

## Private Client Research

4 November 2019

## Rio Tinto

## Investor day feedback

Rio Tinto (RIO) held its investor day in London and Ord Minnett makes the following observations:

1. Rio Tinto has pushed US\$0.5 billion in capital expenditure from 2019 to 2020, and provided new 2022 capex guidance of US\$6.5 billion (with about US\$1 billion unapproved). This was higher than our US\$4.5 billion estimate for approved projects only, due mainly to ongoing iron ore division spending.
2. New 2020 Pilbara shipment guidance of 342 million tonnes (Mt) matched our estimate.

Overall, we didn't view the information from the investor day as material.

**We maintain our Buy recommendation on Rio Tinto with a \$99.00 target price.**

- **Capital expenditure** – Rio Tinto pushed about US\$500m in capital expenditure from 2019 (now US\$5.5bn) into 2020 (now US\$7bn), related primarily to the Oyu Tolgoi operation. New 2022 capital expenditure of US\$6.5bn was provided (OMLe US\$4.5bn). The CFO noted around 50% of development spending was unapproved (about US\$1bn). The breakdown includes a large component of iron ore (general sustaining capex, rail, West Angelas, remaining Koodaideri capex), higher Oyu Tolgoi and related power, aluminium creep, boron tailings, the Jadar project, along with a large number of small projects across the group.
- **Production** – Rio Tinto maintained guidance for a copper equivalent production compound annual growth rate (CAGR) of 2% to 2023.

## Iron ore division

- **Koodaideri** – As we'd suspected for some time, Rio Tinto stated it cannot achieve an annual run rate of 360Mtpa until the 43Mtpa Koodaideri mine is online in 2021.
- **2020 shipment guidance** – Rio Tinto expects a 5% increase on 2019 guidance of 320–330Mt (OMLe 342Mt).
- **Mine planning issues** – Rio Tinto didn't elaborate on Brockman waste stripping issues or autonomous haulage truck conversion setbacks.
- **SP10 product** – Rio Tinto believes the lower-quality SP10 product has a lower cost than the Pilbara blend average. 2019 SP10 sales look to be around 20Mt or about 6% of overall volume.
- **Costs** – WA costs are under pressure. 2019 cost guidance of US\$14-15/t was maintained. 2020 costs are expected to rise on general inflation across the sector.
- **Sustaining capital expenditure** – 2020-22 sustaining iron ore capex has risen to US\$1.5bn from US\$1bn historically. Based on 2020 shipment guidance, this equates to around US\$3.4/t (in line with OMLe).
- **Replacement mines** – There is around a two-year gap between Koodaideri and the next relatively high capital intensity project, with another one about three years later. We estimate US\$5bn of capital expenditure in the five years after Koodaideri is online (2021), highlighting the system is capital-intensive to maintain. Historical guidance was for 50Mtpa to deplete every five years, but more recently Rio Tinto has stated this no longer stands.
- **Indian steel** – Rio Tinto believes India's steel production target of 300Mt around 2030 could be 25% satisfied by domestic iron ore.

## Recommendation

Buy

Risk

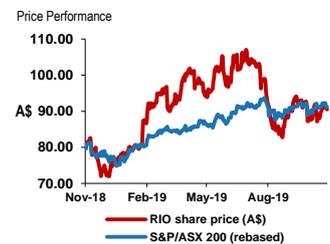
Medium

Target price

\$99.00

Last price

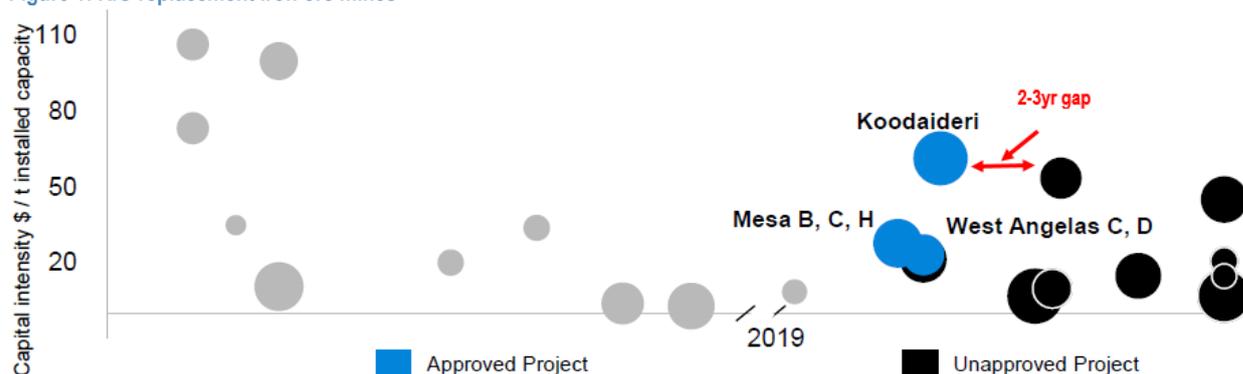
\$90.49



### Replacement mines

There is around a two-year gap between Koodaideri and the next relatively high capital intensity project, with another one about three years later. The bubbles shown in the chart below equate to our estimate of US\$5bn of capex in the five years after Koodaideri is online (2021), highlighting the system is capital-intensive to maintain. Historical guidance was for 50Mtpa to deplete every five years, but more recently Rio Tinto has stated this no longer stands.

Figure 1: RIO replacement iron ore mines



Source: Company reports, Ord Minnett estimates

## Investment Thesis, Valuation and Risks

### Investment Thesis

Rio Tinto is Buy rated based on strong P/NPV support, attractive FCF and dividend yield, along with a low EV/EBITDA multiple. The stock is our preference amongst the diversified miners.

### Valuation

Our Dec-20 PT is based on our NPV estimate rounded up to the nearest dollar. Our NPV is based on a sum-of-the-parts DCF valuation using a 10% discount rate. The 10% discount rate is in line with our coverage universe.

Current DCF	US\$m	A\$m	A\$ps
Iron Ore	81,662	109,106	67.25
Aluminium	17,208	22,991	14.17
Copper	20,844	27,848	17.17
Energy	-	-	-
Diamonds, Minerals, Other	6,976	9,321	5.75
<b>Total operations</b>	<b>126,690</b>	<b>169,266</b>	<b>104.34</b>
Net debt	(4,245)	(5,672)	(3.50)
Corporate costs	(2,152)	(2,875)	(1.77)
Exploration	-	-	-
<b>Total valuation</b>	<b>120,293</b>	<b>160,719</b>	<b>99.07</b>

Source: Ord Minnett estimates.

### Risks to Rating and Price Target

Downside and upside risks include: 1) outcomes in commodities, currencies, production, costs and capex relative to our forecasts; and 2) changes to tax, legislation and other operating conditions.

Please contact your Ord Minnett Adviser for further information on our document.

## Guide to Ord Minnett Recommendations

Our recommendations are based on the total return of a stock – nominal dividend yield plus capital appreciation – and have a 12-month time horizon.

<b>SPECULATIVE BUY</b>	We expect the stock's total return (nominal yield plus capital appreciation) to exceed 20% over 12 months. The investment may have a strong capital appreciation but also has high degree of risk and there is a significant risk of capital loss.
<b>BUY</b>	The stock's total return (nominal dividend yield plus capital appreciation) is expected to exceed 15% over the next 12 months.
<b>ACCUMULATE</b>	We expect a total return of between 5% and 15%. Investors should consider adding to holdings or taking a position in the stock on share price weakness.
<b>HOLD</b>	We expect the stock to return between 0% and 5%, and believe the stock is fairly priced.
<b>LIGHTEN</b>	We expect the stock's return to be between 0% and negative 15%. Investors should consider decreasing their holdings.
<b>SELL</b>	We expect the total return to lose 15% or more.
<b>RISK ASSESSMENT</b>	Classified as Lower, Medium or Higher, the risk assessment denotes the relative assessment of an individual stock's risk based on an appraisal of its disclosed financial information, historical volatility of its share price, nature of its operations and other relevant quantitative and qualitative criteria. Risk is assessed by comparison with other Australian stocks, not across other asset classes such as Cash or Fixed Interest.

## Ord Minnett Offices

**Adelaide**  
Level 5  
100 Pirie Street  
Adelaide SA 5000  
Tel: (08) 8203 2500  
Fax: (08) 8203 2525

**Brisbane**  
Level 31  
10 Eagle Street  
Brisbane QLD 4000  
Tel: (07) 3214 5555  
Fax: (07) 3214 5550

**Buderim**  
Sunshine Coast  
1/99 Burnett Street  
Buderim QLD 4556  
Tel: (07) 5430 4444  
Fax: (07) 5430 4400

**Canberra**  
101 Northbourne Avenue  
Canberra ACT 2600  
Tel: (02) 6206 1700  
Fax: (02) 6206 1720

**Gold Coast**  
Level 7, 50 Appel Street  
Surfers Paradise QLD 4217  
Tel: (07) 5557 3333  
Fax: (07) 5557 3377

**Mackay**  
45 Gordon Street  
Mackay QLD 4740  
Tel: (07) 4969 4888  
Fax: (07) 4969 4800

**Melbourne**  
Level 7  
161 Collins Street  
Melbourne VIC 3000  
Tel: (03) 9608 4111  
Fax: (03) 9608 4142

**Newcastle**  
426 King Street  
Newcastle NSW 2300  
Tel: (02) 4910 2400  
Fax: (02) 4910 2424

**Head Office**  
**Sydney**  
Level 8, NAB House  
255 George Street  
Sydney NSW 2000  
Tel: (02) 8216 6300  
Fax: (02) 8216 6311  
www.ords.com.au

**International**  
**Hong Kong**  
1801 Ruttonjee House  
11 Duddell Street  
Central, Hong Kong  
Tel: +852 2912 8980  
Fax: +852 2813 7212  
www.ords.com.hk

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