Industry Credit Outlook:
The Worst May Be Over For Asia-Pacific Metals And Mining Companies

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Rating Trends And Outlook

The net outlook (-45%) for Asia-Pacific metals and mining issuers that S&P Global Ratings rates was highly negative at Sept. 30, 2016, because of weak prices in 2015 and earlier in 2016, and uncertainty of a sustained recovery (see chart 2).

Nevertheless, we consider the sector's earnings would stabilize and credit metrics would improve in 2017. That's because prices of steel, thermal coal, coking coal, gold, zinc, and iron ore have recovered strongly from record lows earlier in 2016 and companies continue to implement measures to protect their credit quality. If current prices sustain, this could alleviate the downward rating pressure in this sector.

Overview

- The Asia-Pacific metals and mining sector has a high negative outlook bias because of weak prices in 2015 and earlier in 2016 and uncertainty of a sustained recovery.
- Nevertheless, we consider the sector's earnings would stabilize and credit metrics would improve in 2017 because of a strong recovery in most metals from record lows earlier in 2016.
- In addition, companies continue to implement measures such as operating cost cuts and disciplined capital expenditure to protect their credit quality.
- A key risk is an unexpected fall in demand for steel and raw materials from China.

Moreover, miners' ongoing credit-protective measures have maintained their performance and credit metrics broadly within our existing rating expectations. Despite the recovery in some metal prices, companies continue to reduce operating costs and remain disciplined on capital expenditure. Miners are now focusing more on deleveraging than growth. Some companies have even changed their long-held dividend policies to protect their balance sheets.

If the current trading conditions continue for one or two more quarters, we expect the negative bias to reduce in this sector in 2017. However, large merger and acquisition (M&A) activities, if funded by debt, could trigger negative rating actions in 2017.

We expect mining companies' liquidity to be adequate, but securing funding for growth projects remains difficult for junior miners.
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Asia-Pacific Metals And Mining Sector

Chart 1 – Ratings Distribution

Chart 2 – Outlook Distribution

Negative  18%  42%
Watch Neg  3%  11%
Stable  80%  36%
Watch Pos  0%  0%
Positive  0%  6%

Chart 3 – FFO/Debt (%)

Chart 4 – Debt/EBITDA (x)

2013  2014  2015  FY2015e  FY2017f  FY2018f
Median  Weighted average
0  5  10  15  20

2013  2014  2015  FY2016e  FY2017f  FY2018f
Median  Weighted average
0  2  4  6  8

Chart 5 – EBITDA/Interest (x)

Chart 6 – Debt/Debt + Equity (%)

2013  2014  2015  FY2015e  FY2017f  FY2018f
Median  Weighted average
0  2  4  6

2013  2014  2015  FY2016e  FY2017f  FY2018f
Median  Weighted average
0  20  40  60

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Forecasts

We expect a gradual improvement in earnings and could see recovery in credit metrics in 2017. As such, our base case assumes the sector's cash flow leverage, measured by funds from operations (FFO) to debt and debt to EBITDA (see charts 3 and 4), will improve modestly over the next two years, given the sector's rising earnings prospects and companies' disciplined capital spending. In some cases, companies have also sold assets to repair their balance sheets.

Assumptions

We believe commodity prices will moderate in 2017 from the current high levels in late 2016. But we expect 2017's average prices to be higher than that of 2015's. We believe the sector's appetite for greenfield growth project would remain low in 2017 until commodity prices sustain at levels that could encourage investment. As such, we expect the sector's capital expenditure to stay flat in 2017. We assume resumption of dividend payment or a slight increase in the payout due to improving earnings.

Risks And Opportunities

The major risk for the sector is an unexpected fall in demand for steel and raw materials from China. We expect China's demand growth for metals and minerals to remain flat over the next six months. This overcapacity will continue to plague sectors such as copper and aluminum for the next 12 months. Default risk remains at the lower end of the rating spectrum due to weak cash flows and liquidity constraints.

Financial Policy

We expect capital expenditure to stay flat for metals and mining companies, and will not increase materially until a sustainable recovery occurs in commodity demand and prices. Some companies may increase their maintenance capital expenditure after having cut expenditure steeply over the past two years. But investments in large-scale growth projects are unlikely to occur in 2017.

In addition, some companies would resume dividends after stopping distributions in 2015 and 2016.

Only a rating committee may determine a rating action and this report does not constitute a rating action.

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