

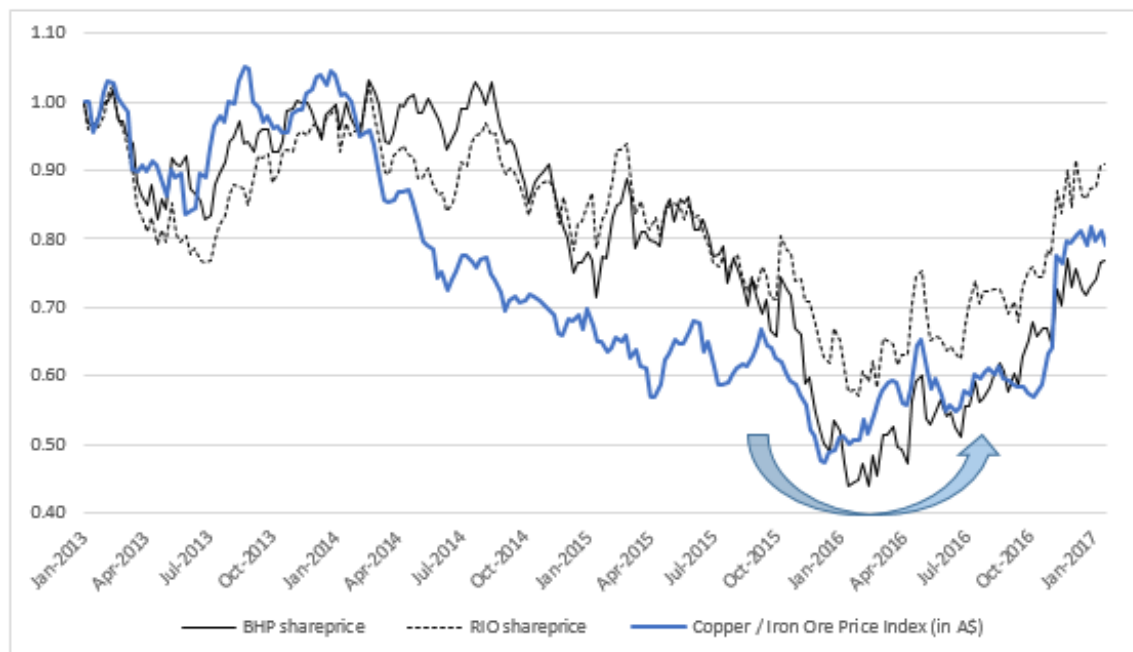
Investment Ideas:

BHP and RIO: looking fully valued

25 January 2017

- Starting early last year, BHP Billiton's (BHP) and Rio Tinto's (RIO) share prices have appreciated strongly on the back of a marked (and mostly unexpected) turnaround in commodity prices.
- However, looking at the strong directional correlation between historical share price performance and commodity prices, we suggest that the two diversified miners are fully valued.
- RIO in particular looks expensive. While the A\$ iron ore price is 27% below its January 2013 price level, RIO is only 9% below its January 2013 price. This disconnect, however, could be due to the increase in output/ production capacity and cost cutting programmes carried out by RIO over the past four years.
- IRESS consensus target prices also indicate that BHP and RIO offer limited upside potential relative to their current share price levels. BHP's target price of A\$25.10 is 10% below its current price of A\$27.86; RIO's target price of A\$62.58 is 6% below its current price of A\$66.71.
- **Without further commodity price gains (or market expectations of gains), we suggest that returns will be limited to ordinary dividend yields and / or capital management (special dividend / share buyback) initiatives.**

BHP and RIO share prices versus A\$ iron ore / copper price index (base Jan 2013 = 1.0)



Source: IRESS, State One Stockbroking forecasts

Note: Price index is weighted 75% iron ore / 25% copper, which reflects the average contribution of iron ore/ other commodities to BHP/RIO profits.



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