

Australian Iron Ore Miners

Iron-Ore Update: Running of the Pilbara Bulls

BUY: BHP.AX, MIN.AX, CIA.AX.

Global Thematic Research

Analyst: Dr Kingsley Jones, CFA

+61 467 555 612

kingsley.jones@jevonsglobal.com

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The Opportunity

Three months ago, we discussed the price correction then underway in iron ore prices and recommended standing back from all stocks, except BHP Group.

In this research note, we review our estimates of the **average cost of entry** for investors in shares of the major listed iron ore producers. This is our method to gauge investor sentiment, and to determine when bear market conditions have abated.

The stocks surveyed are:

- | | |
|--------------------------|--------|
| • BHP Group | BHP.AX |
| • Fortescue Metals Group | FMG.AX |
| • Rio Tinto Ltd | RIO.AX |
| • Mineral Resources | MIN.AX |
| • Champion Iron | CIA.AX |
| • Grange Resources | GRR.AX |
| • Mount Gibson Iron | MGX.AX |

The list comprises all ASX-listed iron ore producers capped over \$500M AUD. To simplify the equation BHP is 70% of the combined market cap, followed by RIO at 14% and FMG at 11% and MIN at 3%. Pick a major for the core, and a minor for the satellite

Update since Last Report

Our previous report, titled “Is Iron Ore Done and Dusted”, was published on 2-Sep-2022. Then we identified that the iron ore sector, apart from **BHP Group** and **Mineral Resources** had entered a bear market, as measured by our **cost basis indicator**.

The purpose of this technical indicator is to alert us to when investors are likely holding positions that are underwater on their purchase price. This affects sentiment negatively and can prolong periods when stocks simply trade sideways to down. Those names with positive sentiment, which we identify with the average investor positions being in profit, tend to do better under such conditions of uncertainty.

The total return since is shown in Exhibit 1. The two stocks highlighted in orange, in panel (a), were the only two that were trading in a positive sentiment condition in our previous report.

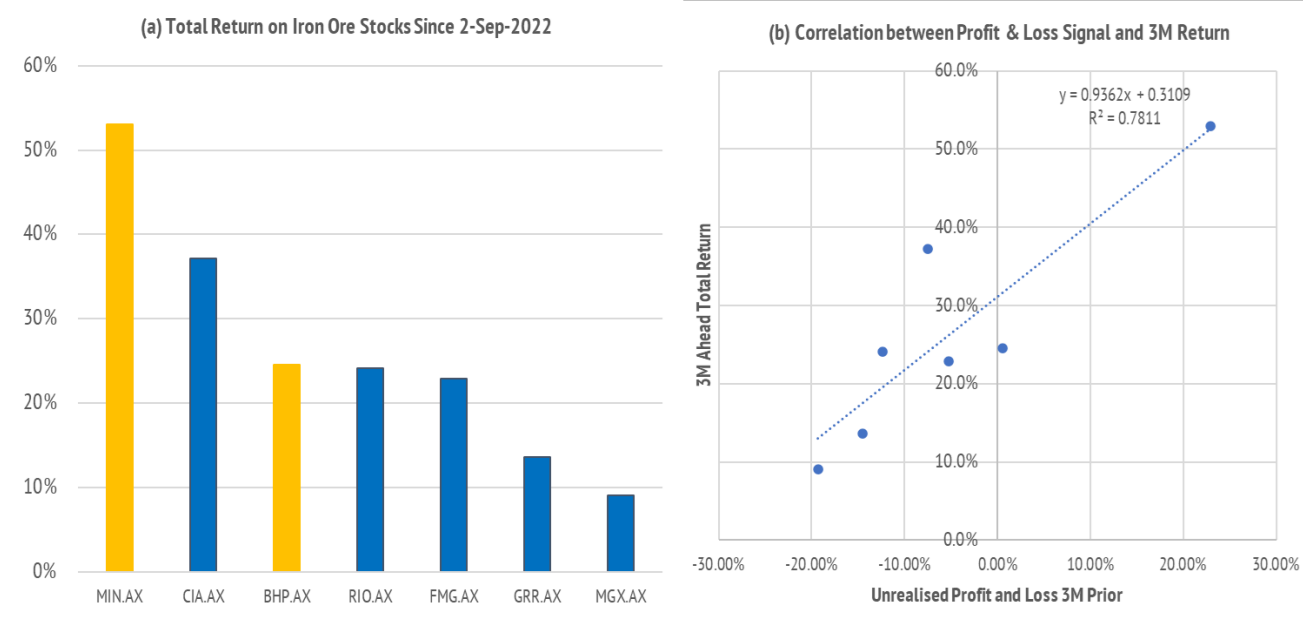
Of course, no purely formulaic approach to selecting stocks can be perfect, any more than the traditional methods of fundamental analysis. **Champion Iron Ore** had negative sentiment in our last note but has come in at number two over this period. Indeed, the fundamentals swayed in this case, as the firm posted a reasonable earnings report and record production.

The correlation between our unrealised profit and loss signal three months prior, and the total return over the period since, is shown at panel (b). There is a near 78% correlation between the two, which is encouraging, but should not be over-interpreted. These tools can be helpful for risk management, but the fundamentals driving changes to the operating conditions of the sector are of key importance.

Favoured Names

The bear market sentiment that made us so cautious in our last note has now largely abated. Five of the seven focus list names are showing positive investor profit and loss, Exhibit 2. The weakest remain the two smaller iron ore plays, **Grange Resources** and **Mount Gibson Iron**. These are clearly still in bear market conditions, as shown at Exhibit 13, and at Exhibit 15. **Fortescue Metals Group** has recovered into positive territory, Exhibit 7, as has **Rio Tinto**, Exhibit 5, but the valuation discount to **BHP Group**, as shown at Exhibit 2, is not great enough for us to change our view on BHP as the preferred major.

On valuation grounds, both **Mineral Resources** and **Champion Iron Ore** are offering some discount to **BHP Group** and improving fundamentals with iron back above \$100 USD/tonne. The investment case for Mineral Resources now rests on the recovery in the iron business profitability providing cash flow to help grow their very attractive lithium business. Our previous concern was that the firm might be under pressure to restructure. In the case of Champion Iron Ore, **CIA**, higher grade iron ore is key to lower carbon emissions from steelmaking. The premium for such products should help support the business. In our view, **CIA** warrants a small position as a satellite to our core portfolio holdings in **BHP**, and the diversified growth options presented by **MIN**.

Exhibit 1 (a) Total return of iron ore stocks since 2-Sep-2022 and (b) correlation analysis between profit & loss signal and later return


Source: Jevons Global & Refinitiv Data (2022).

Exhibit 2 Iron ore producers of capitalisation > \$500M ranked by average investor unrealized profit and loss.

Ticker	Company	Cap (\$B)	Price (\$)	12M Fwd. PER	Yield	Cost Basis	Profit & Loss
MIN.AX	Mineral Resources Ltd	17.10	89.83	7.73	4.2%	59.56	50.8%
CIA.AX	Champion Iron Ltd	3.49	6.75	8.99	3.5%	5.45	23.8%
BHP.AX	BHP Group Ltd	231.81	45.76	11.04	6.5%	37.63	21.6%
RIO.AX	Rio Tinto Ltd	41.55	111.94	10.56	7.3%	103.65	8.0%
FMG.AX	Fortescue Metals Group Ltd	60.59	19.68	10.62	7.5%	18.23	8.0%
GRR.AX	Grange Resources Ltd	0.95	0.82			0.91	-10.0%
MGX.AX	Mount Gibson Iron Ltd	0.58	0.48	7.87	0.0%	0.54	-10.7%

Source: Jevons Global & Refinitiv Data (2022).

Exhibit 3 Price history of BHP (P) versus estimated average Cost-Basis (CB).



Source: Jevons Global & Refinitiv Data (2022).

Exhibit 4 Estimated average unrealized profit and loss for investors in BHP ($PnL = P/CB - 1$).



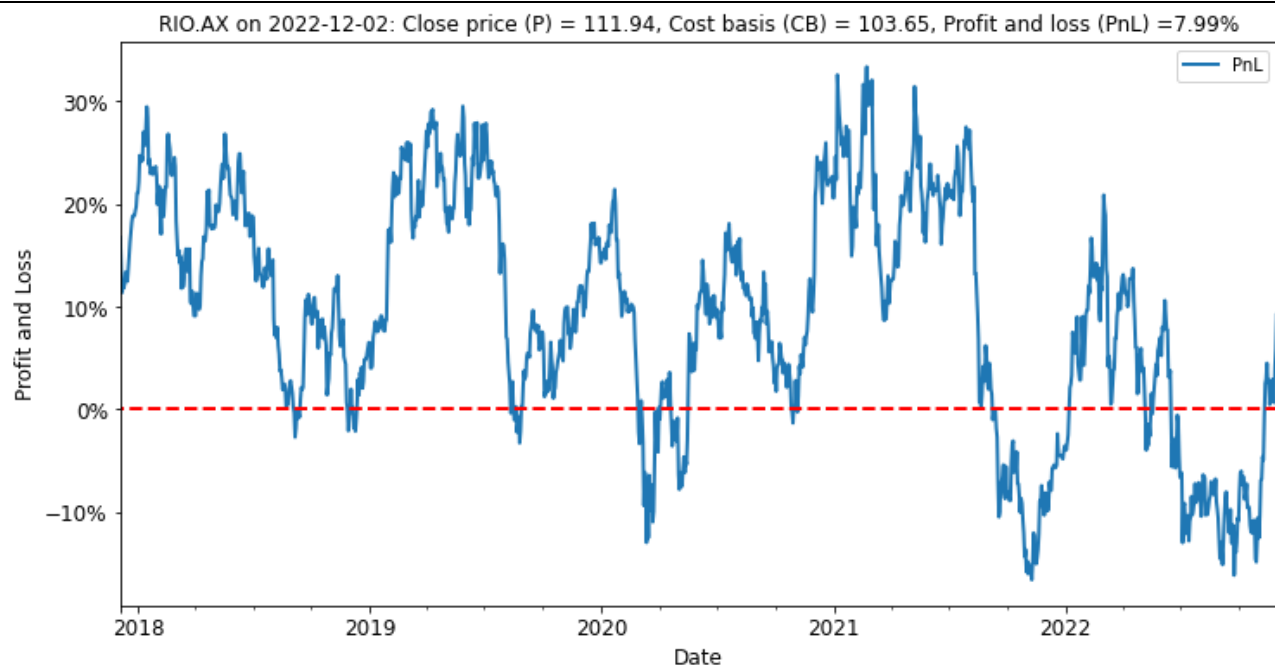
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 5 Price history of RIO (P) versus estimated average Cost-Basis (CB).



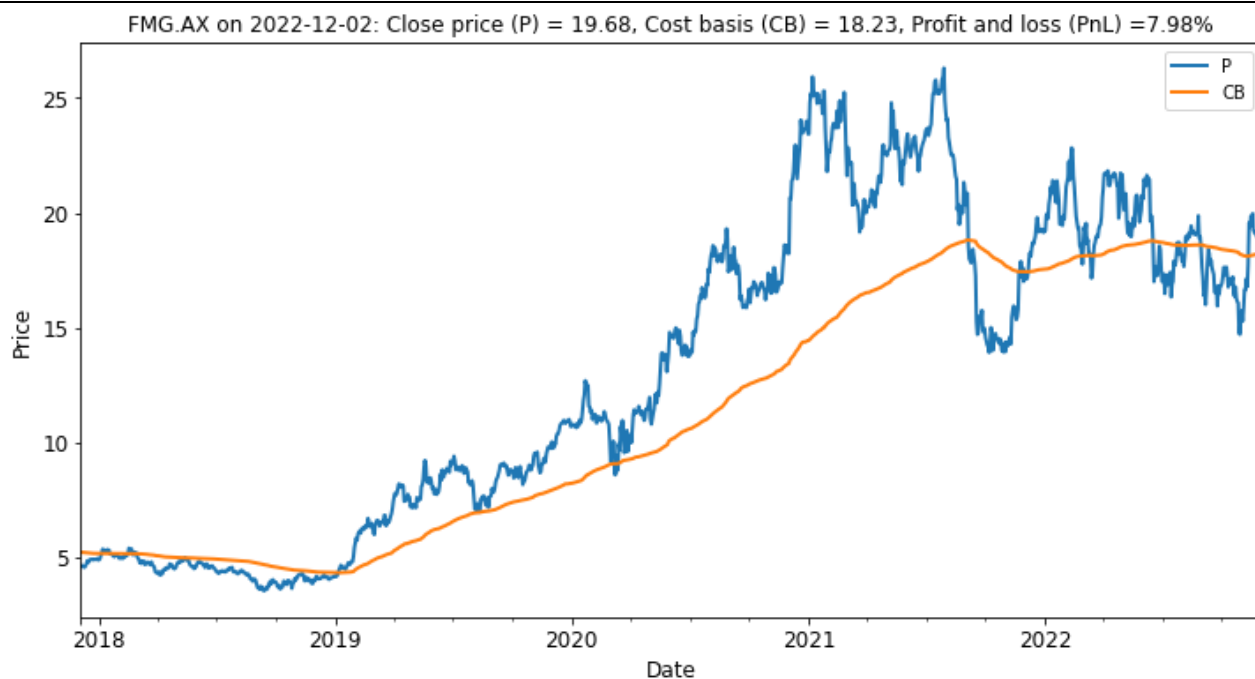
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 6 Estimated average unrealized profit and loss for investors in RIO ($PnL = P/CB - 1$).



Source: Jevons Global & Refinitiv Data (2022).

Exhibit 7 Price history of FMG (P) versus estimated average Cost-Basis (CB).



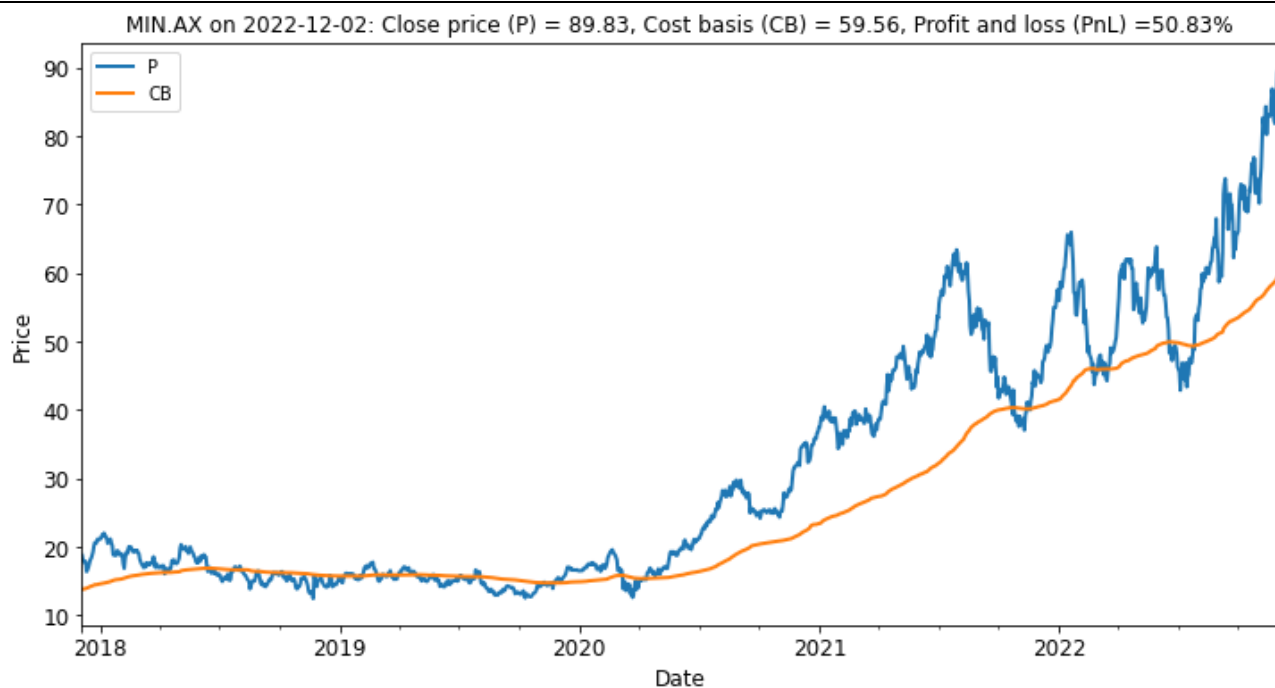
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 8 Estimated average unrealized profit and loss for investors in FMG ($PnL = P/CB - 1$).



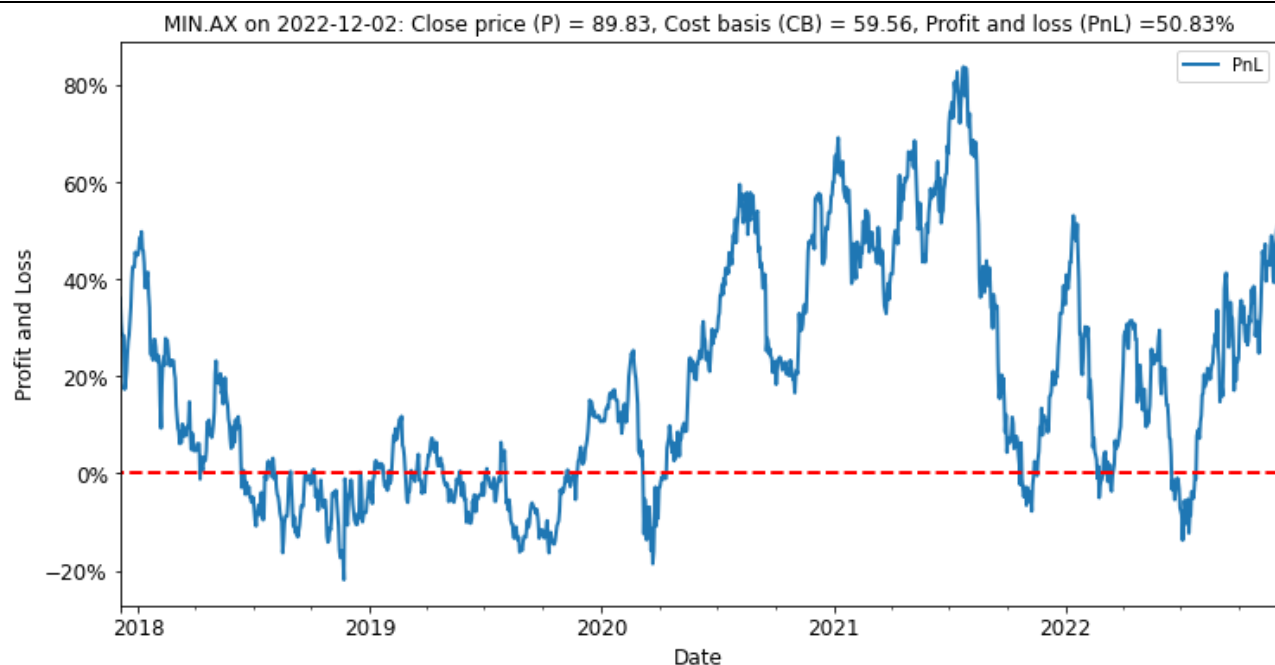
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 9 Price history of MIN (P) versus estimated average Cost-Basis (CB).



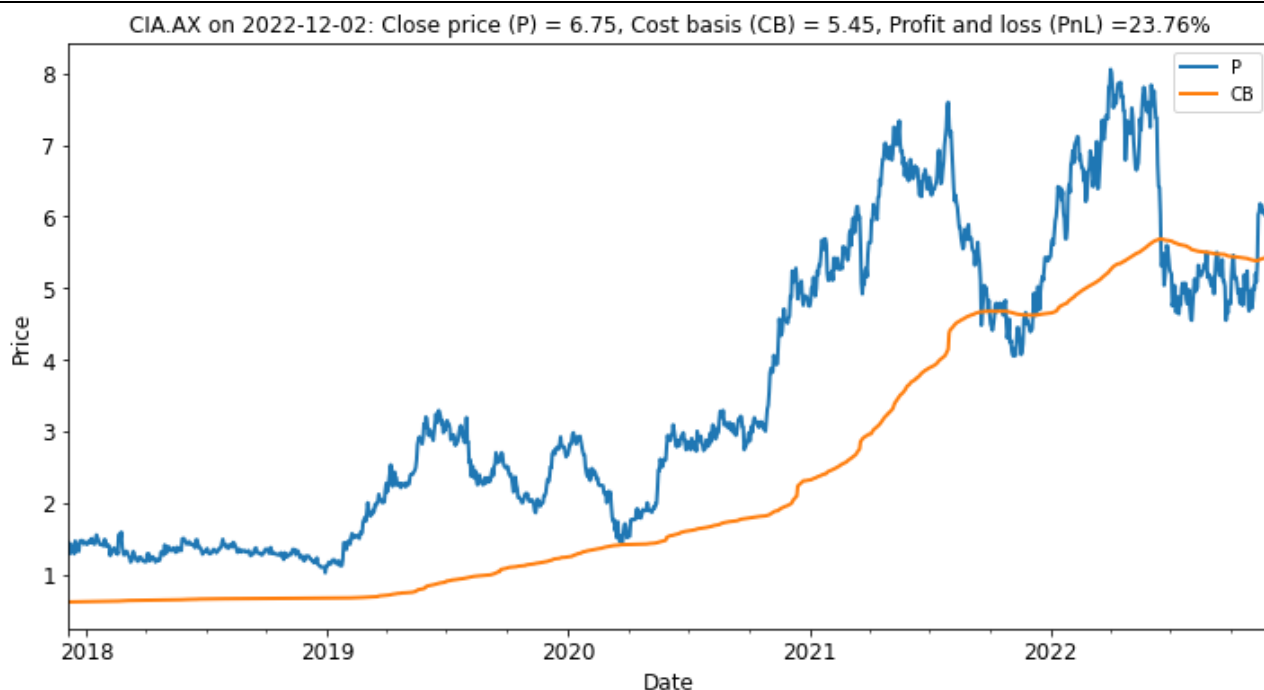
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 10 Estimated average unrealized profit and loss for investors in MIN ($PnL = P/CB - 1$).



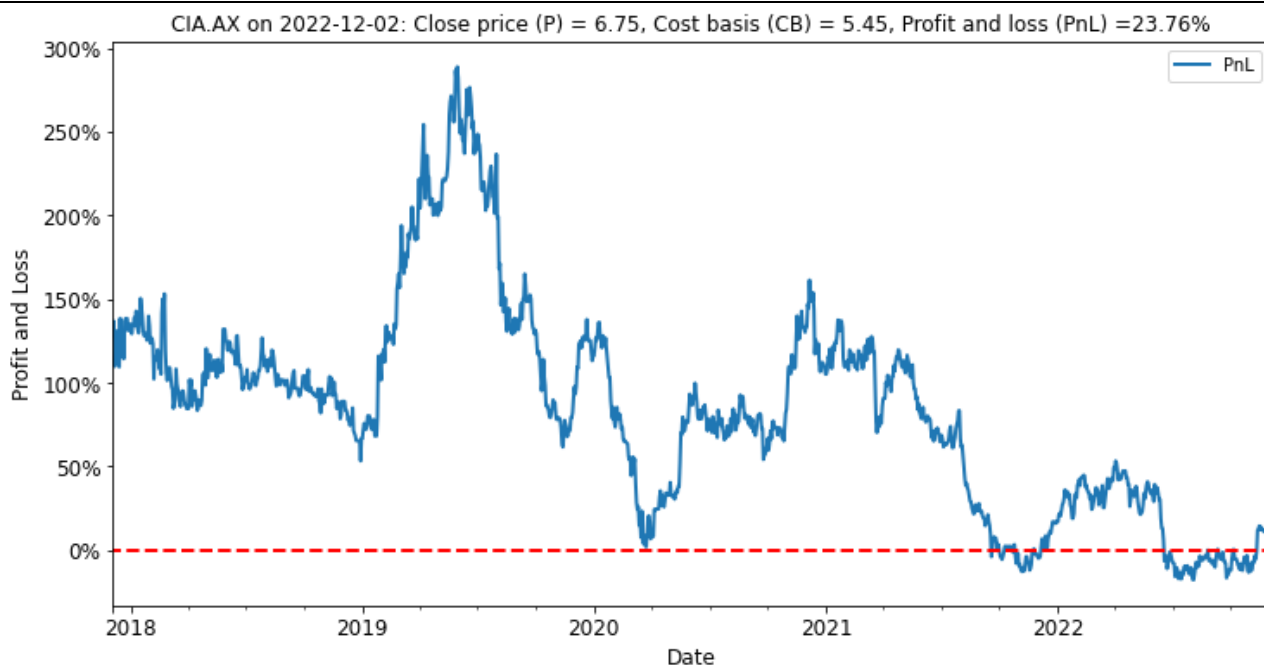
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 11 Price history of CIA (P) versus estimated average Cost-Basis (CB).



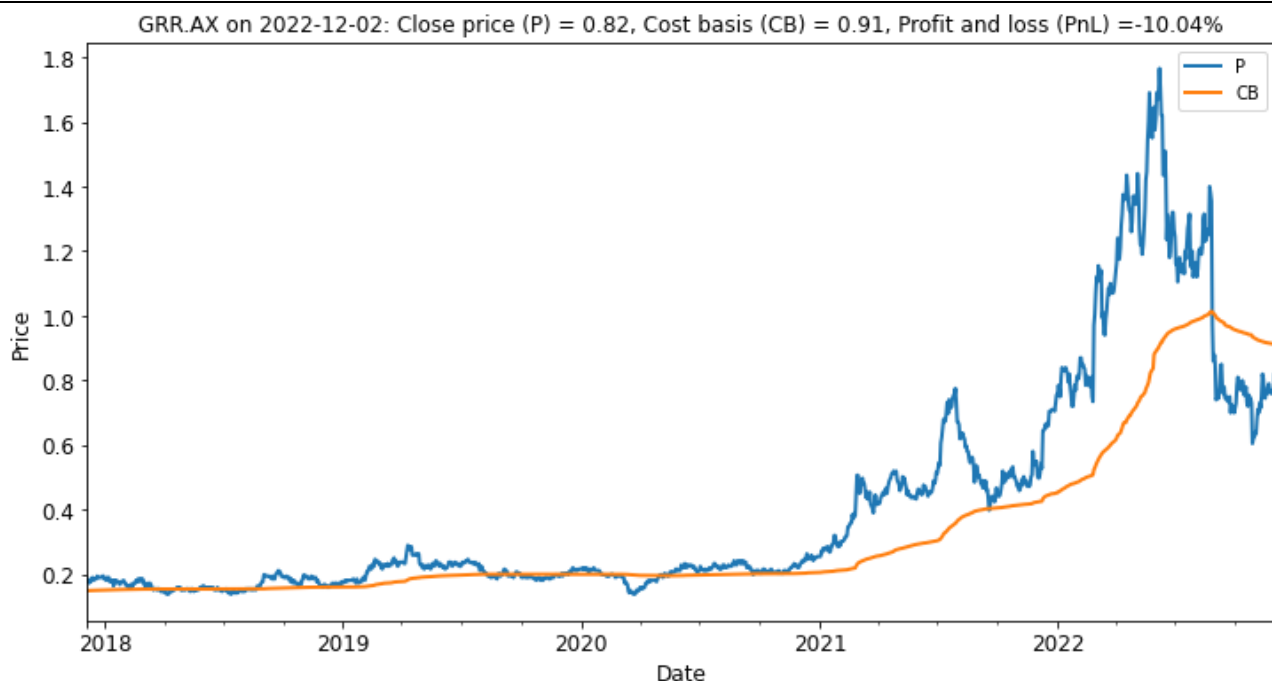
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 12 Estimated average unrealized profit and loss for investors in CIA ($PnL = P/CB - 1$).



Source: Jevons Global & Refinitiv Data (2022).

Exhibit 13 Price history of GRR (P) versus estimated average Cost-Basis (CB).



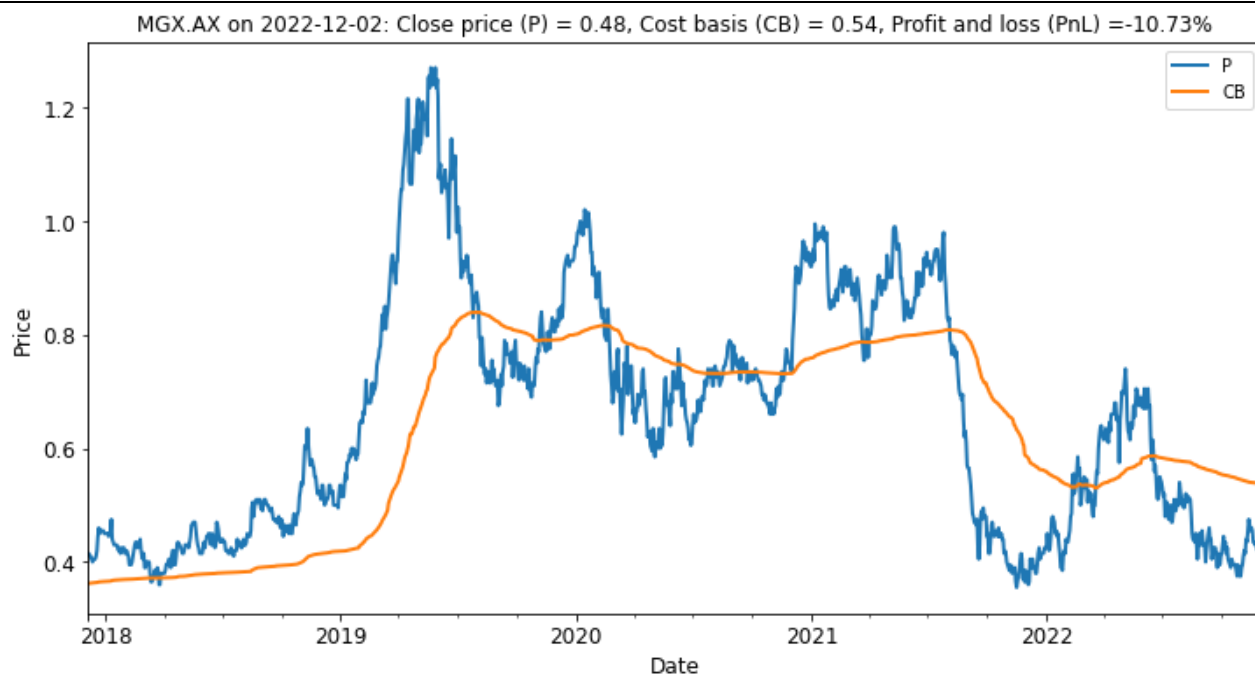
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 14 Estimated average unrealized profit and loss for investors in GRR ($PnL = P/CB - 1$).



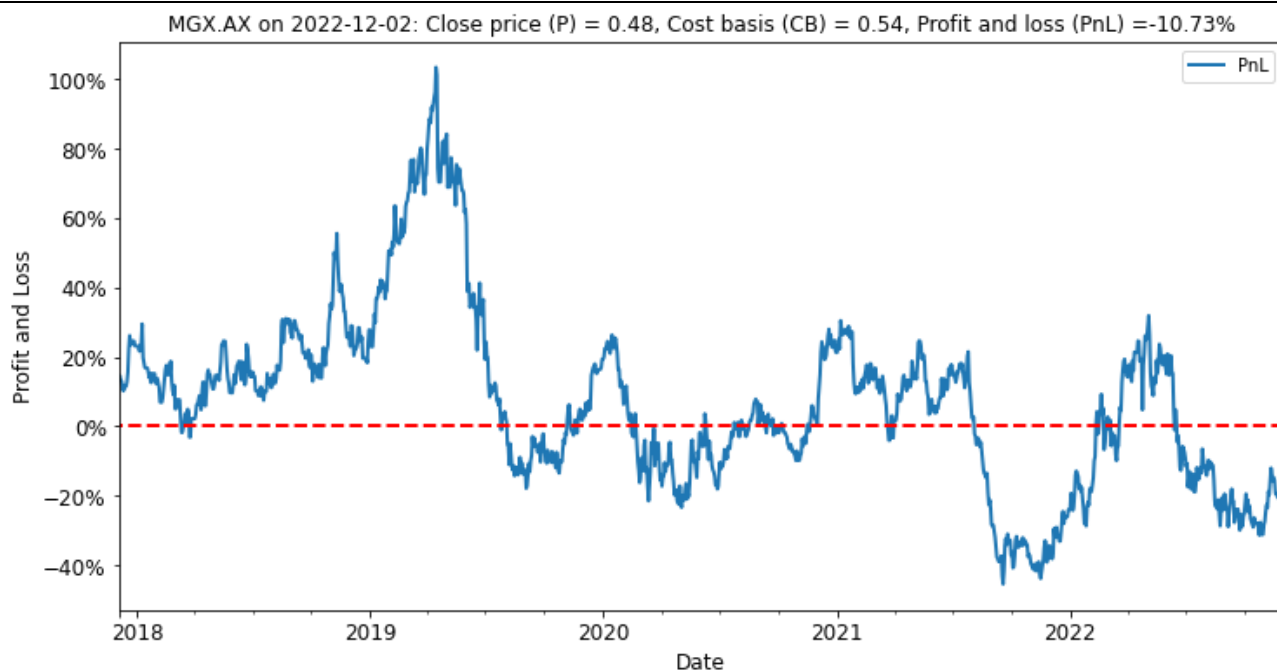
Source: Jevons Global & Refinitiv Data (2022).

Exhibit 15 Price history of MGX (P) versus estimated average Cost-Basis (CB).



Source: Jevons Global & Refinitiv Data (2022).

Exhibit 16 Estimated average unrealized profit and loss for investors in MGX ($PnL = P/CB - 1$).



Source: Jevons Global & Refinitiv Data (2022).

TRADING POSITION DISCLOSURE

The Jevons Global Opportunities portfolio holds these trading positions of relevance to this research note:

LONG Grange Resources Ltd (ASX: GRR.AX)
LONG Rio Tinto Ltd (ASX: RIO.AX)
LONG BHP Group Ltd. (ASX: BHP.AX)

Thematic Sector: Resources & Energy
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The analyst Dr Kingsley Jones, CFA has a beneficial interest in any profit or loss derived from these trading positions.

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