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HD **Ore price pessimism overdone as miners dig in for long game**

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DON'T get too gloomy about the falling iron ore price.

While economists and politicians fret, the sliding spot price, now at 20-month lows after falling 30 per cent this year, has had no discernible effect on the confidence and intentions of the iron ore majors in most resource stock portfolios.

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BHP Billiton, Rio Tinto and Fortescue Metals Group aim for production records of, respectively, 217, 295 and 127 million tonnes this financial year and Fortescue targets capacity of 155mt next year. Brazil's Vale is forecasting 360mt.

The majors are playing a long game of increasing their control of the seaborne iron ore trade and transitioning Chinese steel producers from low-grade ore to the higher-quality blends exported from the Pilbara and Vale's Carajas mine. The majors might not like the near-term pressure on their margins from the weak price, but their huge capacity upgrades make them responsible for it and are deliberately targeted at the small high-cost producers that account for a quarter of global production.

We would not be surprised to see further capital commitments to iron ore by BHP and Rio Tinto when they announce their full-year results. Tellingly, Rio Tinto chief executive Sam Walsh recently boasted his firm was a "price-maker".

The chart (right) shows the majors' advantageous position on the global cost curve.

The multi-year surge in iron ore prices, which peaked in 2011, attracted a variety of chancers hoping to cash in on a once-in-a-century opportunity.

China itself launched several high-cost, uncompetitive domestic producers to fill a seaborne supply gap. Poor grades and lack of scale make many of these junior miners uneconomic at prices below $US100 a tonne.

In contrast, the majors can afford to run their mines at nameplate capacity even at today's subdued prices while they wait for marginal producers to go out of business.

Gloom about price has a secondary benefit for the majors when sell-side analysts and bankers become pessimistic. Lower forward prices in company models make it harder for existing and new juniors to raise equity and debt capital. The majors can also threaten to hike supply, but then roll out only enough capacity to suit themselves, with damage to the juniors done.

Value investors hunt for opportunities created but hidden by popular pessimism. The iron ore majors' strategic endgame to dominate the seaborne market — and increase their volumes and pricing power — means their shares should be on these investors' watchlists.

There is plenty of growth left in Chinese iron ore consumption as the nation urbanises, and it is not hard to see the majors scaling back their capacity upgrades to match Chinese demand growth once the iron ore bit players have been sent packing.

In the near term, there is potential downside to our respective 2015 valuations for BHP, Rio and Fortescue of $US42.75, $US76 and $US8.40 if the **iron ore** price falls further, but these stocks are already trading at discounts to value of 15 per cent, 22 per cent and 46 per cent, respectively.

The **iron ore** majors are only becoming more interesting.

David Walker is senior equities analyst at StocksInValue, a joint venture between Clime Asset Management and Eureka Report. He owns shares in BHP and Rio.

CO ambol : Fortescue Metals Group Ltd | bkhlp : BHP Billiton Ltd | bltplc : BHP Billiton PLC

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