Situation

The mining industry is facing uncertain times. The global financial crisis has fundamentally changed the business environment. High commodity prices have rescued several companies. Boosted by Chinese demand, companies have deleveraged their balance sheets and hold large cash reserves. The top 5 diversified miners alone had over 40 billion dollars in cash at the end of 2010. These same companies are expecting to have cash flow from operations of over 80 billion dollars in 2011. Interest in Mergers and Acquisitions is picking up: total value of deals increased by over 40 billion dollars to 114 billion dollars in 2010. This number could even have been higher if BHP Billiton’s acquisition of PotashCorp had not been blocked by the Canadian government. Countries are not only increasing regulatory control, many are also looking to increase tax benefits.

Keeping these developments in mind, we look forward to the near future: How could the mining industry develop in the period 2011 to 2014?

Scenario Introduction

The direction of the mining industry in the coming years is highly uncertain. The outcome will mainly depend on 2 critical uncertainties:

- Will commodity prices stay high, or return to lower levels?
- Will Chinese companies dominate M&A globally, or can other players compete with China’s spending power?

Nobody can answer these questions with certainty. Different answers lead to diverging scenarios for the near future of the industry. Company leaders will need to evaluate their strategy to determine what actions to take to position their companies favorably for each potential scenario. In response to the Global Mining & Metals Scenarios to 2030, made by the World Economic Forum, we prepared short term scenarios to challenge the mental models of professionals in the industry. We present two possible scenarios. Both are plausible, consistent, potential futures. The first scenario is named ‘Red Wave’, the second ‘Countercurrent’.

In [Red Wave](#), China’s government manages to sustain demand growth, resulting in high commodity prices. At the same time China invests heavily all around the world, forcing other miners to focus on organic growth.

In [Countercurrent](#), revaluation of the renminbi and high interest rates in China lead to lower commodity demand. Prices decrease across the board. Miners struggle to maintain positive margins. New project development becomes of secondary importance.
Red Wave
Let’s first explore the Red Wave scenario in more detail. In this scenario the Chinese government manages to skillfully adjust the interest rates and revalue the renminbi. As a result China continues to grow at 8-10% per year. China’s growth fuels the demand for commodities. Although miners around the world add capacity the supply can hardly keep up with demand. Commodity prices stay high.

To reduce dependency on foreign suppliers, the Chinese government strongly supports Chinese investment overseas. China’s share of global M&A in the mining industry increases to over 50% by 2014. Supported by Development Banks and Investment Funds, Chinese companies manage to outbid foreign competitors to buy growth opportunities. Chinese investment rolls over the world like a ‘Red Wave’.

The world’s largest mining companies struggle to keep up with China’s growth. Large acquisitions are hard to do as Chinese firms will simply pay more. As cash is abundant some companies will pay high premiums in acquisitions to secure growth potential. However, most companies focus on organic growth, pouring a lot of money into project development. As the need for low gearing disappears, money that can’t be invested in growth will be given back to shareholders in either dividends or share buy backs.

Geographic focus of development activity will shift to the New Frontiers: Africa, Central Asia and South East Asia.

Countercurrent
In the Countercurrent scenario China’s growth stalls. Pressured by the US, China revalues the renminbi quickly. The strong yuan reduces competitiveness of China’s exports and slows growth. Upon the first signs of lower growth commodity prices start to fall. The strong currency initially helps China’s steelmakers to make acquisitions overseas. But quickly the focus of China’s firms shifts to domestic issues and industry consolidation.

At the same time, western mining firms are struggling to maintain positive margins. Costs have increased during the period of high commodity prices, and need to be cut fast. Because OPEC reduces oil production the oil price stays high, resulting in high cost pressure for miners. Some firms will see their profits evaporate and get into financial distress.

As demand is low, expansion plans are of secondary importance in this scenario. Development on low cost assets will continue, but many other projects are stopped. Expansion of current operations is the best way to grow at low cost and low risk.

Around 2014 the difference between winners and losers becomes clear. Companies that have maintained a strong cash position and balance sheet see opportunities to acquire less well managed competitors at low price. Those companies that can’t acquire and still have money to return to shareholders will pay dividends rather than buy back shares to keep their leverage as low as possible.

Conclusion
To conclude: both the Red Wave and the Countercurrent scenario describe plausible development of the mining industry over the next 3 years. Obviously there are many other potential scenarios. Managers will need to position their companies to prosper in each of the scenarios. Trusting that the market will continue to function as it did over the last few years is dangerous. Those companies that adapt best to the changing environment will emerge as the winners. Change is the only constant.