

Rio Tinto

RIO

July 10, 2019 FAT-MIN-677

AUD\$104.35

Core



SH

RIO Snapshot

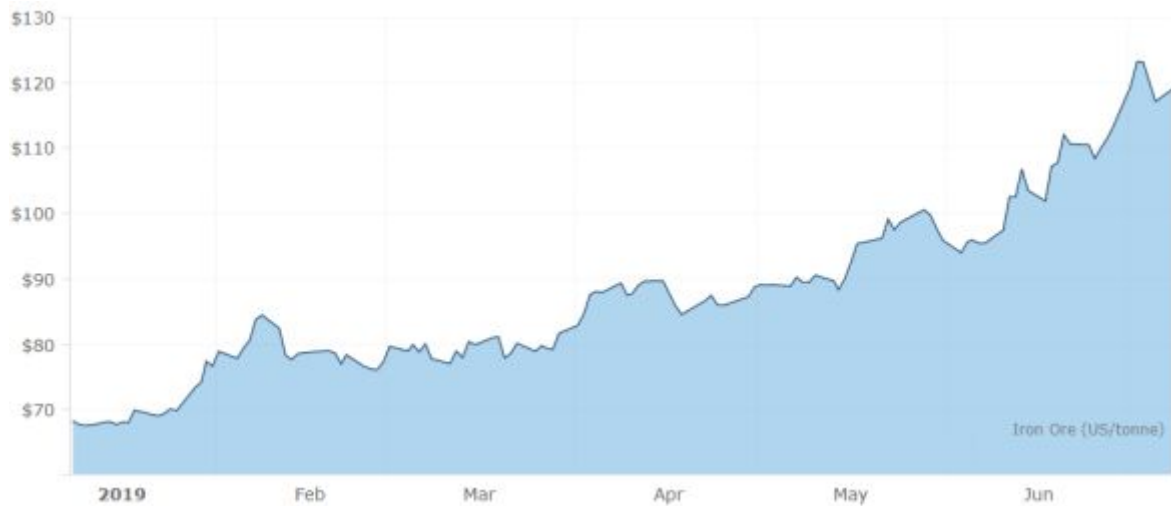


Part collecting on a great price run

Since early 2016, Rio Tinto's share price has climbed out of the basement, to recently challenge its record share price highs. There is no doubt that in the near-term the second Vale tailings dam failure in early 2019 had a significant and lingering positive impact on the iron ore price and propelled Rio Tinto's share price to, again, touch record highs.

With the global economy displaying signs of potential fatigue on trade war entanglements, geopolitical pressures from Brexit to Middle East tensions and growing currency tensions, we are taking some profits off the table in Rio Tinto.

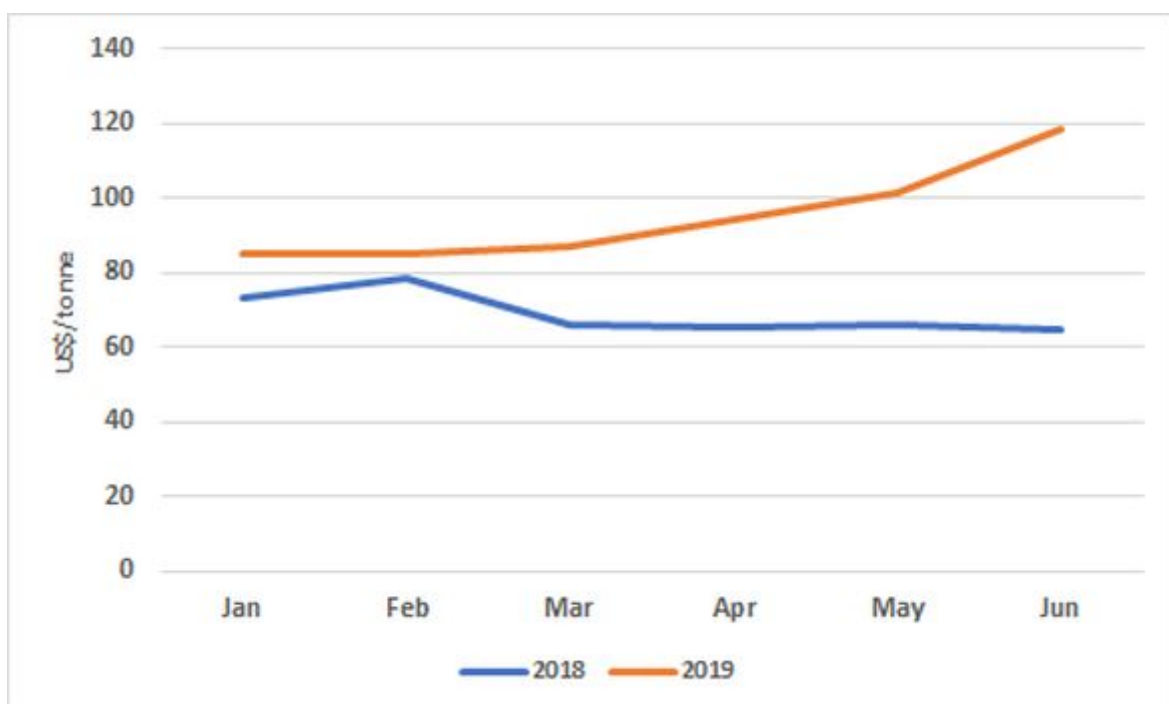
A key driver in the company's share price performance over 2019 was the misfortune that befell Brazilian iron ore producer Vale, following its second tailings dam failure (January 2019). The event had an immediate impact on the iron ore price in 2019. The following chart shows the year to date iron ore price:



Source: MarketIndex.com.au

The event did cause Vale to suspend production of iron ore pellets, with some 28 million tonnes of production likely to be lost in calendar 2019. Vale is guiding 2019 total production of iron ore to be in the range of 307 million to 332 million tonnes. **The return of the impacted production remains under a cloud and will likely not occur until well beyond 2019.** Vale's first tailings dam disaster occurred in November 2015, in the Samarco disaster (Vale's interest 50%); **that facility has yet to recommence production.**

The iron ore price over the first half of 2019 has traded higher compared to the first half 2018, with the comparison shown in the following chart:



Source: UBS

As a result of the positive comparative difference, we expect the company will report a significant improvement in its financial performance, with the first half result to 30 June 2019 to be the first beneficiary (to be released on 1 August 2019). **As we also expect the iron ore price to remain elevated over the remainder of 2019, the company's 2019 financial result will also show a significant improvement over its 2018 result. We are cognisant of the pending earnings up lift in 2019 and believe that the good news is now primarily factored into the current share price.**

On the operational front, the company recently announced a downgrade in iron ore production for 2019. **The company downgraded 2019 iron ore production which it is now forecast to be in the range of 320 million to 330 million tonnes on a 100% basis.** The previous forecast was in the range of 333 million to 343 million tonnes (100% basis). The company delivered 338.2 million tonnes of iron ore on a 100% basis.

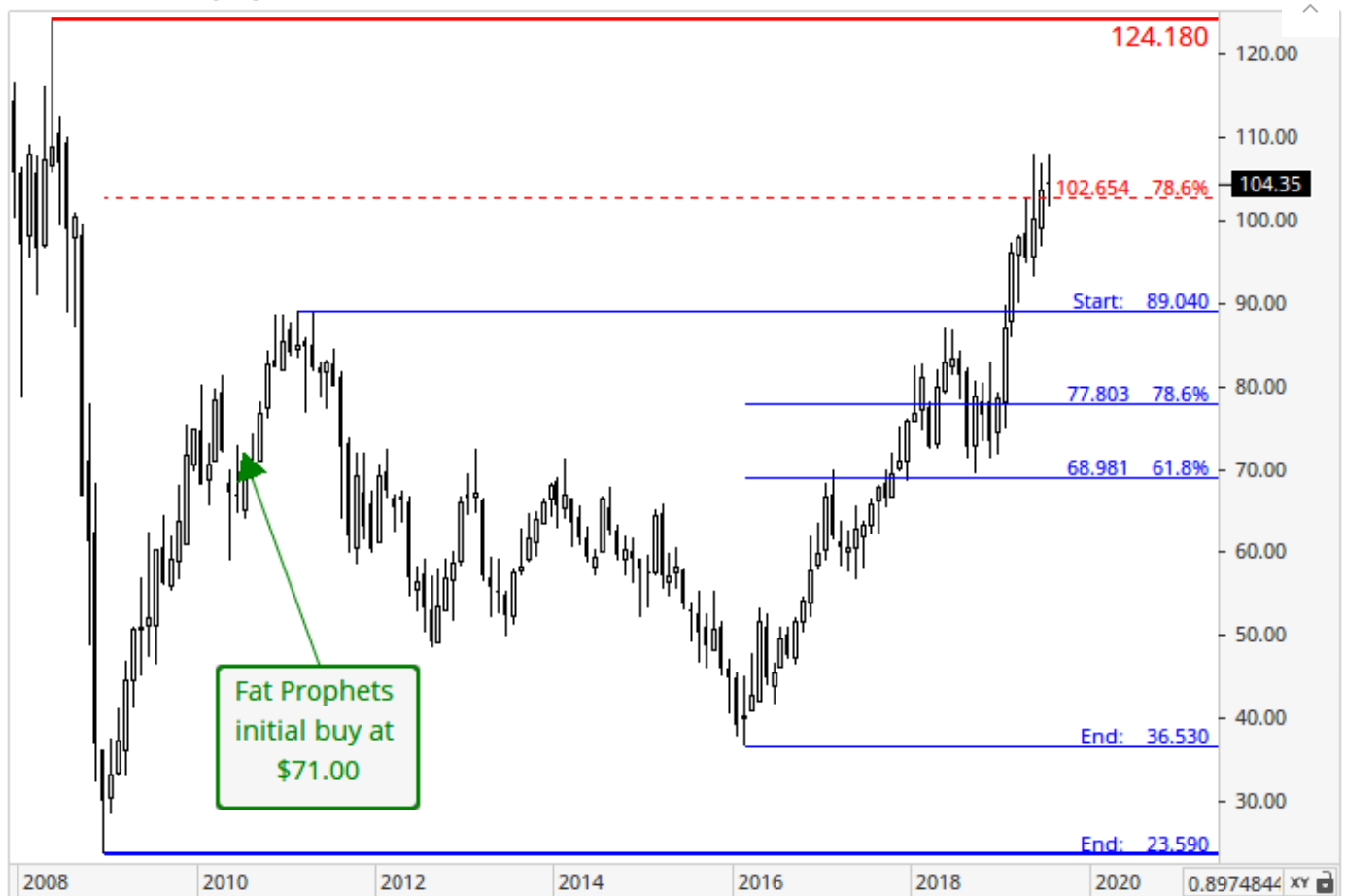
We were disappointed in the 2019 downgrade to the company's key product offering. When the share price was last at these levels, Rio was forecasting higher production and was delivering into a rising iron ore price. In 2019 we have the latter but not the former.

Rio Tinto Ltd - RIO (ASX) - 1 Day CandleStick Chart - AUD



We also question whether the surge in iron ore prices can be sustained. While supply is tight, demand on the other side is vulnerable to a reaction from consumers at some point.

Indeed, Chinese steel mills are becoming more vocal it seems, and are complaining that rampant iron prices have been stoked by market manipulation by futures traders. According to reports, a top official representing China's steel industry said Beijing was preparing to crackdown on pricing 'irregularities' for imported ore. Chinese steelmakers, representing 40% of industry output, have also set up a working group to find ways to tackle the 'distortion' between the price of steel and iron ore.



The reaction is probably not surprising, and with iron ore prices having notched up a 5-year high last week of more than US\$126 a tonne. The robust gains in pricing have also been during a period when many have been fretting over the impact of the trade war on China's economic growth story. However, demand has been underpinned by the country's own stimulus initiatives to ensure domestic construction remains robust, alongside demand from China's Belt and Road initiative. **Arguably however we have seen an interim peak in iron ore prices.**

Due to Rio Tinto's strong share price performance, to see it again approach records highs and prices not seen since late 2007 early 2008, we consider it prudent to take some exposure off the table. This is also as our view of economic global growth is in the balance over the remainder of 2019. **Consequently, we recommend Members sell half their exposure in Rio Tinto at the current price.**

Disclosure: Interests associated with Fat Prophets declare an interest in Rio Tinto.

DISCLAIMER

Fat Prophets has made every effort to ensure the reliability of the views and recommendations expressed in the reports published on its websites. Fat Prophets research is based upon information known to us or which was obtained from sources which we believed to be reliable and accurate at time of publication. However, like the markets, we are not perfect. This report is prepared for general information only, and as such, the specific needs, investment objectives or financial situation of any particular user have not been taken into consideration. Individuals should therefore discuss, with their financial planner or advisor, the merits of each recommendation for their own specific circumstances and realise that not all investments will be appropriate for all subscribers. To the extent permitted by law, Fat Prophets and its employees, agents and authorised representatives exclude all liability for any loss or damage (including indirect, special or consequential loss or damage) arising from the use of, or reliance on, any information within the report whether or not caused by any negligent act or omission. If the law prohibits the exclusion of such liability, Fat Prophets hereby limits its liability, to the extent permitted by law, to the resupply of the said information or the cost of the said resupply. As at the date at the top of this page, Directors and/or associates of the Fat Prophets Group of Companies currently hold positions in: ASX- Listed Australian stocks ABP, ADI, AMC, ANZ, APA, ARF, AVN, BHP, BOQ, BPT, BWP, CBA, CHC, CKF, CQE, DHG, ELD, EVN, FID, FMG, FPC, FPP, GMG, GOR, GPT, HUB, IGO, ILU, JHK, MAI, MCR, NAB, NCM, NEC, NUF, NXT, ORE, OSH, OVH, OZL, PAN, PPS, QBE, RIO, S32, SAR, SBM, SCG, SCP, SFR, SGP, SHL, SHV, SLR, SPK, SRV, STO, SUN, SYD, TLS, TPM, VCX, VOC, WBC, WES, WHC, WPL, WSA, International stocks: Alibaba, Alphabet, Alstria Office, American Homes 4 Rent, Apple, Ashford Hospitality Trust, Avalonbay Communications, Baidu, Braemar Hotel & Resorts, Brookfield Property Partners, Camden Property Trust, Castellum, Champion Real Estate Investment Trust, China Lodging Group, CNOOC, Coeur Mining, Columbia Property Trust, Cubesmart, Deutsche Wohnen, Entra ASA, Euronext, Extended Stay America, Extra Space Storage, FedEx, Frasers Hospitality Trust, Guangzhou Automotive, Heineken, Harmony Gold, Hufvudstaden, Icade, Industrial Logistics Properties Trust, Inmobiliaria Colonial Intu Properties, Japan Airport Terminal, Land Securities Group, Meituan Dianping, MGM China, Mitsui Fudosan Co, National Storage, Nintendo, Office properties income Trust, Prologis, Retail Value, Sands China, Segro, Seritage Growth Properties, Site centres Corp, SMC Corp, Sony, SPDR Gold Trust, Spirit Reality Capital, Sumitomo Mitsui Financial, Tanger Factory Trust, Taubman Centres, Tencent, Vail Resorts, VanEck Vectors Gold Miners ETF, VanEck Vectors Junior Gold Miners ETF, Vereit, Vodafone, Vonovia, Vornado Realty, Trust, Walt Disney, Wharf Real Estate Investment Co, Wynn Macau, Wynn Resorts, Zillow, ZOZO. These may change without notice and should not be taken as recommendations.