-cost blast furnaces.

Lower valuations and large cash balances could test financial discipline. We expect good cash flows will be directed more to corporate development and shareholder returns than debt reduction, taking into account more than five years of capital spending restraint and a generally favorable demand outlook.

Energy transition means more big investments. Steel and aluminum producers in North America are recasting their output, aiming to reduce emissions by replacing older assets or altering production. Miners look to boost output of key metals to support electrification, such as copper, nickel, cobalt, and lithium.

What if there's a recession?

Lower prices would erode buffer, but our ratings incorporate plenty of volatility. Metals prices cycle more often and more violently than economic data and may even defy the economic outlook. Even so, recent upgrades from years of debt reduction indicates good buffer against rapid downgrades when earnings weaken.

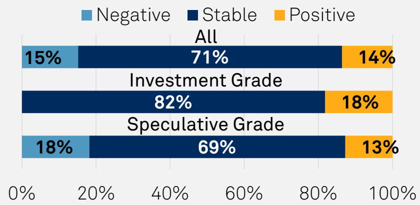
Weaker cash flow amid multiyear capex could consume large cash balances. Companies are often reluctant to cut important capital expenditures in a downturn, exaggerating volatile cash flow measures. The current upswing yielded a huge cash windfall for many companies, which enables continued spending in a downturn.

Flexible shareholder returns could moderate a downturn. Issuers and investors are becoming more accustomed to a variable payout in this highly cyclical sector.

Latest Related Research

- Newmont Corp. Upgraded To 'BBB+' From 'BBB', March 29, 2022
- Barrick Gold Corp. Upgraded To 'BBB+' From 'BBB', March 29, 2022
- Metal Price Assumptions: Shortages Worsen And Prices Spike, March 17, 2022

Outlook Distribution



Ratings Statistics (YTD)*

	IG	SG	All
Ratings	11	56	67
Downgrades	0	3	3
Upgrades	3	7	10

Ratings data as of end-June 2022. * Year-to-date

Ratings Outlook Net Bias