Le dernier mot

Jean-François Lambert unpicks Glencore's H1 2016 results and notes that the fundamentals make it impossible for its marketing division to plug holes in its industrial activities

Presenting the H1 2016 result for Glencore was probably not something Ivan Glasenberg had been looking forward to.

The CEO of the mining-come trading juggernaut had to focus his pitch on cost cutting in the mining division, and on the overall debt reduction as per the stated strategy. However, a closer examination of Glencore's published statements provides an education on the fundamental differences between commodity trading and production.

Trading vs production

Marketing (the trading activities) is doing rather well with a 9% rise of EBITDA compared to the H1 2015. If there is one thing Glencore is consistent on, it is its ability to sustain its trading revenues, come rain or shine. The US$2.4bn to US$2.7bn target for the full year is confirmed – and will probably be met.

When you unpick the different trading activities, a varied pattern for metals, energy and agri (on the wane as around 50% of the portfolio is being sold) unfolds:

- Metals and minerals did extremely well (note the sharp contrast with the production dynamics), up 92%, over H1 2015 (but this was when metals were in free fall last year…).
- Energy is sharply down – 47% over last year's period. There is much less contango to play with (note that this has probably helped the borrowing position of the company when less carry was to be financed).
- Agri is profitable but 77% down H1 2015. The sector is suffering and most announcements made over August by agri traders Louis Dreyfus, Cargill, and to a lesser extent, Bunge, confirms that.
- The industrial activities are suffering with EBITDA falling 20%. Interestingly, this is almost in sync with the average flat price drop of copper, nickel, zinc and coal, showing an almost linear relationship between the prices of the produced commodities and the income generated. Only cost management makes a real difference to this.

Alignment of stars

All this leads us to wonder whether the Glencore model can ever deliver very strong results? It can, but this requires an alignment of stars that does not happen very often. With twothirds of the profit base relying on industrial activities, it means that the combined model can only work in a strong price environment. While trading is not really concerned with the absolute level of prices, miners are.

A weaker US dollar

If the dollar is too weak, commodity prices are sharply up. This is good news for production. However, a weak US dollar could help boost demand – good news for trading, which then has attractive forward curves to play with. Could we really anticipate a weaker US dollar? With negative interest rates in Europe and the growing prospect of the Fed raising their rates this year, this is not a done deal.

Strong Chinese demand

For now, China is not doing too badly. Metals demand is still very strong, but Dr Copper sends a strong cautious message with China's imports falling year-on year in July 2016. So where is the real demand? The One Belt One Road initiative? It is far too soon to say. Can we expect a lot more from China? If only they can sustain the current level of demand. But this is not very promising for metals and ores…

Massive infrastructure push

A massive Keynesian investment programme in the US and elsewhere in Europe could make a difference. This is when policy-makers set out to stimulate one or more of the components of aggregate demand to boost output, jobs and incomes. The US infrastructure deserves this. President Obama tried and failed thanks to the stern opposition of the Republican Congress. Could the next president succeed? In Europe, central bankers are losing their voices in trying to convince the political leadership to boost their economies.

Golden days

The stars are not yet aligned. Meanwhile, Glencore's Glasenberg will have to continue his focus on restructuring, cost cutting and debt repayment. It seems light years since markets buzzed with speculation on a Glencore/Rio Tinto merger. In fact, the problem might be that the marketing activities are too small to buffer the vagaries of the industrial ones. Now, who would have thought that?

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References

1. Source Capital Economics
2. See Reuters at http://reut.rs/2c6Hu72