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Rio Tinto

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Will resurgent prices stimulate a revival of the long-dormant junior iron ore sector?

In recent weeks Black Iron Inc (TSE:BKI) has been trumpeting the heightened margins on offer at its Shymanivske iron ore project in the Ukraine.

In a way, it's not that remarkable for a junior miner to take advantage of a spike in prices to undertake a marketing push.

After all, iron ore prices have been hitting new highs in the wake of the Brazilian tailings dam disaster, and Black Iron has a project with a net present value of over US$1bn and which has already been taken to the cusp of production only to be stymied by the small matter of a civil war.

But the wider picture is more interesting. It's been over a decade since the junior mining market has played host to anything really resembling an iron ore sub-sector. After the blow-out at the end of the mining boom the iron ore companies became skeletal versions of their former selves, increasingly reticent about their billion dollar capex tags, infrastructure costs and crazy jurisdictions, and eventually transformed into gold companies, tech companies, or just disappeared altogether.

So yes, it's interesting to see Black Iron go on a PR offensive, and it's interesting to speculate too that it might be a sign of things to come.

But at this point, it's worth sounding a note of caution. It's a huge advantage for Black Iron that it's already taken its project to a production-ready state. That means effectively that when prices move in its favour, it can just about switch on the project and pick off where it left off. Few other companies are in that position, and few other companies are likely to gain the traction that Black Iron gains because of it.

Is there any sign of the plethora of West African iron ore explorers and developers that use to populate the Aim market and the ASX in such numbers more than a decade ago? No. It will take more than short-term wobbles in sentiment about supply to get that train moving again, especially since last time round investors were really, really burned.

Price: 4026p

Market Cap: £67681400000000M

1 Year Share Price Graph

Share Information

Code:		RIO
Listing:		LSE
52 week	**High**	**Low**
	5,039.00p	**3,460.50p**
Sector:		**Mining**
Website:		**www.riotinto.com**

Company Synopsis:

Rio Tinto is a leading international mining group that finds, mines and processes the earth's mineral resources. The Group's major products include aluminium, copper, diamonds, energy products, gold, industrial minerals (borates, titanium dioxide, salt and talc), and iron ore. Its activities span the world but are strongly represented in Australia and North America.

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What's more, most analysts still think iron ore prices are going to fall back again. To be sure, Liberum has cured itself of some of its initial pessimism, and is now forecasting an average price of US$70 per tonne for 62% fines for the first half of this year and US$50 per tonne for the second half. That's up a bit, but comes against the backdrop of commentary laden with cautionary remarks about the potential downsides.

"We don't believe the current price rally is sustainable in the face of weakening Chinese demand," says Liberum. "Furthermore, despite the outages, there there are still net mine supply additions in 2019 on our assumptions. The iron ore majors have de-rated materially on spot prices and are currently implying an iron ore price of just US$54 per tonne- to US$62 per tonne to hit a target 9% free cash flow yield. With spot prices at US$88 per tonne there is still plenty of cushion for the equities, but we believe we will get there on our new price forecasts."

No-one is going to start putting up seed money for inland iron ore projects in West Africa in that sort of context.

What's more, there's some doubt that Chinese buyers will be able to continue making inroads into the markets at these levels. Chinese steel mills are reportedly suffering intense margin pressure at current prices. The thinking is that prices will need to come back to US$75 before Chinese mills can really suck up supply in a big way.

The speculative buying which has compounded the recent price rise and which led Dalian prices to spike at records high is likely to fade, and although there remains a risk that further to the Brucutu shutdown Vale will have to close other operations, the fear factor surrounding such a development is likely to dissipate by the day.

Even so, the tailings dam collapse in Brazil continues to have rippling effects around the world. Political analysts in Australia note that the new incumbents that will be returned in Australia's upcoming elections will enjoy greater budget flexibility due to increased revenues from the country's major iron ore producers.

And the miners themselves are also benefitting. Fortescue Metals Group (ASX:FMG) is up more than 37% since the start of the year, Rio Tinto (LON:RIO) is up 20% and BHP (LON:BHP) is up more than 10%.

In that the mining sector is running true to its current form: the majors and mid-caps are broadly speaking in recovery or doing well, while the junior sector continues to be starved of capital and to be stuttering along.

To be sure there are success stories, like Strategic Minerals PLC (LON:SML), which has an iron ore component to its production offering in the US. But this is in the way of what fund managers are wont to call a "special situation."

We'll have to wait a while yet before the recovery in iron ore juniors becomes general.