Fortescue

September 2021
Quarterly Production Report

Investor and Analyst Call transcript

provided by Open Briefing

28 October 2021

Company: Fortescue Metals Group Limited
Title: September 2021 Quarterly Production Report (Analyst Call)
Date: 28 October 2021
Time: 2:00pm AEDT

Start of Transcript

Operator: Thank you for standing by and welcome to the Fortescue Metals Group September 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 everyone and welcome to Fortescue's September 2021 Quarterly Production Report. Joining me today in Perth is Ian Wells, Chief Financial Officer, and Danny Goeman, Director Sales and Marketing, and I'm delighted to welcome Shakira Levi who joins us as CEO for a day. Shakira is a proud Aboriginal and Torres Strait Islander woman, with connections to the Kaurareg and Daurareb people of the Torres Strait.

She first joined Fortescue as a Site Administrator at Christmas Creek in 2012 before subsequently re-joining as a Trade Assistant in 2019, and has now secured a secondment as a Condition Monitor at the Engineering Department at Hedland Operations earlier this year.

Shakira is an active volunteer in the Port Hedland community, where she is passionate about helping people overcome barriers to employment and raising awareness of mental health, and it's great to have you with us Shakira.

Shakira Levi: Thank you Elizabeth. It's great to be here with you today.

Elizabeth Gaines: So, let me start with safety and before proceeding, I would like to take a moment to acknowledge the tragic passing of our team member David Armstrong as the result of an incident at the Solomon Hub on 30 September. The health and safety of all our team members is our highest priority and this event has been devastating for the entire Fortescue family. A fatality is a sharp reminder of why safety is our highest focus and we appreciated the show of support from across the industry. We continue to support David's family and his team at Solomon during this difficult time and we're working with authorities to investigate the incident.

Whilst it is difficult to discuss safety in the immediate aftermath of this incident, I would still like to acknowledge the performance of our team members who have maintained our Total Recordable Injury Frequency Rate of 2.0 at 30 September. Safety will remain at the heart of our culture and values and we will continue to empower everyone at Fortescue to take control and look out for their mates on our journey to zero harm.

I would also like to take this opportunity to address the matter of sexual harassment in Western Australia's mining sector. Yesterday, I was joined by our Director of Fortescue People, Linda O'farrell, and Director of Health and Safety, Rob Watson, as we appeared before the WA Parliament's Inquiry into Sexual Harassment Against Women in the FIFO Mining Industry. On behalf of the entire Fortescue family, I would like to personally apologise to any team members who may have experienced sexual harassment of any kind in our operations and we also acknowledge the experiences of the people whose stories led to the establishment of the inquiry. Sexual harassment has no place at Fortescue, in the mining sector, in any workplace or in society.

In July, we launched a Workplace Integrity Review to hear firsthand from our team members and to get their ideas for change. We have gained valuable information and we've heard about lived experiences directly from our team members through this process. We are listening to what we have been told and we are acting on it.

As a result, we are implementing a number of initiatives to enhance the safety, culture and experience of working at Fortescue, and this includes enhancing physical safety features, developing new and refreshed training and induction programs, renewing our approach to calling out behaviour that is not aligned with our values, and the introduction of a revised limit of no more than four mid-strength alcohol drinks in a 24-hour period.

As a company, we acknowledge that inappropriate behaviour still occurs and that as an organisation, we can always do more. Employers in the mining sector have demonstrated time and again that we can be leaders in the field of ensuring workplace safety, and there is no reason we cannot also be leaders in preventing workplace sexual harassment.

Moving to our operational performance for the quarter, and it was a strong start to FY22 with the Fortescue team achieving record first quarter shipments of 45.6 million tonnes, which was three per cent higher than the same period last year. Ore processed and railed also achieved record first quarter volumes, reflecting strong operational performance across mining, processing, rail and shipping, as well as the expanded system capacity following the ramp up of Eliwana.

Importantly, we maintained our industry leading C1 cost of US$15.25 a wet metric tonne during the quarter, and this is a reflection of our strong focus on cost management to mitigate inflationary pressures that are impacting the mining industry.

In line with our strong commitment to working with our Native Title partners on protecting Aboriginal heritage, we announced the establish of a co-management framework with members of the Wintawari Guruma Aboriginal Corporation during the quarter. This new collaborative framework will provide the Eastern Guruma People with the opportunity to guide the growth of Fortescue's operations on their country, while also delivering significant economic opportunities through training, employment and business development.

Ian will talk to the balance sheet, but I did want to mention our movement from net cash to a small net debt position of US$175 million at 30 September, and that reflects the payment of the FY21 final dividend of US$4.7 billion as well as capital expenditure of US$744 million in the quarter.

So, turning to an update on Iron Bridge, and the project is progressing on schedule with forecast capital investment unchanged at US$3.3 billion - US$3.5 billion. During the quarter, the team achieved a number of key milestones including the delivery and installation of the first modules on site, the installation of the first high pressure grinding roll in the tertiary crushing facility, the completion of earthworks for the tailings storage facility and the commissioning and operation of the airport. We also marked the completion of construction of the module offload facility at Lumsden Point, and on Tuesday this week, the first vessel arrived at the facility.

So, turning to exploration. Total exploration and studies capital expenditure for the first quarter was US$44 million. Iron ore exploration in the Pilbara included target and resource definition drilling in the Western Hub, Solomon Hub and Eastern Hamersley with study work progressing at Nyidinghu. Exploration activity on the Australia copper-gold portfolio included the completion of a variety of surveys and on-ground mapping and soil sampling over the Paterson and Rudall projects in WA, with a follow-up drilling program at the Arcoona Project in South Australia underway.

Internationally, a drill program at the Santa Ana project in Ecuador has been completed as well as two project areas in Kazakhstan. Exploration continues in Argentina with the seasonal drilling program to recommence this month, and on that, I'm going to hand over to Danny for an update on the market. Danny.

Danny Goeman: Thank you Elizabeth and good morning or afternoon everyone. I'm pleased to have the opportunity to share some context on the iron ore market and on Fortescue's integrated sales and marketing strategy. The market remained dynamic during the quarter, and that resulted in increased price volatility and the moderation in prices to current levels of around US$120 a tonne.

Starting in China, the market volatility has been influenced by several transient and policy-related factors, and these include a number of adverse weather events, COVID-19 related supply chain impacts, widespread power shortages, ongoing steel and sinter production curtailments, measures focused on reducing emissions and emission intensity, and macro policy developments.

This has in turn contributed to a moderation in Chinese crude steel production in the September quarter relative to levels in the first half of the calendar year. Output is now reported up by two per cent to 806 million tonnes in the nine months to September compared to the same period last year.

Steel production outside of China remains at or above pre-COVID levels, supported by strong steel demands. The recovery has been uneven, however and global steel production excluding China is reported 16 per cent higher in the nine months to September, compared to the same period last year. A coordinated focus on fiscal stimulus and increased infrastructure investment is supportive of a robust demand backdrop.

On the supply side, iron ore supply from traditional producers remains relatively constrained, particularly in the high-grade segment, with low-grade supply earlier in the year playing a part in balancing the overall market. The low-grade segment remains highly elastic with some supply now becoming marginal. Ian will discuss the price realisations achieved in the quarter, but we have been consistent in highlighting that Fortescue's realised price is an outcome of prevailing and expected market dynamics.

The value of an iron ore product, at any given point in time can be influenced by numerous factors including government policy, steel mill profitability, the cost and availability of other steelmaking raw materials, such as coking coal/coke, and the relative pricing of other substitutable iron ore products. The team remains focused on ensuring we are producing the products that our customers need and value, and that includes pricing our products competitively through the different market cycles.

To give you some colour on what this means, this is a highly dynamic process based on thorough market analysis. For instance, in the last 18 months, we have not had consecutive months where product discounts have remained unchanged. In the last quarter, we were also able to capitalise on market opportunities, whilst optimising business value. This resulted in some changes to the product mix as shown in the release.

We continue to see strong demand for all of our products with the percentage of Fortescue inventory in China ports relative to total port inventory decreasing in recent months, despite strong competition in the low-grade segment. Our sales and marketing strategy remains focused on the current and future needs of our customers and the optimisation of our supply chain. It is built on a fully integrated operations and marketing approach and an emphasis on direct customer engagement.

Our diverse range of sales channels, including our RMB portside sales team in China, also known as Fortescue Trading Shanghai, or FTS, compliments our long-term contract base load, while providing flexibility to optimise product placement to different customers and market segments. Since inception, FTS has now sold in excess of 22 million tonnes through nine ports in China.

Fortescue's marketing strategy will continue to evolve, and we remain well placed to deliver on our customers' needs and maximise the value of our product portfolio.

On that note, I will now hand over to Ian for the finance update.

Ian Wells: Thanks, Danny, and hi everyone. The September reporting period was another strong quarter for Fortescue with record production volumes, generating strong cash flows, and included paying a record dividend to shareholders. As you've heard me say many times before, our results are achieved by focusing on the things that we can control, which is safety, production and costs, together with disciplined capital allocation and management.

Kicking off on revenue, as you heard from Danny, the iron ore market experienced some headwinds during the quarter and prices did moderate. The average revenue in Q1 was US$118 a tonne and whilst acknowledging the focus on realisations, just to provide some additional context, US$118 a tonne is the fourth highest quarterly revenue Fortescue has achieved in more than seven years, and of course it's the absolute price that contributes to earnings and cash flow generation.

The US$118 a tonne represents a revenue realisation of 73 per cent of the average Platts 62 Index in the quarter. Average revenue includes the mark-to-market pricing impact of open tonnes, which was a downward adjustment in Q1. That's because the price dropped in the quarter from US$218 a tonne at 30 June to US$118 a tonne at 30 September, and the quarterly average was US$163 a tonne. The contractual realisation, so that's what was achieved under the commercial terms that we've agreed with the customers, was 77 per cent for the quarter.

We've consistently indicated that revenue realisations are cyclical and a result of the market supply-demand dynamics, and we would highlight that our historical quarterly average realisation on a three-year rolling basis is 84 per cent, and since 2012 is 82 per cent. This history doesn't fully reflect our integrated operations and marketing strategy, including the improved product mix and also the introduction of West Pilbara Fines in FY19, or the future benefits of the high-grade Iron Bridge magnetite concentrate.

Now moving to costs, our Aussie dollar total C1 spend decreased quarter-on-quarter, and that was aligned with lower volumes, and our disciplined cost management more than offset wage and fuel cost escalation. In US dollar terms, the C1 cost of US$15.25 was in line with the June quarter and 20 per cent higher than the previous corresponding quarter, and we've listed several contributing factors in our disclosures explaining that year-on-year increase.

Just to reiterate those including appreciation in the Aussie dollar from 71.5 cents this time last year to 73.5 cents in the quarter. Consistent with what others are seeing in the market, price escalation of key input costs, including diesel and labour rates, also reflects the cost base of Eliwana through the integration of a new mining hub and we've been pretty consistent in flagging that through the course of last year, and as part of our FY22 guidance, and of course, life-of-mine plan driven cost escalation.

Cost discipline and productivity gains remain a focus, and so our FY22 C1 cost guidance is unchanged at a range of US$15.00 to US$15.50 and just a reminder, that's at US$0.75 FX, and that maintains our industry-leading cost position.

Moving to cash, we continue to invest back in the business, invest in growth, generate strong free cash flow, and in the quarter, as I said, included the payment of a record dividend to shareholders. Closing cash on hand was US$4.1 billion at 30 September and that was after the payment of US$4.7 billion for that final dividend and just under US$750 million of capital expenditure in the quarter.

On the cash movement for the quarter, there was a reduction in working capital through an increase in provisions and payables, and we expect that to unwind in Q2, and also noting that the cash balance includes approximately US$1 billion for the FY21 final tax instalment which will be paid later this year in December.

On the capex of US$750 million, that's largely in line with plan and represents 25 per cent or a quarter of the mid-point of our FY22 capex guidance, which is a range of US$2.8 billion - US$3.2 billion, and also a reminder, that includes US$1.1 billion - US$1.4 billion on growth projects; Iron Bridge and Pilbara Energy Connect.

Expenditure for Fortescue Future Industries in FY22 is also unchanged, so that's US$400 million - US$600 million including US$100 million - US$200 million of capex and US$300 million - US$400 million of operating expenditure.

Gross debt at the end of the quarter was US$4.2 billion, down a touch from US$4.3 billion at 30 June, and as Elizabeth mentioned, we've moved to a modest net debt position. Our debt capital structure, our earliest debt maturity remains at 2024, and during the quarter we extended the maturity on our undrawn US$1 billion Revolving Credit Facility by two years, so that's now available until 2025.

Our Term Loan maturity will be increased by 12 months to 2026, and through that process we also reduced our interest costs. That continues the trend of proactively refinancing debt and also lowering the company's cost of capital. Just on the Term Loan facility, we increased that by US$400 million, and those proceeds will be available to support the funding of this year's growth capex.

In closing, you can see we've had a strong start to the financial year, supported by our strong balance sheet, liquidity position, and capital discipline, and consistency of performance is always important to us and that comes back to doing what we say we're going to do. On that note, Elizabeth, I will pass back to you.

Elizabeth Gaines: Thanks, Ian. During the quarter we also announced an industry-leading target to achieve net zero Scope 3 emissions by 2040 to address emissions across our entire global value chain. This includes crude steel manufacturing, which accounts for 98 per cent of our Scope 3 emissions. This new target aligns with our transition from a pure play iron ore producer to a green renewables and resources company and complements our target to be carbon neutral by 2030. Collaboration is integral to driving the rapid transition to green energy and we remain committed to actively engaging with our customers, suppliers, and other key industry participants to facilitate the reduction of emissions.

Fortescue Future Industries will be a key enabler of our Scope 3 target through the development of technologies and the supply of green hydrogen and ammonia, supporting a number of key initiatives across iron and steel making and new technologies. In October, FFI announced the development of a green energy and green hydrogen manufacturing industry in Gladstone, Queensland. The first stage development will feature an electrolyser factory with an initial capacity of two gigawatts, supported by the intention to enter into a 50-50 Joint Venture with Plug Power, which provides the ability to expand into fuel systems and other hydrogen-related refuelling and storage infrastructure in the future. Our Chairman Dr Andrew Forrest AO, and FFI CEO Julie Shuttleworth, along with members of the team, are currently in the United Kingdom where they will be participating in COP26.

In closing, the strong start to FY22 means that we're well placed to meet our FY22 guidance, with iron ore shipments in the range of 180 million to 185 million tonnes, a C1 cost of US$15.00 to US$15.50 a tonne, and capital expenditure excluding FFI in the range of US$2.8 billion - US$3.2 billion. Our record operational performance, along with the focus on cost management, means Fortescue is positioned strongly for the future. As always, I would like to thank our team members, contractors, and suppliers for their hard work and commitment this quarter as we continue to deliver on our strategic priorities. 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. Please note there is a limit of two questions per participant. You will need to re-join the queue to ask additional questions.

Your first question comes from Hayden Bairstow from Macquarie. Please go ahead.

Hayden Bairstow: (Macquarie) Morning, Elizabeth. Just a couple from me. Firstly, just following on from Danny's comments, I'm just interested to understand during the quarter there was obviously a lot of price volatility, whether there was some variance in when you were completing shipments or were things pretty even over that period? I'm just trying to get a feeling for the price in September, the month was obviously miles below what it was in July, or was it just a large PP adjustment off the shipments that you outlined in the Annual Report that were floating still on the water post the end of the quarter.

Then the second one is just on costs. Obviously, we're pushing up towards the top end of guidance. There's a lag effect of higher diesel prices. I'm just keen to understand is there anything offsetting that for the rest of the year that would keep us comfortable on the range in lower strip ratios or whatever initiatives for the rest of the year. Thanks.

Elizabeth Gaines: Thanks, Hayden. In terms of shipments, it's been even. There's been no significant change to shipments and your second scenario, it’s an assumption of the final pricing on those open tonnes drives that difference between the contractual realisation and revenue realisation. So, no change in terms of shipments, all very even. In terms of costs I'm not sure we're at the upper end, we're right in the middle of that range, and obviously there's a number of different factors.

The strip ratio in the quarter is pretty much in line with what we expect to see for the rest of the year, so no major changes there. We have seen some increase in some of those external costs, fuel, ammonia nitrate, for example, but we continue to stay very focused on those things that we can control and continue to implement strategies to make sure we keep our costs low. There's not one thing that I would call out in particular but just a constant focus around costs.

Operator: Thank you. The next question comes from Peter O'Connor from Shaw and Partners. Please go ahead.

Peter O'Connor: (Shaw and Partners) Good afternoon, Elizabeth. Two questions, costs as well, following up on Eliwana, the integration costs, is that once-off? Also, life-of-mine plan driven cost escalation, can you elaborate?

Second question on COVID headwinds in the next couple of months with these injections 1 and injection 2, or vaccination requirements for the mining industry. How comfortable are you with your level of vaccination across the firm and can you get a handle on that going into the 1 January change?

Elizabeth Gaines: Thanks, Peter. I might start with life-of-mine plan. Really, that escalation that we referred to is the opening of new mining areas, the increased haulage distances, some of which we're addressing through capital investment in conveyors, but it's all driven by by the more we mine the further away our mining areas become. So, that's what we're referring to there. I'll get Ian to talk about Eliwana.

In terms of COVID, the mandatory vaccination requirement in Western Australia is 1 December for the first vaccination, and second vaccination by 1 January. So, the deadline is really 1 December for everyone to have their first vaccination. Despite it being announced more than three weeks ago, we haven't received the formal directions from the Western Australian Government yet, to really understand the detail. We've only had the announcement.

We are actively encouraging all of our team members, unless they have an exemption, to be vaccinated in line with that 1 December timeframe. I think I heard on the news this morning Western Australia's first vaccination rate is up to about 77 per cent so there has been an uptick in recent times. We're collecting that data, we've established methods to collect vaccination data from our team members, and we're just gearing ourselves up to be ready for that date. We will continue to have rapid antigen screening before anybody travels to site as well, even after that vaccination date has passed.

Ian Wells: Peter, on Eliwana the integration costs are one-off, but the cost base of Eliwana is ongoing. You will recall that when we announced Eliwana as the placement for Firetail, we were at about 170 million tonnes per annum. We're now at 185 million tonnes. So, what we've done is we've added the cost base of a 30 million tonne per annum site but increased tonnes by 15 million tonnes. So, if we just did a replacement, we would have rolled back at other sites and therefore a reduced cost, however, we’ve had a disproportionate increase in the unit cost of production but we’ve increased revenue and increased systems capacity.

Clearly, the economics associated with the Eliwana project are significantly attractive - Eliwana's going to pay back itself in less than 12 months. So that's the permanent difference, if you like, or the permanent impact of the Eliwana cost base, albeit understanding that 15 million tonnes difference.

Operator: Thank you. The next question is from Paul Young from Goldman Sachs. Please, go ahead.

Paul Young: (Goldman Sachs) Yes, hi, Elizabeth, Ian and Danny. First question is on the product strategy and a question maybe for you, Elizabeth. Noting the West Pilbara Fines production has only been running at - well it was less than 10 per cent for the quarter, and I guess the development of Eliwana was designed to mitigate the risks around what's happening now as we saw at the end of 2017.

If we look at the prior plans and you know this very well, the West Pilbara Fines production is supposed to be around more closer to 30 million tonne mark or close to 15 per cent of the total product mix. So why is right at the time you need it the most, West Pilbara Fines production below where it should be?

Elizabeth Gaines: Well firstly, Eliwana has had a period of ramp up period so there's the initial product from Eliwana was Fortescue Blend product grade. So Eliwana wasn't going to achieve those sorts of numbers until quite a period after that ramp up. But there's a range of factors that have gone into that, Paul, it considers that we're keeping our costs low, the impact on strip ratios and the like.

In addition, at Eliwana there are some sensitive heritage issues that we're working through with the PKKP people, particularly after they have had the experience of Juukan Gorge, as they work with Rio Tinto on the aftermath of that. We've just been very sensitive to their availability to conduct surveys and we're managing our mine plan around some of those ongoing discussions. The Q1 product mix will largely be representative of the full year as well.

Paul Young: (Goldman Sachs) Yes, okay. Maybe a part B to that, then? Well, leading me to another question, with those discussions with the PKKP, any indication - and also noting that no section 18 approvals permits have been approved this year in the Pilbara - well since February, I should say. Any idea of the timeframe around those discussions and being able to access that high grade material?

Elizabeth Gaines: The discussions are ongoing, and we have good engagement with PKKP. Some of this is around the resource availability that they have and their focus more recently has been around their discussions with Rio Tinto. One of the impacts of COVID that we are seeing is the availability of people to undertake the heritage surveys. So, Elders from the Native Title groups.

That's something we're monitoring very closely. We had some lockdowns this year as well, which meant there was no survey activity underway. So that's just a feature of what we've seen with COVID. We're about to go into Law Time so that means there'll be shutdown really from December to February.

So, we just have to work closely with them and allocate that survey time. I think we are getting some survey time fairly soon, before they go into Lore Time, but it has been something that we have to just work with them very closely and respect the process that they're going through and therefore we've made some amendments to our mine plan accordingly.

Paul Young: (Goldman Sachs) Yes, okay. Thanks for that. The second question is on decarbonisation of the Pilbara. You no doubt would have seen Rio Tinto's news from last week about their strategy about putting renewable power into the Pilbara to reduce the reliance on natural gas and then obviously working through potentially decarbonisation of their truck fleet.

Just curious around the two or three gigawatts of renewables that you plan to install. Where are you with the studies on that and the potential timing of the spend and installation of that two to three gigawatts of renewables?

Elizabeth Gaines: Well, I think we're already down the path of renewables. We've got the Chichester solar farm. That's in commissioning at the moment. We've invested in Pilbara Energy Connect, where we're installing 150 megawatts of solar, as well as that broader transmission infrastructure. So when that's all installed, about 25 to 30 per cent of our stationary energy will be powered by renewables. So we're actually well advanced on this.

And yes, as we look forward to our goal to be carbon neutral by 2030, we see the addition of significantly more renewable energy, including that two to three gigawatts that you mentioned. So that work is ongoing but we're already pretty well advanced in terms of the first phase of that with Pilbara Energy Connect.

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, Ian and team. I just wanted to ask one question on the actual pricing in terms of the contractual realisation of 77 per cent. Could you give an understanding of the realisations at quarter exit? So around September and directions which they've moved in October?

Just with the provisional pricing adjustment, I think you mentioned they have been relatively even but I'm just wondering if there's a pricing that's been moved from either one, two or three month, and I'll circle back on the second question. Thanks.

Elizabeth Gains: Kaan, we don't disclose end of quarter or as we go into a next month. You know we will report after we get to the end of the quarter. In terms of provisional pricing, we haven't seen any changes to our provisional pricing terms. So no, no shift of settling sales.

Danny Goeman: And the open tonnes or the tonnes subject to provision pricing at the end of the period haven't materially changed either, Kaan. So it's just a function of the volatility of the iron ore price throughout the period and then ultimately the maths associated with that.

Kaan Peker: (Royal Bank of Canada) Sure, thanks and just second one, I think it's just going back on Danny's comments around capitalising on market opportunities and it's also touching on Paul's question before. It seems like there was more Super Special Fine sales discounts being elevated. Given that access to that high grade ore for Eliwana may be limited, what flexibility does Fortescue have in its product mix over the next year to capitalise on market opportunities as Danny mentioned? Thanks.

Elizabeth Gaines: Well actually, Fortescue Blend had a more significant increase in the quarter than Super Special Fines. So I think as Danny mentioned as well, the percentage of Fortescue inventory in China's ports relative to total port inventory has actually decreased in recent months so we're seeing strong demand for our product.

Obviously as we move forward, the change to our product mix will include Iron Bridge with a high-grade magnetite concentrate product, and the first ore due in December 2022. Anything you want to add to that, Danny?

Danny Goeman: Yes, I would just say that the Fortescue products are obviously not the only ones where the gap to 62 Index has increased. I think there's numerous examples in the market where other products have also seen those spreads widen.

Operator: Thank you. The next question comes from Lyndon Fagan from JP Morgan. Please, go ahead.

Lyndon Fagan: (JP Morgan) Thanks very much. Look, my first question is on the Scope 3 net zero target. I'm just a bit confused about how you can actually have a target there and I'm wondering whether you can maybe elaborate on what drives into that, and how much green steel actually forms part of that plan, and whether you can speak about the flow sheet that was announced earlier in the year, where that's up to? That's the first one and I'll come back with another one.

Elizabeth Gaines: Well look, in terms of Scope 3, we have set an ambitious, industry leading target for net zero by 2040. We know that technology is rapidly developing. Importantly for us, Lyndon, that is really enabled by the supply of renewable energy by FFI. So, our view is the steelmaking technology will continue to develop.

I don't think we talked about a flow sheet. We said we did some initial lab-scale testing work, but that work is ongoing, so nothing further to elaborate in that regard, but that supply of renewable energy will be key to achieving that net zero emissions. We're also looking at shipping and the shipping industry and that will contribute to a reduction in Scope 3 emissions.

So, there's a range of different initiatives across FFI, working closely with our customers as well. There's a lot of customer engagement. Our customers in China and elsewhere are also focussed on emissions reduction, so this is going to require significant collaboration, both with customers and with industry, and we're working with universities.

So, a bit early to map out all of it at this point in time, but unless you set stretch targets, you won't achieve them. That's one thing we do know, so we've set that stretch target and we'll continue to work through how we achieve that.

Lyndon Fagan: (JP Morgan) I guess just to press a bit more, doesn't Scope 3 net zero mean that a blast furnace purchasing your iron ore needs to be carbon neutral?

Danny Goeman: Yes, look, if I can comment, Danny here. I think the blast furnace emissions reduction is certainly part of the transition. But there comes a point where if we are successful in developing certain new technologies, that we are exploring at the moment, that we would go straight to a DRI or HBI solution, where you basically bypass the blast furnace. So all of those options are in the mix.

Lyndon Fagan: (JP Morgan) Okay, thanks, Danny and while I've got you, I'm actually interested as my second question on your take around Chinese steel production and demand. Obviously down 21 per cent year-on-year in September and one of the lowest run rates we've seen for multiple years. I'm wondering what the feedback from customers is and what the Fortescue take on where things are at, is? Thanks.

Danny Goeman: Yes, look, we've certainly seen some headwinds in the last few months, and I mentioned obviously some of the transient and policy-related factors that have been impacting and probably will continue to impact in the short-term on steel demands.

Yet when we talk to our customers, they are still confident that the underlying fundamentals in terms of steel demand are still intact and we know obviously that the government is also motivated in that space. When we consider the global economic growth that lies ahead, we believe that that will continue to support good steel output and demand for iron ore.

If we look at rest of world, for instance, we continue to see very strong steel production growth as economies emerge from COVID. I mentioned also that we're seeing significant fiscal stimulus and infrastructure investment in many countries. On the supply side, you would have noticed that traditional supply remains relatively constrained, particularly in the high-grade segment.

So overall, we continue to see robust steel production and steel demand going forward and that will obviously translate into healthy demand for iron ore. We're a low-cost producer, so we will continue to generate strong margins throughout the market cycles.

Operator: Thank you. The next question is from John Tumazos from Very Independent Research. Please, go ahead.

John Tumazos: (Very Independent Research) Thank you. I'm very interested in the green iron ore initiative. Congratulations. Are you going to begin to ship despite the freight, to places like Sweden, Germany, where public attitudes would rejoice and embrace and encourage the customers there to pay the premium for green iron ore and the freight first?

Second, there have been some ripples in China about Australian coal, beef, barley, which could be a risk to iron ore. Third. I believe no country in the history of the world has ever cut steel production round numbers, 1 million tonnes a day without a recession. It raises questions about the desirability of China as a destination. Four, even if you don't think that, the stock market might and penalise your shares. Please discuss marketing.

Elizabeth Gaines: John, there's a number of different questions there. Let's try to address them. I think firstly, on green iron ore, our goal to be carbon neutral is by 2030. So, we're some way from being in the position where we'll have iron ore that is free of emissions, but that's certainly our goal. That does open up other opportunities we think for other markets, which might actually have a carbon charge and might be prepared to pay a premium for a green iron ore product which would offset any increased shipping costs.

So there's a range of opportunities, but we are some way away from being in that position. I think you're right. It does actually afford some further market diversification when we get to that point where we have an iron ore product that is free of emissions. So certainly that will be part of our consideration.

We're still seeing strong demand from China. Agreeing with your observations on the market, the reduction in crude steel production, but we also know that China has a goal to increase the level of urbanisation to 65 per cent by 2025. You're only going to achieve that through further investment in infrastructure, whether that's airports, rails, other forms of infrastructure, which tend to be steel intensive.

Now, China last calendar year was close to 60 per cent of global crude steel production. Now that the rest of world is getting back to pre-COVID levels, it's probably closer back to 50 per cent, but it's still part of global crude steel production. So, a very important market. The next biggest market is 100 million tonnes, which is only 10 per cent of China's crude steel production. So, China is by far the most significant market.

A combination of the Iron Bridge magnetite concentrate, the work we're doing on green iron ore and then on green iron, all of that will facilitate the ability for us to look to diversify into other markets. We already work with customers in Japan and Korea as well and we're seeing some strong demand from customers there. So, it's not lost on us, that this does present a significant opportunity for diversification. It certainly doesn't mean that we in any way would not pay a lot of attention to our core market, which is the most significant market, which is China.

Operator: Thank you. The next question is from Tim Elliott from Regal Funds Management. Please go ahead.

Tim Elliott: (Regal Funds Management) Great, thank you. Look, it's important that the world decarbonises and I really commend Fortescue's commitment to this, particularly as its operations and investing in new technology. I do have real concerns that green hydrogen takes us in the wrong direction because it increases global emissions by being a wasteful use of scarce renewable power.

My first question today is about transparency and disclosure. I'm not sure that I've seen a public company announce such large spending plans, many multiples of its market cap without providing shareholders at least indicative economics of what this means for shareholder value. I don't think it's quite sufficient to say that no numbers can be given until there's a specific project. Speaking to a number of fund managers we'd like to see Fortescue next month host a green hydrogen investor call and disclose indicative economics, underlying assumptions of green hydrogen and green steel, even if they're plus or minus 25 per cent.

Elizabeth Gaines: Tim, thanks for that feedback, we'll take that onboard. We haven't actually announced or approved any projects. We're talking about the opportunities of this industry, which we think will be significant and clearly we would develop a portfolio of opportunities. Anything that we have announced, including Gladstone, we have provided a capital estimate for that. So there's a long way to go on a number of these areas. We think it presents a significant opportunity but we take your feedback onboard.

Operator: Thank you. The next question is from Rahul Anand from Morgan Stanley. Please go ahead.

Rahul Anand: (Morgan Stanley) Hi Elizabeth and team, two from me. First one's perhaps for Danny and the second one for you, Elizabeth. So, first question is obviously the margins in Chinese steel industry have risen and perhaps quite close to what they were in the past cycle when iron ore discounts went to about 40 per cent.

What I wanted to understand was, I would have thought that this cycle was a bit different because last time we had capacity cuts, which pushed producers to go towards higher grade iron ore. This time, we basically have production cuts which should have, I would have thought perhaps incentivised the use of low-grade iron ore. Why do you think we're seeing these widened discounts this time and do you think it's perhaps because producers are producing more lower grade now? Rio is doing more SP10 as we know. That's the first one.

The second is perhaps an update on Queens. Is there any potential delay there from the Traditional Owner survey delays that you highlighted earlier on the call and how does that make your product mix look going into FY23?

Elizabeth Gaines: Rahul, maybe I'll deal with the second question. No, there's no change to our outlook for Queens. The issue we talked about was particular to the Western Hub, not to the Queens development. In fact, we talked about the co-management framework we've just signed with members of Wintawari Guruma Aboriginal Corporation, who are the Traditional Custodians of that area. They're looking forward to working closely with us as we develop further mining areas in the Queens Hub. So no change as a result of Queens. Danny, did you want to talk to mill profitability.

Danny Goeman: Yes, thanks Rahul. I'll elaborate on a few of the questions that you posed. Look, if I can start with margins. Certainly margins are relatively healthy. I mean, we're looking at about $170 for rebar, $160 for HRC depending on where you are. They are coming down; and they are very different though to what we saw in 2018. Margins were RMB1,500. So very different dynamic.

The second point really relates to some of the factors that I was describing earlier, that have obviously impacted the value in use of different products. It's hard to disentangle what the bigger driver is, but for low-grade, for sure, the sort of coking coal and coke prices that we've seen are obviously influencing the value in use of lower grade products.

When we talk about curtailments, we have to distinguish between capacity curtailments and production curtailments. What we've seen in the last few months in China is really production curtailments, which means that in some cases mills are actually incentivised to run at lower blast furnace utilisation rates in order not to exceed their cap, but they want to keep their blast furnace running.

So, what that means is that in some cases they revert to lower cost, lower grade material. That's one of the reasons why we've seen very strong demand for our product and if curtailments continue, we expect to see ongoing, strong demand for our product. Ultimately for a steelmaker obviously the cost of hot metal includes all the inputs. Iron ore is one of them, coking coal is a material other. So all of those factors really play into how mills value a product at a given point in time.

Operator: Thank you. The next question is from Robert Stein from CLSA. Please go ahead.

Robert Stein: (CLSA) Hi, notwithstanding the aspirational nature of the goal, are you able to just provide a little bit more insight, and this is leveraging off a question earlier on the net zero aspect of the Scope 3 target? So where does the ring fence lie between what you're claiming, I guess, emission reductions against focusing on the net aspect?

Are we saying that hydrogen being used to displace other carbon intensive sources of energy are going to be used against the emissions intensity of steel or are you saying the steel industry itself is a zero emission industry by 2040, or the arrangements that you've got from a marketing point of view, focus on those customers. That's the first question. The second one is a bit shorter.

Elizabeth Gaines: Look I think we see hydrogen playing an important role. So, I think to Danny's point if we can get more product where we can bypass the blast furnace. We see hydrogen playing a role. Hopefully that gives you some insight into to what our current thinking is, but it is early - and we're talking about 2040. We're going to be working with our customers and new technologies continue to develop and emerge. We're on that journey with our customers in terms of how we address Scope 3 emissions, and we do think green hydrogen will play an important part in that.

Robert Stein: (CLSA) Thank you and then the second aspect of the question is given that we're talking direct charge and DRI, is there a plan for Fortescue to upgrade its quality suite in the Pilbara out in that 2030/2040 outlook given the low grade nature of what you’ve currently got and typically DRI takes a high quality iron feed?

Danny Goeman: We continue to obviously monitor developments there and adjust our product strategy accordingly. But I would say that we are actively engaged already and exploring opportunities with a number of stakeholders with respect to DRI and HBI. That includes looking at solutions for lower grade sinter fines. We're actively working on that as we speak with a number of counterparties.

Operator: Thank you. The next question is from Lachlan Shaw from UBS. Please go ahead.

Lachlan Shaw: (UBS) Yes, good morning, Elizabeth and team. Thank you for the update. Just a question on I guess net debt. Obviously back into a very modest net debt position at the end of the quarter given upcoming capex commitments, doing a dividend. How are you thinking about that net debt heading into the rest of the financial year and FY23?

Ian Wells: Yes, we've always thought about net debt in gross debt terms because each quarter or half year and full year, we've pretty much allocated capital to the various components. So, we've always said that with respect to Iron Bridge and our growth capex, that we would intend to consider funding that with debt. Obviously last year with significant cash flows generated, we funded our entire portfolio from cash last year. So I flagged in in my commentary around the additional facility, the term loan facility to help fund debt but our balance sheet is in good shape.

So, the debt capacity on our balance sheet is an important part of funding our growth capex. Cash on hand for us is in the most part already allocated as we go through the cycle, either generating free cash flow and that getting allocated to the accumulation of profits and therefore dividends, together with our commitment to funding FFI, expenditure as well. And then obviously our growth program through this year and Iron Bridge will complete in FY23.

I guess the other point is that our stated objective to have investment grade credit metrics, which to reiterate that's one to two times debt to EBITDA on a gross basis and 30 to 40 per cent on debt over debt plus equity. So we’re at the bottom we're less than half a turn of debt to EBITDA for the last year and through the cycle. Still probably lower than one, about a half a turn through the cycle. So we have capacity on that basis.

Lachlan Shaw: (UBS) Yes, great thank you. So second question, it may be a little early but obviously Iron Bridge set to commission end of next year. How are you thinking about the marketing strategy there? You've talked about that's still up for grabs, but any sort of developments there? I guess related to that, to the extent Iron Bridge adds to the portfolio grade and quality, would you look at potentially scaling back some of the lower quality production as part of that? Thanks.

Elizabeth Gaines: Look, Iron Bridge is not until December 2022, and as you rightly pointed out the market does change, and market conditions can change. So we're always very agile and responsive to market conditions. We're not currently anticipating that we dial back our hematite production.

Let's not forget that Iron Bridge is a joint venture. It's not 100 per cent Fortescue, but Iron Bridge, the marketing strategy associated with Iron Bridge, there are opportunities. We've been doing technical assessment of blending opportunities but we'll do whatever we think is going to optimise both the demand and the profitability of Iron Bridge. If that means it's a standalone product, then that's how we'll sell it.

We don't have to make those decisions today. We know that there will be strong demand for a 67 grade magnetite concentrate in its own right.

Danny Goeman: Yes, I would just say the marketing strategy for Iron Bridge is fairly straightforward. We will sell the product to those customers and those markets that need and value it the most. We've had very strong interest to date, and we expect that to continue.

There's a number of possibilities also in the context of green steel, so as Elizabeth said, we'll continue to monitor how the market evolves and then we'll place the products with those customers that value the product the most.

Operator: Thank you. The next question is from Glyn Lawcock from Barrenjoey. Please, go ahead.

Glyn Lawcock: (Barrenjoey) Good morning, Elizabeth. Just wanted to dive a little bit more into the staffing that Peter O'Connor talked about at the start. Could you maybe put some numbers around what staff turnover is now and where it's maybe come from if it's got worse? Some of your peers are talking about that.

With vaccination rates, you talked about you were I think surveying the workforce. Are you in front or behind that 77 per cent the state is at? Just curious on that front. That's the first one.

Then the second one is, I understand the WA Government is still in its consultation period for South West Creek. Just do you have a sense on when that consultation period is going to end and what is it you expect to come out of that? What would be a good outcome for Fortescue? Thanks.

Elizabeth Gaines: Hi Glyn. Good to have you back. Look, in terms of turnover, we haven't seen any significant increase in turnover. We do see some seasonal increases around this time of year after the end of the financial year but our turnover consistently is around about 9 per cent, so we haven't seen any significant change.

On vaccination data, we've only just started to collect that data and quite frankly, it's pretty sensitive. It's confidential data, I'm not sure we're going to be sharing our rates of vaccination. We know what the mandate is and we'll be collecting that data but we've only just set up the data capture capacity to do that.

In terms of South West Creek, my understanding is that the consultation period is coming to a close. I'm not exactly sure on timeframe. I expect it to be this calendar year but that's up to the government to finalise that consultation process. I think there's a range of outcomes. I think the best outcome out of that will be a recognition that there is increased capacity through the port of Port Hedland.

There may be some reallocation of A, B, C and D-class capacity but I think that's going to be the most important outcome, is the recognition that there is increased capacity through the port of Port Hedland.

Operator: Thank you. The next question is from Alex Wallis from Polymer Capital. Please, go ahead.

Alex Wallis: (Polymer Capital) Hi Elizabeth. I was hoping you might be able to give us an update on expected timing around the YAC settlement and secondly on that, whether you might be willing at this point or at some time in the near future, to give even just a wide range on the potential settlement outcome?

Elizabeth Gaines: Well, we haven't had a claim made against us, Alex. So there is nothing to settle. We've had no claim for compensation lodged by Yindjibarndi. The legal processes in terms of our denial of our right to seek further appeal, that was denied in May last year and we've had no claim for compensation since then.

But look, Fortescue remains open to entering into a Native Title agreement with the Yindjibarndi people on terms consistent with our other land use agreements but there is nothing to settle at this point in time, just to be clear, because we've had no claim.

Alex Wallis: (Polymer Capital) So is that in some sort of mediation phase at the moment then?

Elizabeth Gaines: No, we haven't had a claim.

Alex Wallis: (Polymer Capital) Okay. Secondly, just on the Heritage Act, do you have any updated insight as to when that might be finalised and any early read on potential ramifications for the group?

Elizabeth Gaines: Well, I don't think there will be any potential ramifications to Fortescue. I think there's going to be implications for the broader industry, and Native Title partners are going to need to really digest what that Act might mean and what it might require. What the transition periods might look like. So we don't have the details.

My understanding was the State Government were keen to try and get this finalised this calendar year. I don't know if it's going to make this year in terms of Parliament or whether that will move into next year. We don't have any further clarity on that, but this is going to be a state-wide and industry-wide implication, nothing particular to Fortescue.

Operator: Thank you. We have come to the end of the Q&A session. I'll now hand back to Ms Gaines for closing remarks.

Elizabeth Gaines: Thanks Rachel and thanks everyone for participating in the September Quarterly Production Report. I hope you all stay safe and well and look forward to speaking to you again soon. Take care.

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

End of Transcript