FMG Fortescue

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Start of Transcript

Operator: Thank you for standing by and welcome to the Fortescue Metals Group Ltd June 2021 Quarterly Production Report analyst call. All participants are in a listen only mode. There will be a presentation followed by a question and answer session. If you wish to ask a question you will need to press the star key followed by the number one on your telephone keypad. I would now like to hand the conference over to Ms Elizabeth Gaines, CEO. Please go ahead.

Elizabeth Gaines: Thank you Rachel and good morning or afternoon everybody and welcome to Fortescue's June 2021 Quarterly Production Report. Joining me today in Perth is Ian Wells, Chief Financial Officer. I'm also delighted to welcome Bill Bennell who joins us as CEO for a day.

Bill is a proud Nyungar man from the South West and he joined Fortescue in 2014. Bill is passionate about protecting Aboriginal heritage in his role as a Heritage Field Supervisor across our Pilbara operations, working hard to educate his workmates about Aboriginal culture. Bill has worked to develop a very strong team and he embodies the very best of our culture and values and it's great to have you with us Bill.

Bill Bennell: Thanks Elizabeth.

Elizabeth Gaines: So that brings me to our fourth quarter results. It was an outstanding quarter for Fortescue, with the team's strong operational performance delivering across our key metrics of safety, production and cost, despite the impact of wet weather and COVID 19 restrictions.

I will make a comment firstly on safety and I do want to commend the entire Fortescue team for achieving our lowest ever TRIFR safety performance of 2.0 at 30 June 2021, and that's an improvement of 17 per cent from 30 June last year. Importantly, the injury severity rate also continues to trend lower. This is a reflection of our core value of Safety and our commitment to always look out for our workmates and ourselves.

Significantly this safety performance was achieved during a quarter where we saw COVID-19 restrictions which required many of our team members to remain onsite for extended periods during WA's lockdowns.

I'd also like to take the opportunity to address the recent allegations of sexual harassment at mining operations in Western Australia. Fortescue has a zero tolerance approach to harassment, bullying and intimidation. Harassment of any kind is considered serious misconduct and may be grounds for dismissal.

We have a strong culture and that's built on integrity and respect and we're committed to providing a safe and inclusive work environment for all of our team members. In line with this commitment we've launched a Workplace Integrity Review to encourage our team members to provide feedback on what we can do as a business to enhance the measures that we already have in place.

This review includes an online survey and focus group discussion across our operational sites, in addition to independently reviewing and assessing our current site security and safety measures. Our clear guidelines for the responsible consumption of alcohol remain in place, including daily mandatory alcohol screening for all team members before the start of every shift as well as random drug testing.

As part of the industry-wide response to this issue, we will be contributing to the WA Parliamentary Inquiry into sexual harassment against women in the FIFO mining industry, as well as the Commonwealth Government's inquiry into the *Sex Discrimination and Fair Work Amendment Bill.*

So moving to our operational performance for the quarter and the unwavering focus of the Fortescue team has resulted in record quarterly shipments of 49.3 million tonnes which contributed to our highest ever annual shipments of 182.2 million tonnes for financial year 2021.

Ore processing and rail, together with the ramp up and successful integration of Eliwana contributed to record quarterly performance despite the headwinds from wet weather. And it's also worth noting that our autonomous haulage fleet marked a significant milestone during the quarter, moving over two billion tonnes of material since the program was launched in 2012.

C1 costs of US$15.23 a wet metric tonne were two per cent higher than the previous quarter, and that reflects inflationary impacts and COVID-19 related costs. These were largely offset by higher volumes and the continued focus on cost management, with our FY21 C1 cost of US$13.93/wmt, in line with guidance and maintaining our cost leadership position.

Moving forward, productivity gains through innovation and technology will remain a focus to mitigate mine plan cost escalation, materials and consumables inflation and a strong labour market. In line with our commitment to protecting places of cultural significance, heritage surveys and consultation with our Native Title partners remains a priority, with mine plans and schedule aligned with the heritage approvals process.

We also remain committed to achieving our target of carbon neutrality by 2030 with Fortescue Future Industries achieving a number of significant decarbonisation targets during the quarter, which I will speak to a little later.

Ian will talk to the balance sheet, but I did want to highlight that the strength of our operating performance combined with record average revenue resulted in strong cashflow generation in the June quarter, as demonstrated by the movement from a net debt position at the end of March of US$1 billion to net cash of US$2.7 billion at 30 June 2021.

So turning to the market and Chinese crude steel production was 563 million tonnes in the first half of this calendar year, and that's an increase of 11.8 per cent compared to the same period last year. Pleasingly, crude steel production outside of China has largely recovered to pre-COVID levels.

During that same period we have seen ongoing strong economic activity, supporting robust steel demand in China and across the rest of the world. Steel prices and margins in China remain volatile during the quarter and that was impacted by policy uncertainty relating to production curtailments, and we are continuing to monitor market developments closely.

Iron ore supply from the traditional producers remain constrained, particularly in the high grade segment with high cost supply balancing the overall market. Against this backdrop, we achieved record average revenue of US$168/dmt for the quarter and that's an increase of 17 per cent over the previous quarter and a realisation of 84% of the average Platts 62 Index.

For FY21, we achieved an average revenue of US$135/dmt, representing a revenue realisation of 88% of the Platts 62 Index, and this is a 72 per cent increase in revenue per tonne compared to FY20, reflecting the strong market conditions and sustained demand for our products.

As always, we engage closely with our customers in China and elsewhere to ensure that we continue to respond to market conditions.

Turning to Iron Bridge and during the quarter we completed the technical and commercial assessment of the Iron Bridge Magnetite project with a revised capital estimate of US$3.3 billion to US$3.5 billion including Fortescue's share of US$2.5 billion to US$2.7 billion.

The project will deliver 22 million tonnes per annum of high grade 67% Fe magnetite concentrate, with first production scheduled by December 2022 and a ramp up period of 12 to 18 months. As indicated at the time of the announcement, the revised capital estimate is subject to Joint Venture approval. This process is well progressed with good engagement from Formosa.

The project continues to progress well with the first of the major modules delivered to site during the quarter and we continue to work closely with our partners and suppliers to monitor any potential impact of COVID-19 border restrictions on the movement of specialist skills as we ramp up activities at Iron Bridge.

Turning to exploration, and in line with our strategic focus to invest in the future of our core iron ore business and to diversify to commodities that support decarbonisation, total exploration and studies capital expenditure for FY21 was US$186 million. That includes US$93 million during the June quarter.

Iron ore exploration in the Pilbara included target and resource definition drilling in the Western Hub, the Solomon Hub and Eastern Hamersley with study work progressing at Nyidinghu. In June we acquired a strategic tenement adjacent to our Mindy South iron ore tenement package in the Pilbara with mapping and drilling to be prioritised in the coming financial year.

Exploration on our Australian copper-gold portfolio included the completion of a number of surveys across the Paterson and Rudall projects in Western Australia and the drilling program at the Arcoona Project in South Australia. In Ecuador, field activities and drilling have restarted and we've commenced drilling in Kazakhstan.

The drilling season concluded in Argentina during the June quarter with geological reviews underway in preparation for the next field season.

On that, I'm going to hand over to Ian for an update on the finance. Ian.

Ian Wells: Thanks Elizabeth and hi everyone. The record June quarter and full year operating performance marks another period of consistent and predictable execution and has contributed to strong cashflow generation, and it's a real privilege to highlight some of these numbers to you today.

As I have indicated previously, our results are achieved simply by focusing on the things that we can control, which is safety, production and cost, together with disciplined capital allocation and capital management.

We are also seeing benefits from our investment in the whole-of-business integrated planning process to support our integrated operations and marketing strategy and deliver the best outcomes for the company.

Starting with the top line, as you heard from Elizabeth, the iron ore market strengthened with Fortescue's average revenue increasing by US$25 per tonne on the quarter to an all-time high of US$168 per tonne. That represents a realisation of 84 per cent of the Platts 62 Index.

So that represents the tenth consecutive quarter of realisations at or around 85 per cent. The consistency in realisations can also be seen on an annual basis with FY21 at 88 per cent, and that follows FY20 at 84 per cent and 81 per cent for FY19.

Quite rightly there's a lot of attention paid to the price relative to the index, but I just want to focus for a moment on the dollar value of revenue received, because cash margins are ultimately a function of revenue minus cost. Putting revenue of US$168 per tonne into perspective, this is more than double the average revenue we received of US$81 per tonne in Q4 this time last year.

Moving on to costs. Our Aussie dollar C1 spend increased quarter on quarter in line with shipments, with the C1 cost in US dollars up two per cent to US$15.23 per tonne. This is due to the impact of Eliwana ramping up and that was offset by increased volumes and also our continued focus on cost management.

C1 cost for the full year of US$13.93 per tonne was in line with our guidance of US$13.50 to US$14.00, and our total Aussie dollar costs for the year were about flat year on year, while shipments as we mentioned were two per cent higher.

The majority of our operating cost base is incurred in Australian dollars and in Aussie:US dollar exchange rate averaged $0.75 for FY21, and that compared to $0.67 in FY20, so it's a 17 per cent increase.

C1 cost guidance for FY22 is US$15.00 - US$15.50 per tonne at an assumed Aussie:US dollar rate of $0.75 and that's similar to the cost performance that we delivered in the June quarter.

We remain focused on delivering productivity gains through innovation and technology to mitigate both mine plan cost escalation and general economic cost inflation.

We also have the additional cost base of Eliwana, and our guidance is subject to restrictions and any other potential COVID-19 related disruptions and the usual forex and market driven assumptions. On that and our cost sensitivity, a $0.01 movement in the Aussie:US dollar exchange rate impacts our US C1 cost by about US$0.15 per tonne. Previously we indicated that that was around US$0.13, and the increase reflects a modest increase in our A$ cost base.

Moving to the balance sheet, and the cash balance at 30 June 2021 was US$6.9 billion, and that reflected strong free cashflow generation. We ended the quarter with an additional US$3.3 billion of cash on hand. That's after investing US$835 million in capital expenditure and also completing the bond repurchase program.

So, on completion of that bond redemption process, gross debt was then down to US$4.3 billion at 30 June 2021, and that compared to US$4.6 billion at 31 March 2021.

Just a reminder the refinancing activity included a 10 year, US$1.5 billion note issue that moved our earliest debt maturity out to 2024 and also lowered our average cost of capital. Just to note, there will be a pre-tax early redemption premium and costs of about US$80 million and that will go into the profit and loss statement.

This follows our track record of proactively managing our debt maturity profile, our disciplined approach to capital allocation and balance sheet management. We've also highlighted in our disclosure today that the FY21 final tax instalment payment of approximately US$1 billion is due and will be paid in December, later this year.

So, our balance sheet and cash on hand positions Fortescue with strength moving into FY22 to enable us to reinvest back in the core business, invest in growth through Iron Bridge and FFI, together with delivering on our commitment to shareholder returns.

So, moving to capex, FY21 capital expenditure of US$3.6 billion was right in the middle of our revised guidance of US$3.5 billion to US$3.7 billion. That included a combined investment of US$2 billion in major projects, being Eliwana, Iron Bridge and the Pilbara Energy Connect project.

Turning to FY22, capital expenditure guidance excluding FFI is US$2.8 billion to US$3.2 billion. So just to provide a little bit of additional breakdown on the categories.

With regard to sustaining capital, that steps up due to the fleet maintenance and asset replacement cycle of both engines and equipment, an increase in resource definition drilling and also mine plan-led dewatering activity.

That increase in sustaining capital also reflects the incremental production where we've shipped at an average rate of over 170 million tonnes per annum since FY15. As a reminder, that's from a system that was designed with an initial installed capacity of 155 million tonnes. So we're seeing life cycle maintenance, resource definition drilling and dewatering costs increase with volume and these are not always spread evenly over the life of mine.

In FY22, our small hub development capital is relatively consistent with FY21. And that includes the completion of the Queens development and also opening up of new mining areas in the Chichester's.

On what we call operations development capital, and as a reminder, the purpose of this category is to provide a fast payback and high return on investment, and these projects are discretionary and generally opportunistic depending on the market cycle, providing a return through either a combination of increased production, revenue enhancement or a reduction or mitigation of cost.

Examples include the investment we've made in rolling stock to support incremental systems capacity, also conveyers and autonomy to mitigate costs.

FY22 major projects capex is a range of US$1.1 billion to US$1.4 billion, of which Fortescue's share of Iron Bridge is up to US$1.1 billion and the balance being the Pilbara Energy Connect project.

We have also provided an update on the ownership structure of Iron Bridge. Of course you're aware that Iron Bridge is a joint venture, where our JV participant company was previously owned 88 per cent by Fortescue and 12 per cent by Baosteel. We've advised that Fortescue now controls 100 per cent of this company as at 30 June 2021.

So what that simply means is that Fortescue now owns a direct 69 per cent of the Iron Bridge Joint Venture. Previously that was 61 per cent and noting that all of our capital guidance has historically been based on the total 69 per cent share.

On capital allocation, you will recall that earlier in the year Fortescue's capital allocation framework was updated to allocate 10 per cent of net profit after tax to FFI. FFI expenditure funded by that allocation in FY21 was a total US$120 million across operating and capital expenditure. We've also provided some details of FFI's expected investment in FY22 in our disclosure.

Our commitment to capital returns is unchanged, with our stated intent to target the top end of our dividend policy to pay out 50 per cent to 80 per cent for full year net profit after tax. Our track record is reflected in the actual full year dividend payouts from FY19 and FY20 which were 78 per cent and 77 per cent respectively, and also the FY21 interim dividend which was exactly 80 per cent.

So in closing, delivering consistent predictable performance and being transparent by doing what we say we're going to do is a really important choice, focusing on the things that we can control and delivering value to all of our stakeholders. We look forward to updating you on the full set of financial results and the relevant detailed disclosures at the end of August and on that note Elizabeth, back to you.

Elizabeth Gaines: Thanks Ian and just turning to an update now on Fortescue Future Industries. FFI is taking a global leadership position in the green energy and green products industry by harnessing the world's renewable energy resources to produce green electricity, green hydrogen, green ammonia, and other green industrial products. FFI's vision is to make renewable green hydrogen the most globally traded seaborne energy commodity in the world.

As a key enabler of Fortescue's decarbonisation strategy, FFI has made significant progress on its 30 June 2021 stretch targets during the quarter, and that included the successful combustion of ammonia in a locomotive, the testing of battery cells for use on Fortescue haul trucks, as well as design and construction of a hydrogen-powered haul truck. The finalisation of design work for the next-generation ore carrier that will consume renewable green ammonia, the completion of design and construction for a hydrogen-powered drill rig, and the successful production of high-purity green iron from Fortescue's ores at a low temperature.

FFI continues to progress a global portfolio of renewable green energy projects and decarbonisation technologies, with FY22 expenditure anticipated to be US$400 million to US$600 million across operating and capital expenditure. The key areas of activity will include green fleet development and decarbonisation technologies as well as studies and asset identification across Australia and the globe. This includes studies expenditure for the Bell Bay project in Tasmania which remains subject to a final investment decision.

In closing, building on a second consecutive year of record performance, our FY22 guidance reflects our ongoing commitment to optimising returns from our integrated operations and marketing strategy with iron ore shipments in the range of 180 million to 185 million tonnes, C1 costs in the range of US$15.00 to US$15.50 a wet metric tonne, and capital expenditure excluding FFI in the range of US$2.8 billion to US$3.2 billion.

I've said it before, I'll say it again, Fortescue has never been in better shape. We have a strong balance sheet, a very clear focus to reinvest in the business with an eye on the future, and delivering enhanced shareholder returns, all while tackling climate change, which is the most pressing issue facing our generation.

As always, I'd like to pass on my sincere thanks to all of our employees, our contractors, and suppliers for their contributions during this quarter and the year. We continue to work through some uncertain times and I know that by keeping our culture and values at the centre of everything we do, we will continue to ensure that Fortescue is strongly positioned for the future.

Thank you. I'll now hand back to Rachel to facilitate Q&A. Rachel.

Operator: Thank you. If you wish to ask a question, please press star 1 on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star 2. If you are on a speakerphone please pick up the handset to ask your question. As a reminder, we ask you to please limit to two questions per participant.

Your first question comes from Rahul Anand from Morgan Stanley. Please go ahead.

Rahul Anand (Morgan Stanley): Hi, Elizabeth and team. Thanks for the opportunity. Two questions from me. The first one is on FFI, the US$300 million to US$400 million of opex. I just wanted to compare this to the March expenditure estimate of US$90 million to US$100 million. Perhaps if you can help me understand where this additional opex is directed and what capabilities you're adding through this spend in FY22. That's the first one.

The second one is related to the sustaining capex, the US$1.6 billion number today a bit higher than last year which sat at about US$1 billion. Obviously, it includes the hub and operational development just like last year. Could you help us understand the drivers here and also, is this the new base case going forward? Also, if it is the new base case then with Nyidinghu in the future that needs to come on, that spend would still be additional to this extra sustaining capex. Am I right in saying that. Thanks.

Elizabeth Gaines: Thanks, Rahul. Actually, we'll start with the second question first. I'll hand over to Ian just to provide that update on sustaining capex. Ian.

Ian Wells: Yes. In terms of the increase is largely in the purely sustaining capital, Rahul, where we've called out the asset maintenance cycle and so forth. Importantly, by breaking sustaining, hub and operational out, the hub development or the smaller hub development are really around a couple of years, so they'll get us through until the next major development which is - we've talked about Nyidinghu and we've talked about an FID out in FY2025 or halfway through the decade.

With regards to operational development capital, it's really important to understand that that is opportunistic and market-driven, so that can be turned on or turned off. Sometimes they're one-to-two-year-type programs. So, the extent to which we're in a low iron ore price environment to low cash flows, it's unlikely that we'd be doing those projects.

Sustaining capital steps up because, as I say, the asset lifecycle replacement, which is more than likely going to be consistent for the next couple of years, but by FY25 of course we're now 10 to 12 years post-T155, so that's where we'll be looking to replace HME equipment and so forth. That also importantly lines up with our decarbonisation initiatives and to be emissions-free in 2030 means that we need emissions-free technology for our HME fleet.

Elizabeth Gaines: I think on FFI, Rahul, we've previously guided, it was US$80 million to US$100 million and that was for FY21. What we're seeing is a rapid acceleration in the transition to renewable energy. We are at the forefront of that, we've got a clear pathway envisioned, and for Fortescue to decarbonise and achieve our very ambitious target to be carbon neutral by 2030 we have to continue to invest in green fleet development. That's going to be an important part of that opex.

Not all of this can be capitalised at this point in time so studies work for example can't yet be capitalised but we are ramping up. We've got a great portfolio globally of opportunities. We're increasing our investment in the studies internationally as well as continuing studies here in Australia. So, it's across all of the various areas we've called out before but really, what we're actually seeing is this rapid acceleration. We are at the forefront and we have that clear vision, so we are definitely on the right path.

Operator: Thank you. Your next question comes from James Redfern from Bank of America. Please go ahead.

James Redfern (Bank of America): Hi, Elizabeth and Ian. I just want to circle back to that question on sustaining capex. It's $6 a tonne in FY22 compared to $3 to $4 a tonne historically. I just want to confirm whether we should assume that circa $6 a tonne sustaining capex rate going forward in light of the comments. I just want to be really clear on that, please.

Ian Wells: Well, I think you've got to take into consideration the asset lifecycle the $3 to $4 a tonne when we spent the best part of $10 billion through the T155 program, sustaining capital versus depreciation has been lower than depreciation for a number of years. So, over the life cycle if we get close to that sustaining capital, depreciation, which is closer to US$1.4 billion. For the time being, around that level we think is about right. We obviously work hard to sweat our assets and get the best value for money from all of our investments and I think the point that we're flagging today, is that the fleet replacement program is probably the biggest sustaining-type capital investment, and we are specifically calling out the smaller hub but then also the next major hub, as we've been flagging for some time now, is in the second part of this decade.

James Redfern (Bank of America): Okay, thank you. Second question, if I can, please, which is maybe some comments or thoughts around how you're seeing iron ore demand and Chinese steel production in the second half of this year, just following on from the very strong first half. How are you thinking about the second half, please?

Elizabeth Gaines: Thanks, James. I think the first half is an interesting comparison because that is comparing to a half year last year where China was in significant lockdown at the outset of the COVID pandemic. So yes, 11.8 per cent is a significant increase year-on-year but that is somewhat flattered by the fact that last year was a more subdued operating environment. Our view is that there will be some seasonality in this, as we get towards the northern hemisphere winter we will some slowdown in production and that's a usual pattern that we see.

We're seeing at the moment some uncertainty obviously with weather events, whether that's flooding or typhoon that has just recently passed over Shanghai in particular. There's a number of different factors that are impacting that. Overall this year we would still anticipate that crude steel production will still be up year-on-year. I'm not sure it's going to be sustained at 11.8 per cent rate; as I said, that's flattered a bit by the first half of last year being fairly subdued, but we do anticipate strong ongoing demand and that there will be an increase in crude steel production.

Obviously, there is some uncertainty at the moment about government restrictions, but it's not really clear whether those restrictions are on production, on capacity, or on sinter production. There's lots of speculation but we're staying very close to our customers, we're delivering under our long-term contracts and we're not seeing any change to behaviour under the terms of those contracts.

Operator: Thank you. Your next question is from Lyndon Fagan from JP Morgan. Please go ahead.

Lyndon Fagan (JP Morgan): Thanks very much. First question is just on FFI. It looks like you'll be spending the best part of US$1 billion over the next few years, but we're a bit light on in terms of details around the projects. I'm just wondering how you would recommend shareholders value FFI at this stage.

Then the next question is just on Nyidinghu. Can you maybe give us a refresher on the scope? Is it around the 40 million tonne type level, and the timing for construction starting, I think you mentioned FID in 2025 but just wanted to make sure we've got the right sort of numbers in the model for that. Thanks.

Elizabeth Gaines: Thanks, Lyndon. On FFI, in terms of how you value that at the moment, clearly we are very committed to decarbonisation. We think that that is an important part of our profile moving forward and that there's absolute value in the decarbonisation and technologies that we're investing in. There's a lot of value that's already been created. I appreciate that that is difficult from a straight valuation perspective but we've amassed a global portfolio of opportunities, the team are undertaking studies.

We have a clear goal to invest in decarbonisation and we also have a view that hydrogen will become the most globally traded commodity in the world. We are making significant investment in those technologies, there is absolute value there, we're on the right pathway. Some of this technology at this stage is more research and development but we are creating significant value both in the technology, the intellectual property, and also our plans for developing a significant export market. Just think about the work we've already done on locomotives, on haul trucks, on ships. These are going to be significant in terms of contribution to the growing markets, and we are seeing demand.

We're talking to customers globally. The market is developing, there are customers there, there is demand and we are creating significant value. We're on the right pathway. We absolutely have created significant value already. We will be investing because the only way that we're going to decarbonise our operations is to continue to invest, and we're also at the cusp of the next development of a major export cycle and export opportunity. So, there's value being created but obviously as projects are approved, that's when we'll be able to give greater clarity around those projects, the investment parameters of those projects, and our anticipated return from those projects.

Ian, did you want to touch on Nyidinghu?

Ian Wells: Yes, sure. Lyndon, I think the best way to think about Nyidinghu, is it's probably 30 million to 40 million tonnes scale and similar to the Firetail replacement and the Eliwana project because they'll more than likely be not only mine and processing infrastructure but also we've talked about an infrastructure solution, so therefore you need the economies of scale to make the economics work. That's the sort of order of magnitude. Obviously, it's hard to be absolutely precise on timing and also cost because market conditions will dictate, but that's the way to think about it at this point in time.

Operator: Thank you. Your next question comes from Paul Young from Goldman Sachs. Please go ahead.

Paul Young (Goldman Sachs): Hi, Elizabeth, Ian, and team. First question is on production and Eliwana. There's good creep coming through the system based on the FY22 guidance. Can I ask, does FY22 shipments guidance include Eliwana 100 per cent ramped up? Then also your product mix has changed a little bit from FY21 to FY20 but not a lot. Can we expect the product mix to change at all in FY22?

Elizabeth Gaines: Hi, Paul. In terms of Eliwana, they've achieved annualised ramp-up rate in July this month. So, largely for FY22, given it's July, we're going to see that full contribution from Eliwana. It's been a very successful ramp-up I have to say. We indicated maybe six to eight months and they've certainly managed to achieve that. So, that's been a real success. Eliwana, as you said, has contributed to our performance.

We've invested in additional rail fleet, that's contributed to a record June quarter, so we have seen the benefits of that investment. Actually, in this current market environment the payback period on Eliwana is very short. It will pay back itself very quickly, so the right decision to make in terms of sustaining our business but also a fast payback, so it's been a very successful investment.

In terms of our product mix, it will be largely consistent with FY21, no major changes to product mix. Volumes of West Pilbara Fines will be at around the same level at FY21, so yes, we're going to see a pretty consistent product mix.

Paul Young (Goldman Sachs): Thanks, Elizabeth. Can I ask a second question on FFI and the US$400 million to US$600 million guidance on spend. I know money doesn't go far these days but how do you actually spend circa US$500 million on R&D on decarbonisation?

Elizabeth Gaines: Well, it's not all R&D. About 25 per cent of that is on green fleet, which is important, as I said, to Fortescue's decarbonisation. Not only important to our decarbonisation but creates incredible value that can actually be commercialised globally. When we think about shipping, for example, and the demand that that would create for green ammonia. It's about 25 per cent on that green fleet development, around 25 per cent on international studies, so there's a significant investment in international studies because we've got a sizable portfolio of opportunities.

The demand is growing; we're seeing a huge acceleration of demand. We're talking to customers and we've got to meet that demand, so the international studies work. We're also seeing capital investment as well, and that capital will be on some of those technologies that we're exploring, as well as our operating costs and some of the other Australian studies as well. That's a broad overview. It's not just 25 per cent on decarbonisation; in fact, the vast majority of it is actually on creating the significant export market that will be developed as this demand for green hydrogen is gathering pace and we're at the forefront of that.

Paul Young (Goldman Sachs): Great. Just to confirm, Elizabeth, it doesn't include Bell Bay project capex?

Elizabeth Gaines: That's correct. It includes the studies work; it doesn't include the capex, which will be subject to a final investment decision.

Operator: Thank you. Your next question is from Kaan Peker from Royal Bank of Canada. Please go ahead.

Kaan Peker (Royal Bank of Canada): Good morning, Elizabeth and your team. Just two questions from me. The first one is on product mix. Someone had a similar question before. It does look like other products sold increase to about 8 per cent of the product mix and the sales mix. Maybe can you talk about what's driving that? Is this due to the Eliwana ramp-up? Also, there seemed to be a couple of new products in the market from FMG P2 and Chichesters product. Can you please talk about that? I'll circle back with the second question.

Elizabeth Gaines: Okay. Other products were 5 per cent of our overall shipments in FY21. It's not particularly material, and the majority of our products are under long-term contracts, so we're delivering our product mix of our well-known products to our customers and have been for a long time. That 5 per cent comprises three products. Now, we weren't immune to the weather impacts that everybody felt across the Pilbara.

We had significant rainfall, pretty much unprecedented rainfall, and that had an impact particularly on our mining operations, but because we are agile and responsive, we saw a very strong demand so we're able to draw down on existing inventory to meet that demand, which resulted in a couple of other products, but they are not material to the overall product mix and aren't a major feature of our long-term contracts with our customers. But we are responsive to the market and we're agile.

Kaan Peker (Royal Bank of Canada): Thanks. The second one is on Iron Bridge. It does sound like they were directed to forego their equity stake in Iron Bridge. I'm just wondering how much additional capex is included in FMG's equity state and does it include any deferred contributions from capital spend by Formosa to fund Iron Bridge stage 1, the pilot and demonstration component. Was there any offtakes included for Baosteel with Iron Bridge? Thanks.

Elizabeth Gaines: Yes. Ian, you start and then I'll round it out.

Ian Wells: High possession count today for Kaan. With respect to all of our capital numbers for Iron Bridge, Kaan, they've always been based on the basis of the full 69 per cent. Baosteel has been progressively diluting and we've specifically called this out and discussed this I think at least two if not three quarters. Obviously, they had a 12 per cent interest in the company. As part of that they didn't have offtake rights, unlike we had offtake rights. The deferred contribution that Formosa had made, they were completed this year. So, this year if you look at the Iron Bridge 100 per cent capex, we were disproportionate to that 69 per cent, so the deferred contribution has now been unwound and as you go forward it's a pretty simple 69 per cent to 31 per cent.

Elizabeth Gaines: I think just to add to that, Baosteel entered into that shareholders' agreement over a decade ago. We've been in discussions with them for some time. It's certainly not connected to the recent project review and they do remain a key customer of Fortescue and they're very supportive of our high grade magnetite product. I can't speak for their strategic decision to exit but we're certainly delighted to now have 69 per cent of the joint venture and as Ian mentioned, all of our capital estimates have been based on that assumption of 69 per cent.

Operator: Thank you. Your next question is from Peter O'Connor from Shaw and Partners. Please, go ahead.

Peter O'Connor (Shaw and Partners): Hi Elizabeth, Ian. Two questions. Firstly, costs with trend over the last two quarters. I guess the word, alarmingly high, may be over stating it but the trend, how structural and how cyclical is that? Separate to that, freight rates. How are they driving the change in realisation year-on-year and quarter-on-quarter basis?

Then if you could just touch on the realisation trend. What's driving that lower over the last two quarters and how cyclical/versus structural that is?

Elizabeth Gaines: Thanks, Peter. Maybe we'll start with the cost trends. I mean, we were in line with guidance. So I think we've managed our costs very well for a long period of time now and obviously we've seen Eliwana come into production but we flagged for some time that our cost base would increase.

The benefit we've seen is additional volumes that we've talked about. So the fact that we're able to have a record quarter with another two million tonnes on top of the same quarter last year, Eliwana's been a big contributor to that but there's clearly costs that we're incurring as we operate Eliwana.

Currency has been a big impact as well. Over the year-on-year from FY20 to FY21, we saw a 17 per cent appreciation in the Australian dollar so that had nearly a dollar per tonne impact on our full year C1 cost. So there are external factors, things that we can control and actually, the fact that our Aussie dollar expenditure year-on-year was about the same as Ian mentioned earlier. So it was a pretty flat year-on-year in terms of Aussie dollars.

We've got, obviously Eliwana for a full year in FY22 but we've also got the benefit, as you've seen, of our guidance on shipment so we continue the trend. So we manage our costs very well.

We're very focussed on mitigating cost inflation. we are seeing in some key skills, we're seeing some labour rates increase. It's not across the board but we are seeing it in some key skills and trades. We're meeting the market to make sure we don't have any disruption to our operations.

We don't have the same exposure to shortage of truck drivers, for example, because we've gone down the path of autonomy, all of which has contributed to keeping our costs low. So we haven't waivered in any way, shape or form from being the lowest cost producer and keeping our costs low but we've seen a fuel price increase, the Aussie dollar's stronger. We're seeing some of the consumables, like ammonium nitrate is higher as well. So those are the factors that we continue to mitigate and manage. In terms of freight rates, do you want to touch on that, Ian?

Ian Wells: Yes, freight rates, Peter, I think the best way to think about that is that so long as the recovery of the freight rates are reflected in the CFR price, then you should have a one-to-one. So your realisation, effectively should be 100 per cent of that.

We also have our ore carriers so that's the cost of capital is below the line. So effectively, you get a slight benefit for that. So we generally don't see a disconnect because in the most part, our contracted freight rates match the market and if anything, the team do slightly better than the average market rate. So I guess the question is more, have freight rates disconnected from the CFR price? Which is a separate question.

With respect to the realisation trend, we have seen realisations that were a bit lower in the previous quarter and lower in the current market based on spot prices and that's part of the cyclical nature of the market. We're sort of pointing back to the fact that our realised price over 10 quarters now, with a similar product mix, has been through those various cycles.

So we've been in this cycle before. It's in the most part, it's driven by the supply and demand dynamic on lower grade product. Partly because of the Chinese policy and curtailment, which we have seen in these types of circumstances before, over that period.

Elizabeth Gaines: On spot prices, based on the current 62 Index, the average revenue received would still be higher than the whole of FY21, which was at US$135 per tonne.

Peter O'Connor (Shaw and Partners): Was there any particular segment of your sales mix that was driving that edging lower in that cyclical nature? Or was it across the board, you were getting the so-called lower realisation?

Elizabeth Gaines: Well, I think we've seen that across the board and also with competitor products as well. This is not confined to Fortescue products. I mean, port inventories in China remain relatively steady. They're about 128 million tonnes. Lower grade material makes up about 43 per cent of that but Fortescue's been pretty consistent. We're about 11 per cent or 12 per cent of those port inventories. That's been consistent.

So there's constraints, supply of high-grade, there's been a build-up of low-grade materials. Some of that coming from India. We're not seeing any particular changes or trends and we're certainly seeing strong demand from our customers but it is a dynamic market. There's no doubt about it but as I said, at spot prices, we would still be getting an average revenue that is higher than the whole of FY21.

Operator: Thank you. Your next question comes from Robert Stein from CLSA. Please, go ahead.

Robert Stein (CLSA): Thank you for the opportunity. A quick question on FFI and exploration and portfolio. So if you look at the, I guess the step up in spend. It's obviously in relation to how quickly you're progressing the FFI initiatives.

However, if I look at activities elsewhere in the sector, we're seeing a lot of competition in terms of battery raw materials and acquisitions for pure resources there. One of your competitors bidding on Noront and obviously having the Chairman bidding on that as well.

I'm just curious why those opportunities aren't being executed within Fortescue where the capability is more adjacent to what your current capabilities are as a miner and a good cost controller?

Elizabeth Gaines: I can't comment on the Chairman's business interests but I know he has a lot of capabilities within his own private company. So I wouldn't discard the capabilities of Wyloo.

But look, we are active largely through exploration. We continue to drill for copper, gold. We've been saying that for some time. Some of our activities were impacted by COVID last year, particularly in Ecuador but we're continuing our focus on that.

We look at potential other more advanced transactions from time to time but there's some key fundamentals around scale. That's when you look at the size and scale of our business. So we always look to have a certain size or place in the market, be a low cost producer, routes to market. So scale is one aspect that's important to us as well.

But we've got exploration activities under way as I mentioned, in Argentina, Ecuador, Kazakhstan and in South Australia. So we've got quite a significant portfolio, and Western Australia, as well as our iron ore exploration. So a significant part of our exploration budget is actually attributed to iron ore because we continue to drill on our tenements in the Pilbara and that is an important part of our overall exploration activities.

But I think yes, you can look at the materials that support decarbonisation, I think we're far more advanced and taking a bigger step in terms of, this is going to be a significant export market. There will be demand for green hydrogen and green ammonia and other renewable energy.

So we're actually looking at the development of a significant export market. Demand globally, this is not contained to Asia Pacific, this is going to be a global market and we're actually putting, as you rightly pointed out, a lot of our investment into the development of that export opportunity as well as our own decarbonisation. So I think they're all complementary.

Operator: Thank you. Your next question comes from Hayden Bairstow from Macquarie. Please, go ahead.

Hayden Bairstow (Macquarie): Yes, thanks, Elizabeth. Just a couple from me. On FFI, I just want to confirm that the 10 per cent allocation that we assumed going forward, do we have to roll some of that back through the P&L as opposed to just assuming it's all capitalised? Is that the best way to think about it?

Also, on the market itself, I mean, a great quarter on price realisations but we're seeing some pretty aggressive moves through July. Are you seeing the same thing for your prices? Are you getting better realisations than what some of the spot discounts would imply? Thanks.

Elizabeth Gaines: Do you want to comment on FFI, Ian?

Ian Wells: Yes, the capital allocation, Hayden, is effectively the equity contribution into the entity. So that's one stage but in terms of thinking about the P&L for FY20, we've called out US$120 million. US$100 million goes through the P&L, US$20 million goes to capital. Then we've split the same, on the same basis for FY22.

So, the total capital funded, effectively, by the equity contribution is going to be US$400 million to US$600 million, of which US$300 million to US$400 million goes through the P&L and US$100 million to US$200 million will be on the balance sheet and through capital expenditure. So sort of two different things. One is the allocation of equity, second is the funding of that allocation. So as you say, you roll forward, which some of the allocation from FY21 has been spent.

Elizabeth Gaines: On price realisations, I mean clearly, yes, there's been a bit of market volatility in July. Some of that's associated with this bit of uncertainty around curtailments, for example. The team are staying very close to our customers. We set our pricing on a monthly basis but we have the benefit of Fortescue Trading Shanghai, which gives us good visibility over what's happening on the ground in the markets as well.

So we're staying close, we've set our pricing accordingly and we're monitoring those price realisations but as I said earlier, Hayden, even based on the current spot prices, taken from published prices, we'd still be generating significant average revenue per tonne.

Operator: Thank you. Your next question comes from Paul McTaggart from Citi Group. Please, go ahead.

Paul McTaggart (Citi Group): Good afternoon, all. So I just wanted to follow up, back on the sustaining capital. So you called out that the trend is going to go up, there's mine plan inflation etc. You're spending some of that money.

How should we think about this in the long run? If I include replacing hubs, mining hubs, etc, include that as sustaining. The number that's required to sustain our output at circa 180 million tonne per annum, what would be that dollar per tonne number? Can you put a number to that?

Elizabeth Gaines: Yes, I think major hub developments are hard to call out. That's going to be a function of the market conditions at that point in time.

Ian Wells: I think I would come back to the point of the accounting depreciation is a reflection of the use of the assets. When you look at that as a proxy, it's a good proxy. Otherwise we would have actually got the accounting depreciation wrong. It doesn't necessarily flow that way, but the point I made earlier of you do a major expansion, you don't have to reinvest at that rate in the early years and over time, it increases.

That's exactly what's happened with us except that we've probably done it in a more innovative way and what we've done is to call out some of the key lumpy parts, which is the fleet replacement. The operations development as I said in my script, that is opportunistic in relation to market conditions.

So if you have a very low iron ore price into the future, clearly there won't be the same level of free cash flow so therefore you'd need to back that out. Then, in terms of the smaller hub, as I said, probably around the same level for a couple of years and then the next lumpy part is Nyidinghu which we've been speaking about and identifying for quite some time.

So it's not as simple as saying here's the number because the timing of the cashflow is important but they're the types of things that we think through in terms of our capital allocation. I guess it's hard for us to answer your question specifically because it depends.

Paul McTaggart (Citi Group): Okay but you reckon broadly that sort of depreciation number divided by the annual tonnage is going to be somewhere in the ballpark?

Ian Wells: Yes, that's right. Exactly right and then the rest, if you think about ops development, you put that in because you're going to either increase revenue or reduce costs. So if you don't put it in, then you'll have the exact same assumptions of cost escalation and so forth but if you add it in to perpetuity, you've got to add the returns as well. That's why we've structed it that way. Yes.

Operator: Thank you. Your next question comes from Saul Kavonic from Credit Suisse. Please, go ahead.

Saul Kavonic (Credit Suisse): Thanks, folks. Just one quick question. On the operational development capex and I guess we can also lump the, something like the green fleet developments from the FFI spend in there. All this is there to, you say discretionary to help reduce opex and so on. Can you give an indication of if this kind of spend is actually likely to move the needle from an opex base and if so, when?

Elizabeth Gaines: Well, I think it's all part of maintaining our low cost position. Green fleet development, that'll be in line with our next major fleet purchase program and absolutely, we want that to be lower cost than our current fleet but we're not actually looking to - in our current schedules, those major fleet renewals will be happening around FY25, FY26.

So that would be aligned with our next major investment cycle and that is designed to get our costs even lower. In terms of operational development, that's largely to offset otherwise increasing costs. So adding a conveyor, for example, as opposed to additional capital on fleet and the cost of operating that fleet. This is about mitigating what would otherwise be a bigger increase in capital or a bigger increase in costs. So that's a mitigation exercise.

Ian Wells: Yes, I would say the operations development capital does move the needle because it's fast payback, for example, autonomy. Has autonomy moved the needle in this business? Absolutely, it's moved the needle. The conveyer technologies that we put in place, the other more industrial autonomy that we put in place, absolutely it's moved the needle.

Has it moved the needle by being able to contribute billions of dollars of value? I think if you actually took a step back and went through it, it probably has because you look at our cost profile over the last five years, we've been around the US$13 per tonne, the US dollar has moved through that but we've been consistently mitigating a combination of economic and mine plan inflation for a long period of time.

It's just it's starting to show now because you've got five years of compound annual growth, probably, of both economic and mine plan inflation, which we've consistently been able to mitigate through innovation and some of it, specifically in this ops development category.

Operator: Thank you. Your next question comes from Brenton Saunders from Pendal Group. Please, go ahead.

Brenton Saunders (Pendal Group): Good afternoon. Elizabeth, just observing how everybody is tip toeing around the issue of the FFI capital allocation and where it's actually going, my observation as a shareholder both for myself and for other people is that it sounds like an expense to me. You know, I think decarbonisation is a process, not an investment case or a business case.

I honestly think you owe it to shareholders to properly articulate what those projects are and what the business case around them because otherwise, the market's just going to continue to assume it's an expense. I'd have to say that to date, the communication around what is now a substantial capital allocation within the context of Fortescue, maybe not a US$200 a tonne iron ore but at US$80 a tonne iron ore, it would be very material.

You owe it to shareholders to properly articulate the business cases around these and not as second and third derivative explanations to develop global markets in hydrogen because for every expert I hear - I speak to, that tells me hydrogen's going to work, I speak to one that tells me it's not.

So I think it's still up in the air. It's not a dead certainty and I'd have to say, in future communications, you owe it to shareholders to properly articulate the businesses cases around this capital allocation. Otherwise we will all just continue to assume that it's an expense and not an investment.

Elizabeth Gaines: I take that feedback on board, Brenton. I guess at this stage, it is an expense because under the accounting rules, we can't capitalise some of the work that we're undertaking but I can assure you that all the work that's under way is about creating value and ultimately creating capital investment that will deliver significant value to Fortescue.

Look, the investment we're making in green fleet development, for example, that's an important part of our decarbonisation. We are not going to achieve decarbonisation without actually investing in the green fleet development.

Waiting for the OEMs to come up with that - with the green fleet of the future, I mean, they're just not getting there. So we are making substantial in-roads into our own decarbonation initiatives, which I personally think is a really positive contribution.

We're also investing, obviously, in renewable energy across the Pilbara, through our Pilbara Energy Connect project for example, which will contribute to lowering emissions and to also reducing costs. So low-cost energy. There's opportunities to expand that across the rest of our operations because that's largely to support the energy we need for Iron Bridge.

But take that on board, we know that there's a lot of work underway, we are creating significant value. It's an expenditure at the moment because we actually under accounting laws can't capitalise it but we are focussed on projects that are going to create significant opportunities in the future and there is a view there. There are always different views but there's a view that the green economy will be a $12 trillion industry in the coming decades.

So as you can say, you can always find someone to be the cheerleader for that and others to be the detractor but there is definitely a firming and emerging view that this will be a significant industry and a significant market.

Brenton Saunders (Pendal Group): Be that as it may, I do not accept the notion that there has been value created because you haven't articulated to us and the market isn't pricing it. I just re-emphasise, decarbonisation as you're describing it is a process, not an investment.

Until you can describe the business case around what you're doing and what you're allocating substantial capital to, it will continue to be an expense. So, I'll take that on notice, because I honestly believe you owe all shareholders a properly articulated explanation for the projects and the details around where those investments are being made. I'm not seeing it right now.

Elizabeth Gaines: Okay, all right, take that on board, Brenton.

Operator: Thank you. Your next question is a follow-up from Lyndon Fagan from JP Morgan. Please go ahead.

Lyndon Fagan (JP Morgan): Thanks a lot. Yes, I was going to ask a bit more on FFI, too. I was hoping you could tell us what the headcount is within FFI? I thought it was somewhere around 200 people, but given the spend, it feels like it may have grown a bit. So, it would just be good to understand how many people Fortescue have got working on all these initiatives.

Then I guess, further to Brenton's question, are you able to tell us the top three projects at least? So, we know the Bell Bay project, but what would be the next ones? I mean, there's been announcements on DRC hydro and other things, but what's the most likely thing to firm up near term? Thanks.

Elizabeth Gaines: Yes, look, I think, in terms of headcount, it's probably a couple of hundred in FFI. But then there's also the green fleet team, which is quite a number of people that were previously in the Fortescue business and are now focused on green fleet. So, that's about another 150. So, 350 to 400 in total. There's about 40 internationally. In terms of some of those key projects and key areas of focus, I mean, the Pilbara, right on our doorstep, is a significant focus for us. We see that as a contributor.

As Fortescue looks to decarbonise and we actually do go down the path of using alternate fuels, we're going to need a supply of those fuels. So, the Pilbara is obviously very key to that. We're looking at opportunities in Papua New Guinea, in the DRC, Indonesia and also in South America. Let's not forget that part of the value that's being created is that our goal is that our operating costs will reduce.

If you think about the future, where there may not be a diesel fuel rebate or there could be a carbon charge, this is actually a risk mitigator as well. So, we see the value that's been created is that our costs will decrease and we're mitigating against other costs imposts that might occur later this decade.

Operator: Thank you. That is all we have time for today. I'll now hand back to Ms Gaines for closing remarks.

Elizabeth Gaines: Thanks, Rachel. Thanks everybody for joining us for the quarterly. We look forward to speaking to you again in about a month's time when we produce the full year results. To those of you who are on the call from New South Wales, our thoughts are with you and let's hope you get out of lockdown as soon as you possibly can. So, take care.

Operator: Thank you. That does conclude our conference for today. Thank you for participating. You may now disconnect.

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