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Vale SA (ADR)

06:26 20 Mar 2019

Iron ore market tightness set to remain as Vale's woes in Brazil continue

Royal Bank of Canada, one of the more up-to-minute banks when it comes to commentary on the mining sector, has set ratings of underperform for Vale SA (NYSE:VALE) and outperform for Anglo American (LON:AAL).

RBC's price target for Vale on the New York stock exchange is US$9.00, some way lower than the current US$13.70. Its target for Anglo American is 2,300p, some way higher than the current 1,964p.

Industry watchers won't be overly surprised at the different outlook RBC has in respect for two of the world's most significant iron ore producers.

Following the collapse of a tailings dam at the Córrego do Feijão mine in Minas Gerais in January Vale has been under severe pressure from the Brazilian government. The dam collapse killed at least 165 people but, what was worse for Vale in terms of regulatory pressure, it wasn't the first accident of its kind.

A similar tailings dam collapse in 2015 also caused scores of deaths.

So Brazilian regulators are now gunning for the least safety infraction by Vale and have forced several operations to shut down, including the large Brucutu mine, also in Minas Gerais.

Brucutu may now be allowed to reopen, following the latest court ruling at local level, but that news came only a day after regulators forced to more Vale operations to cease production. One of Vale's major shipping terminals has also been forced to close in recent days, although the company says it knows of no permitting or other infraction involved at the operation.

But in the immediate term that may not matter.

It is, in short, an uncertain time for the Brazilian mining champion, one of the few truly world-class mining companies that originates from outside of the Anglosphere.

But that in turn means that other iron ore producers like Anglo American, Rio Tinto (LON:AAL) and BHP Group PLC (LON:BHP) are likely to pick up the slack.

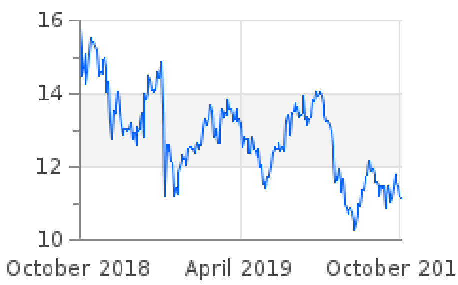
Or so the thinking in some analysts' minds goes. But there may be a little more to it than that. It was interesting to see the sharp rise in Vale's shares following the news of a potential re-start at Brucutu, and that 2% move may be indicative that the market now feels that Vale has been oversold.

Indeed, on the day of the Córrego do Feijão disaster the shares plunged by more than 25%, a huge move for a US$70bn company. The shares have since clawed back more than half of that loss and are now trading roughly at levels they were at throughout much of 2018, before a surge at the end of the year.

Price: 11.15

Market Cap: $57.18 billion

1 Year Share Price Graph



Share Information

Code:		VALE
Listing:		NYSE
52 week	**High**	**Low**
	15.92	**10.2**
Sector:		**Mining**
Website:		**www.vale.com**

Company Synopsis:
Vale is a global mining company headquartered in Brazil, with a workforce of over 100,000 employees. The company is produces iron ore, nickel, coal, aluminum, potassium, copper, manganese and a range of other metals.

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And the tightness in the market resulting from Vale's loss of production - which could amount to as much as 90mln tonnes - may also have another paradoxical effect: the price of the iron ore it does produce and sell will be much higher, owing to the lack of supply from the company's own mines.

How marked this effect will really be is open to question, as some analysts, including those at RBC note that for 2019 Vale will be able to make up for its likely production shortfall by drawing on stockpiles both in Brazil and in Asia.

Nevertheless, old certainties are now gone. Vale is no longer unassailable in Brazil. And the arrival of Jair Bolsonaro as Brazil's new right-wing president poses more questions than it answers. On the one hand he is very pro-business, and ought to be able to mitigate the worst of the fallout against Vale. On the other, he's also a populist, and with his business credentials firmly established may feel secure enough to take a swing or two at Vale in pursuit of short-term electoral gain.

The losers in all this are the Chinese buyers who will inevitably have to pay more for their ore. This is already happening, as the iron ore price has moved more sharply than anyone expected in the immediate aftermath of the dam collapse.

Partly, this is because of the unexpected robustness of the Brazilian regulatory response, and partly it's because of the uncertainty that now exists around supply.

A general consensus can now be found for an iron ore price of close to US$100, although some, like the analysts at London broking house Liberum are cautious about this. In their view such a price would require "the maximum possible disruption to supply" as well as strong demand from China.

Liberum cites lower steel prices as likely to put significant margin pressure on Chinese manufacturers if the iron ore price remains high. It's not alone in assuming that in the longer term the iron ore price is likely to fall back significantly, possibly to as low as US$50 per tonne.

In the meantime though, the prospect for a further share price fillip to some of the world's largest miners continues to look very real.

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