



02nd March 2020

Large Cap

South32: Buying Opportunity After Correction

Reading Time: 5 Mins

By Team Ace Investors

Stock Code	ASX:S32
Shares O/S	4.9bn
Closing Price	AUD 2.21
Market Cap	10.88
(In AUD billion)	
52 High/Low	3.97/2.17
One Year Stock Performance	-43%
Avg volume (TTM)	1,86,84,070
EPS (TTM)	-0.04
P/E	-
Annual Dividend Yield	2.57%
Franking	100%
Last Dividend Ex-Date	05-Mar-20
Last Dividend Pay Date	02-Apr-20
DPS (AUD)	0.12
ROE %	3.73

COMPANY OVERVIEW

South32 Limited (**“South32” or the “Company”**) is a globally diversified mining and metals company producing bauxite, alumina, aluminium, energy and metallurgical coal, manganese, nickel, silver, lead and zinc in Australia, Southern Africa and South America.

Business Operations:

[1] WORSLEY ALUMINA – South32 holds an 86% interest in Worsley Alumina. Bauxite is mined near the town of Boddington, 130km south-east of Perth then it is transported to the alumina refinery near Collie and turned into alumina powder, before being transported by rail to Bunbury Port.

[2] BRAZIL ALUMINA – South32’s interests consist of the non-operated Mineração Rio do Norte (MRN) mine (14.8%), South32’s share of bauxite produced from the MRN mine is supplied to the Brazil Alumina refinery. The alumina produced from the refinery is exported through the Alumar Port.

[3] HILLSIDE ALUMINIUM – The Hillside Aluminium smelter is located in Richards Bay in the South African province of KwaZulu-Natal and is 100% owned and operated by South32.

[4] MOZAL ALUMINIUM – South32 has a 47.1% share of Mozal Aluminium. Mozal Aluminium is located 20km west of Mozambique’s capital city Maputo. Mozal Aluminium is the only aluminium smelter in Mozambique and the second largest aluminium smelter in Africa. It produces standard aluminium ingots.

[5] ILLAWARRA METALLURGICAL COAL – Located in the southern coalfields of New South Wales, Illawarra Metallurgical Coal is 100% owned by South32 and operates two underground metallurgical coal mines.

[6] AUSTRALIA MANGANESE – Australia Manganese consists of Groote Eylandt Mining Company (GEMCO) in the Northern Territory and Tasmanian Electro Metallurgical Company (TEMCO) in Tasmania. South32 owns 60% of GEMCO and Anglo. TEMCO is wholly owned by GEMCO.

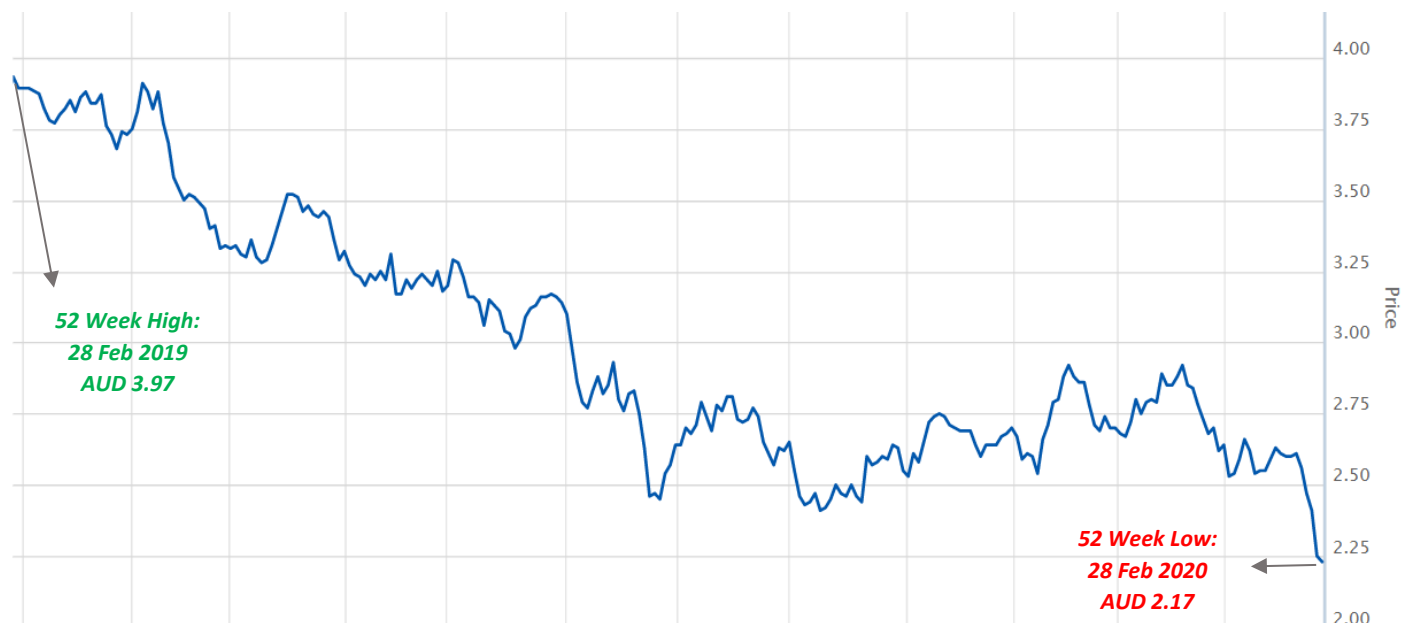
[7] SOUTH AFRICA MANGANESE - South Africa Manganese is made up of two manganese mines and an alloy smelter.

[8] CERRO MATOSO – Cerro Matoso is an integrated nickel laterite mine and smelter located in the Cordoba area of northern Colombia, consisting of a truck and shovel open-cut mine and a processing plant. South32 owns 99.94% of Cerro Matoso.

[9] CANNINGTON Located in north-west Queensland, Cannington is 100% owned by South32 and is one of the world's largest producers of silver and lead.

[10] SOUTH AFRICA ENERGY COAL – South32 owns 92% of South Africa Energy Coal (SAEC). From 30 April 2018, the Company has managed SAEC as a stand-alone business separately from the rest of the South32 Group.

One Year Stock Price Performance



Source: ASX

KEY FINANCIAL FIGURES

	2015	2016	2017	2018	2019
Revenue (In U.S. \$ million)	3,843	5,812	6,950	7,549	7,274
Growth %	-	51.24%	19.58%	8.62%	-3.64%
EBITDA (In U.S. \$ million)	146	-666	2,558	2,461	1,644
EBITDA Margin (%)	3.80%	-11.46%	36.81%	32.60%	22.60%
PAT (In U.S. \$ million)	-919	-1,615	1,231	1,332	389
PAT Margin (%)	-23.91%	-27.79%	17.71%	17.64%	5.35%
EPS (In U.S.\$)	-0.13	0.03	0.23	0.26	0.18
BALANCE SHEET FIGURES					
Shareholders Fund (In U.S. \$ million)	11,036	9,423	10,236	10,710	10,169
Debt (In U.S. \$ million)	1,046	913	1,035	929	904
Cash (In U.S. \$ million)	658	1,225	2,705	2,973	1,408
D/E Ratio	11,036	9,423	10,236	10,710	10,169

INVESTMENT RATIONALE/CONCERNS

- **Strong Production Highlights** – The Company achieved increased alumina production by 4%, achieving record year to date production at Brazil Alumina and maintaining higher rates of calciner availability at Worsley Alumina. The Company in its quarterly report mentioned that they have maintained their production guidance across the majority of its operations.

FY20e production
(South32's share)

Operation		Unit	Guidance		Key FY20 guidance assumptions	
Worsley Alumina			FY20e	FY21e		
1,933	2,032	kt	3,965	3,965	Guidance unchanged Improvement in calciner availability and a drawdown of excess hydrate, notwithstanding calciner maintenance scheduled for Q3 FY20	
Brazil Alumina (non-operated)						
702	628	kt	1,330	1,370	Guidance unchanged Continued realisation of De-bottlenecking Phase One benefits and maintenance scheduled for Q4 FY20	
Hillside Aluminium						
362	358	kt	720	720	Guidance unchanged (subject to load-shedding) Smelters continue to test technical capacity despite the impact of load-shedding	
Mozal Aluminium						
134	139	kt	273	273		
Australia Manganese – Ore						
1,775	1,785	kwmt	3,560	Subject to demand	Guidance unchanged (subject to market demand) Continue to operate PC02 circuit above nameplate capacity Wet season expected to impact production across H2 FY20	
South Africa Manganese – Ore						
1,038	1,062	kwmt	2,100	Subject to demand	Guidance unchanged (subject to market demand) Higher cost trucking has been reduced and we continue to monitor market conditions	
Illawarra Metallurgical Coal			FY20e	FY21e		
Metallurgical coal	2,859	2,941	kt	5,800	6,800	Guidance unchanged Continued improvement in longwall performance and a longwall move scheduled at Dendrobium in Q3 FY20
Energy coal	836	364	kt	1,200	1,200	
Cerro Matoso						
Payable nickel	20.6	15.0	kt	35.6	37.4	Guidance unchanged Planned furnace outage in Q4 FY20
Ore to kiln	1,389	1,111	kdmmt	2,500	2,750	
Cannington						
Zinc equivalent	120.1	100.9	kt	221.0	213.7	Guidance unchanged Inventory drawn down to normalised levels following FY19 floods, enabling higher mill throughput in H1 FY20 Lower lead and silver grades expected in H2 FY20
Ore processed	1,394	1,306	kdmmt	2,700	2,600	
South Africa Energy Coal						
Domestic coal	6,763	8,537	kt	15,300	Not provided	Guidance adjusted to bottom end of prior range and remains subject to market demand Continue to adjust volumes to maximise margins
Export coal	5,022	5,678	kt	10,700	Not provided	

■ H1 production

▬ H2 guidance

■ H1 production □ H2 guidance

Source: South32 H1FY20 Presentation

- Sound Balance Sheet** – The Company's balance sheet is sound. South32 operates with a net cash balance of U.S. \$277 million. The Company's strong financial position has supported the return of U.S. \$300 million to shareholders:
 - U.S. \$54 million fully franked interim dividend, payable in April
 - U.S. \$ 54 million fully franked special dividend, payable in April
 - Continuation of its buyback program, whereby the Company purchased 106 million shares at an avg price of AUD 2.66 per share for cash consideration of U.S. \$ 192 million.
- South32 produces metals and ores, prices of which are largely driven by global demand and supply for each of these commodities. Commodity prices were generally lower in FY19 compared to FY18 as most physical markets weakened on the back of slower demand and heightened macroeconomic uncertainty. For H1FY20, the Company is facing lower realized prices.
- H1 FY20 Performance Summary** – On 13 Feb, 2020, the Company declared its H1FY20 performance. South32 delivered strong operating result. The Company PAT's decreased 84% to U.S. \$ 99 million as volatile macro-economic conditions impacted the price of key commodities. Trade war between China and U.S. have resulted in lower prices for its products. Lower realized prices for its key commodities contributed to U.S. \$595 million reduction in revenue. The Company generated free cash flow from operations amounted to U.S. \$124 million despite a reduction in the average realized prices.

STOCK RECOMMENDATION

The Company's share price has been under pressure since last year. In FY 2019, the Company reported 16% drop in earnings as well as a revenue slump. For South32, it hasn't been a good 6 months to December 2019 (1H20) compared with the same period last year (1H19). The Company is facing temporary macro-economic challenges and we believe that at this price point, it could be value buy for the investors.

*The correction in the stock price gives investors the opportunity to buy into the stock at cheap price. Any positive resolution to the U.S.-China trade war will boost the earnings as well as the share price of the Company. At current levels, we would like to recommend **BUY** rating on the stock.*

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