Gold-related Industries During COVID-19 Pandemic

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Executive Summary

PEFINDO views that the COVID-19 pandemic has a moderate impact to gold-related industries including gold mining and jewelry segments. In the first nine months of 2020 (9M2020), the global demand for gold decreased by 10.0% year-on-year (YoY) due to weakening disposable income amid the high price of gold. Jewelry segment is the main contributor to plummeting gold demand during pandemic which hit the lowest level since past ten years of 904 tons or dropped of 41.0% YoY. It could not be fully compensated by soaring gold demand for investment motive by 62.9% YoY. The unprecedented global economic contraction and the low interest rate have induced people to convert their liquidity to safe haven instruments, including gold, particularly gold-backed exchange traded funds (ETF). It pushed the gold price up to USD2,000 per troy ounce in August 2020, the highest level in decades. Gold supply also declined in 2020 due to lockdowns in most countries, which disrupted the gold mine production and the recycled gold supply. Similarly, weakening consumers' purchasing power in domestic market has reduced gold affordability, resulting in lower demand for gold. The domestic gold supply in 2020 experienced a deterioration due to the transition of mining activities in PT Freeport Indonesia (PTFI), which is expected to be fully operational in 2021. Considering, PTFI contributes a significant amount to national gold supply at around 40%.

Decreasing demand in almost every segment

The lockdown policy in a number of countries has weakened consumers' purchasing power and reduce their spending, including for gold. In 9M2020, the global demand for gold decreased by 10.0% YoY. The demand for gold in almost all segments showed a contraction, particularly jewelry and technology component segments. In addition, the high gold price and closure of retail outlets have severely disrupted the demand for physical gold, particularly jewelry.

Figure 1. Gold demand in 2016-9M2020 in tonnage

	2016	2017	2018	2019	9M'19	9M'20
Gold demand	4,436.3	4,267.4	4,400.3	4,386.8	**3,304.0**	**2,972.1**
Jewelry	2,103.9	2,241.0	2,248.4	2,122.9	1,532.8	904.0
Technology	323.0	332.6	334.8	326.0	242.6	217.3
Investment	1,614.6	1,315.3	1,160.5	1,269.5	1,000.8	1,630.2
Total bar and coin	1,073.3	1,044.0	1,090.1	871.4	625.8	626.9
ETFs and similar products	541.2	271.2	70.3	398.1	375.0	1,003.3
Central banks & other inst.	394.9	378.6	656.6	668.5	527.8	220.6

Growth	2017	2018	2019	9M'20
Total Gold demand	**-3.8%**	**3.1%**	**-0.3%**	**-10.0%**
Jewelry	6.5%	0.3%	-5.6%	-41.0%
Technology	3.0%	0.7%	-2.6%	-10.4%
Investment	-18.5%	-11.8%	9.4%	62.9%
Total bar and coin	-2.7%	4.4%	-20.1%	0.2%
ETFs and similar products	-49.9%	-74.1%	466.0%	167.6%
Central banks & other inst.	-4.1%	73.4%	1.8%	-58.2%

Source: Metals Focus, World Gold Council

The sharpest decline came from jewelry segment by minus 41.0% in 9M2020. Almost 50% of the total global demand for gold came from the jewelry segment, with mainland China and India being the largest contributors of jewelry segment of 30.0% and 18.9%, respectively. Although the demand for the jewelry in those countries has rebounded in the third quarter of 2020 and may further strengthen in the fourth quarter, in total the global demand for jewelry during 2020 is projected to be well below that in 2019. The simultaneous global economic recovery is expected to increase the global demand for gold.

Figure 2. Top 10 global jewelry consumption growth

Top 10 consumers (tons)	9M'19	9M'20	9M'20
China, P.R.: Mainland	477.6	271.0	-43.3%
India	395.6	170.6	-56.9%
United States	81.9	71.0	-13.3%
Russian Federation	31.5	24.4	-22.6%
Turkey	27.6	19.1	-30.9%
Saudi Arabia	28.4	18.3	-35.5%
UAE	25.4	14.6	-42.5%
Islamic Republic of Iran	23.7	14.6	-38.5%
Egypt	19.5	13.9	-29.1%
Indonesia	30.6	13.0	-57.4%
Others	390.9	273.5	-30.0%
Total	1,532.8	904.0	-41.0%

Source: Metals Focus, World Gold Council

Economic downturn triggers gold's demand for investment, particularly gold-backed ETF

We expect that ETF remains the main driver of the global demand for gold during the pandemic. The negative sentiment aroused by the economic downturn in 2020 and the extremely low interest rate set by central banks have prompted investors to turn to gold as a safe haven instrument as reflected in a hike in the demand for gold for investment at 62.9% YoY in 9M2020. Among others gold investment, ETF is considered as the most attractive, it is reflected on a surging growth by more than 150% YoY. Meanwhile, gold investment in the form of coin and bar (precious metal) has remained virtually unchanged with an increase of only 0.2% after recording a contraction in the first and second quarter of 2020. The increase in the demand for precious metal was induced by the signs of recovery of the global economy in the third quarter.

We view there is a different investment motives between the western and eastern people. The western people tend to hold their liquid asset in the form of gold as an alternative of hedging, while the eastern people are in favor of investment in gold for profit-taking motives. Accordingly, the growth in the demand for precious metal has not been as robust as ETF during the pandemic. Considering, ETF is quite popular in North America and Europe, while the Asian, such as Chinese and Indians mostly prefer gold coins and bars.

In the near term to medium term, we expect the gold price will decline to around USD1.500-1.600 per troy ounce, in line with the intensive vaccination program worldwide, which will lead to an expectation of global economic recovery and attracting investors' interest to invest in capital market instruments or in US dollar currency. In Indonesia, Antam's gold price is commonly used as a reference. The local price is not only influenced by the global gold price, but also the rupiah exchange rate. A weakening rupiah exchange rate will certainly raise the local gold price in domestic currency. Align with expectation of global price, we project that Antam's gold price will decline along with the expectation of the global as well as Indonesia's economic recovery.

Demand expectation in Indonesia

We are of the view that the demand condition in Indonesia is declining, as is the case with the global demand. The pandemic has weakened the consumers' purchasing power, resulting in the lower affordability of gold leading to the decline in the demand for gold. We project that demand for local jewelry will remain under pressure during the pandemic as jewelry is not affordable most notably when people lose their income. In addition, demand for jewelry declined due to temporary closure of malls and retails in many regions, particularly in greater Jakarta area during March-June 2020.

In Indonesia, physical gold, both in the form of jewelry and bars, is commonly used as an alternative investment. The bullish price during the pandemic leads people to be a net seller than a net buyer due to a profit-taking motive. The combination of weak disposable income and profit-taking motives brings a negative sales volume growth of jewelry and precious metal (coin and bar) by minus 60.4% and 42.7% YoY in 1H2020, respectively. Nevertheless, the demand of physical gold has improved in the second semester of 2020 along with the uninterrupted operational activities and the expectation of economic recovery. We also view that offering light-weight online-based gold sales will attract public investment interest, especially the millennials segment, it is expected will encourage the improvement of physical gold demand.

Lockdown not only disrupted demand, but also global supply

In 9M2020, the global gold supply declined by 5.4% YoY due to lockdowns in China, South Africa, Peru, and Mexico that have caused mining activities to come to a halt. In addition, the lockdowns followed by the closure of malls and gold retails outlets, have cut the supply of recycled gold. In Indonesia, declining gold mine production has started earlier in 2019 of 109.0 tons, 19.4% lower than 135.2 tons in 2018. This was due to the transition of mining activities in PT Freeport Indonesia from an open pit to underground mining, which is expected to be fully operational in 2021. Freeport Indonesia has significant contribution of more than 40% of the national supply in 2019. We estimate that Indonesia's gold production will remain below 100.0 tons in 2020.

Implication to the rated companies

PEFINDO has rated four gold related companies, consisted of three gold mining companies, namely PT Aneka Tambang Tbk (ANTM, $_{id}$A/stable), PT J Resource Asia Pasifik Tbk (PSAB, $_{id}$A/stable), PT Merdeka Copper Gold Tbk (MDKA, $_{id}$A/stable), and one jewelry manufacturer (PT Hartadinata Abadi Tbk, or HRTA, $_{id}$A-/stable).

We are of the view that the business activities of gold miners and manufacturer under our portfolio is moderate affected by the pandemic. For gold mining companies, we find the pandemic will not bring about significant impact. However, lockdown in several countries disrupts gold supply chain for a couple weeks due to airports and seaports closure. In terms of operating profit, we expect that PSAB and ANTM's gold segment will be able to generate a stronger EBITDA in 2020 due to stable demand and high gold price. However, we expect that MDKA will book a weaker EBITDA due to an incident in Tujuh Bukit mine, which halted production activities. In addition, MDKA will secure its reserves until Porphyry and Pani projects are fully operated around in 2024-2025, resulting in lower sales volume over the near to medium term.

HRTA's sales volume is expected to decline in 2020, since the demand for jewelry is very dependent on consumers' purchasing power. However, we view that HRTA will manage to generate strong EBITDA in 2020 thanks to gold price uptrend. During the pandemic, HRTA and ANTM have diversified its products offering by providing gold bar in various weights. We view that both companies will manage to expand its customer base by offering gold bars in smaller sizes, which is more affordable for most customers.

The financial risk of those companies under our review remains manageable, as reflected in the capital structure and cash flow protection indicators, measured in terms of debt to EBITDA and FFO to debt ratios, which are consistent with the rating category.

Figure 4. Financial highlight

[Unit] Account	ANTM		PSAB*		MDKA*		HRTA	
	Jun-20	Dec-19	Jun-20	Dec-19	Jun-20	Dec-19	Jun-20	Dec-19
[IDR Bn] Total Adjusted Assets	29,920.8	30,083.6	13,293.5	13,340.2	13,468.9	13,223.4	2,758.6	2,310.2
[IDR Bn] Total Adjusted Debt	8,242.0	8,557.5	5,826.9	6,199.9	3,804.5	3,985.0	2,758.6	1,037.9
[IDR Bn] Total Adjusted Equity	17,991.2	18,022.1	4,497.7	4,479.9	7,920.6	7,287.5	1,289.2	1,210.2
[IDR Bn] Total Adjusted Sales	9,226.1	32,718.5	1,696.3	3,404.5	2,843.4	5,588.7	1,968.9	3,235.5
[IDR Bn] EBITDA	937.3	2,074.8	850.2	1,597.2	1,414.5	3,173.1	155.8	265.4
[%] EBITDA Margin	10.2%	6.3%	50.1%	46.9%	49.7%	56.8%	7.9%	8.2%
[X] Debt/EBITDA	4.4	4.1	3.4	3.9	1.3	1.3	4.6	3.9
[X] DER	0.5	0.5	1.3	1.4	0.5	0.5	1.1	0.9
[%] FFO/Debt	17.8%	13.8%	19.1%	15.1%	55.4%	57.7%	11.9%	15.1%
[X] EBITDA/IFCCI	4.2	3.6	3.1	2.9	11.8	9.6	2.8	4.3

*Converted into IDR

Source: Various report, processed by PEFINDO