



**Half Year results to
31 December 2021**

Investor and Analyst Call transcript

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Start of Transcript

Operator: Thank you for standing by and welcome to the Fortescue Metals Group FY22 Half Year Results 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. Please limit your questions to two per person. If you wish to ask further questions, please re-join the queue. I would like to hand the conference over to Ms Elizabeth Gaines, Chief Executive Officer. Please go ahead.

Elizabeth Gaines: Thank you Darcy and good morning or afternoon everyone and welcome to Fortescue's FY22 Half Year Results Presentation. Joining me today in Perth is Ian Wells, Chief Financial Officer. As always, I'll start with safety and the health and safety of all of our team members is our highest priority and I thank the entire Fortescue family for continuing to look out for their mates on our journey to zero harm.

Pleasingly, our Total Recordable Injury Frequency Rate – or TRIFR, reduced to 1.8 at 31 December and that was 14 per cent lower than 31 December the prior year. That was achieved while still managing the ongoing challenges resulting from COVID-19 restrictions. Fortescue maintains our robust COVID-19 management plan which is designed to safeguard team members and communities and this is regularly reviewed in light of changes to Commonwealth and State health requirements and the ongoing COVID-19 situation.

In response to the recent increase in COVID-19 community transmission in Western Australia, we have introduced enhanced screening and testing in addition to our mandatory pre-flight screening, and this includes daily testing of our team members working at our integrated operations centre - the Fortescue Hive - as well as expanding our rapid antigen test program to include an additional test within 72 hours of arrival at a Fortescue site. We're also investing in business continuity planning measures, including ensuring we have adequate resourcing to help manage any potential increase in workforce absenteeism.

During the half year, we conducted a Workplace Integrity Review together with an independent assessment of site security and safety measures and as a result, we've introduced a number of initiatives to enhance the safety, culture and experience of working at Fortescue, and we strongly encourage all of our team members to speak up in line with Fortescue's Values and our zero-tolerance approach to harassment, bullying and intimidation.

So, turning to the half year results and Fortescue's performance for the first half of FY22 has been outstanding, and we are very proud of the entire team who have delivered record half year shipments and contributed to net profit after tax of US\$2.8 billion, the third highest half year profit in Fortescue's history. Ian will talk to the financials shortly, but I would like to highlight that the strength of our operating performance and our integrated marketing strategy resulted in revenue of US\$8.1 billion, an underlying EBITDA of US\$4.8 billion with an EBITDA margin of 59 per cent.

On the strength of this performance, the Board has declared a fully franked interim dividend of A\$0.86 per share, and that represents a 70 per cent payout of first half net profit after tax, and this dividend continues our track record of delivering enhanced returns to shareholders and is consistent with our stated intent to target the top end of the dividend policy, which is to pay out 50 to 80 per cent of full year net profit after tax.

I will discuss a number of other significant developments shortly but for now, I'll hand over to Ian to take us through the financials. Ian?

Ian Wells: Thanks Elizabeth and hi everyone. It's always a privilege to present a summary of our financial performance, and the results that you can see today have been driven by market factors and as you've heard, the first half wasn't without its challenges, and those included managing the impacts of COVID-19 and increasingly tight labour market, supply chain disruptions, a material increase in diesel costs, as well as iron ore, shipping and general market volatility. So, in that context, it was pleasing to deliver another clean set of numbers that are pretty much in line with market expectations.

So, turning to the results, we generated strong earnings and cashflow by focusing on what we can control, and that also includes the planning cycle. We continue to invest and improve in that planning cycle through long term investments in data analytics, digital systems and process improvement that support our integrated planning processes, which means we continue to deliver the best outcomes across the business.

First half revenue of US\$8.1 billion was 13 per cent lower than the same period last year, as average revenue per tonne declined by 16 per cent to US\$96 per tonne. That was 70 per cent realisation of the 62% Platts Index. We're operating in an environment of industry wide cost inflation, and we've been really transparent on our cost profile and the drivers of those costs. At the Quarterly, we reported that unit costs increased 20 per cent year on year, and that's a result of price escalation on key input costs, particularly diesel. Also, other consumables and labour and importantly, the integration of the Eliwana operation, as well as general mine plan driven cost escalation.

We also noted that our first half C1 costs of US\$15.28 included the direct costs of managing COVID-19 of US\$0.15 to US\$0.20 per tonne. Just reflecting on the cost base of Eliwana, that relates to optimising our existing operations and infrastructure which has enabled an increase in systems capacity for both processing and rail, and that's what positions us really well to deliver on this year's guidance of shipments of 180 to 185 million tonnes per annum.

EBITDA was US\$4.8 billion in the half and that's at a margin of 59 per cent. Drilling down on the slide for those following the webcast, you can see our track record of delivering and generating strong margins through the cycle. So, the EBITDA margin in H1 FY22 was US\$58 per tonne, and that compares to an average of around US\$50 per tonne achieved over the past five years. EBITDA flows through to NPAT which was US\$2.8 billion in the half. That translates to US\$0.90 per share and in Australian dollar terms, A\$1.24.

The next slide on the webcast shows the EBITDA to NPAT waterfall relative to the same period last year, and you can see again all the moving parts, including the impacts of volume, price and cost. Another point to note is the FFI operating expenditure of US\$174 million, compared to US\$22 million this time last year, and you will see when you get a chance to look at the Financial Statements, we have included updated segment disclosures and we're showing our iron ore and FFI as separate segments, and also showing the net funding available for FFI expenditure.

Moving to cashflow and as a reminder, the half year net operating cashflow included the FY21 prior period final tax instalment, and that was just over US\$900 million, as well as a working capital outflow, all of which reported in our Quarterly result.

So, first half capex of US\$1.5 billion - that was pretty much in line with plan. A touch under the halfway point of our full year guidance and drilling down on that, US\$1.5 billion - just under half. So, US\$740 million combined expenditure in our sustaining development and minor hub development capital. US\$590 million in growth and decarbonisation, being Iron Bridge and Pilbara Energy Connect. In terms of the full year capital expenditure guidance, that's unchanged from the Quarterly at a range of US\$3.0 billion to US\$3.4 billion, and that reflects the announced acquisition of Williams Advanced Engineering. In terms of the split of the US\$3.0 to US\$3.4 billion, that includes US\$1.1 to US\$1.4 billion on growth capex. So that's a combination of Iron Bridge and the Pilbara Energy Connect projects.

On free cashflow, historically matches NPAT when capex and depreciation align, and as we continue to invest in growth capex, just calling out the key variances between NPAT and free cashflow for the half were the working capital outflow which we spoke to earlier, the US\$1.0 billion prior period tax payment and also capex was about double depreciation, with the variance being US\$750 million which is clearly the growth capex that I spoke to earlier.

If we move now to balance sheet cash on hand, reported at 31 December was US\$2.9 billion and gross debt increased to US\$4.6 billion after we drew down US\$400 million of the Term Loan facility. That Term Loan facility took US\$1.0 billion and is now fully drawn. We also retain additional liquidity through the US\$1.0 billion revolving credit facility and that is undrawn.

Also, if you're on the webcast, we've got our credit metrics and what those credit metrics show is that we have balance sheet capacity within our targeted investment grade credit metrics, which are gross debt to EBITDA of one to two times, and gross gearing, which is the book value of debt plus equity, of 30 to 40 per cent through the cycle. So, what this simply means is that we have balance sheet capacity to fund future growth.

We also flagged in the Quarterly that we've established our Sustainability Financing Framework, and that will enable future issuance of Green and Social debt instruments to fund eligible projects, and the framework leverages off Fortescue's commitment to ESG leadership, and our market leading emissions target for Scope 1, 2 and 3 and also recognises the growth in sustainable and green sources of capital in the marketplace.

As you heard from Elizabeth, the fully franked interim dividend declared by the Board represents a payout ratio of 70 per cent of half year net profit after tax. So, then looking at the last 12 months, including the final dividend from last year of A\$2.11, that's A\$2.97 over the last 12 months which implies a trailing fully franked dividend yield of 13.5 per cent on a share price of A\$22.00.

Moving to capital allocation, and just a reminder on our capital allocation framework, it incorporates the four pillars of reinvesting in the business, maintaining a strong balance sheet, capital returns to shareholders and investing in growth. Our disciplined capital allocation is really important to us. For us that simply comes back to doing what we say we're going to do. That's evident in the capital allocation slide in the pack.

Just a summary, since FY14 - so over the past eight and a half years, Fortescue has generated over US\$40 billion of net operating cash flow. We have reinvested US\$12 billion of that back into the business and into growth. We have repaid US\$9 billion worth of debt. We've declared now, US\$19 billion of dividends - and that's about A\$8 per share, that equates to a payout of almost 70 per cent of net profit since 2014.

So, in closing we have achieved strong financial results in the first half and are really well positioned heading into the second half. Central to our consistent and predictable performance is our Values, remaining focused on the things that we can control, safely maintaining operating and capital discipline which optimises margins and delivers returns to shareholders.

On that note Elizabeth, back to you.

Elizabeth Gaines: Thanks Ian. Touching on sustainability, as societal expectations change, sustainability has never been more important to our investors, our stakeholders and our employees. As a business we are very focused on meeting and exceeding these expectations. Our continued focus on sustainability has generated strong recognition throughout the first half. There were a number of highlights including a Gold Class Sustainability Award in the 2022 S&P Global Sustainability Yearbook, and the inclusion in the Australian, Asia Pacific and World Dow Jones Sustainability Indices for a third consecutive year.

In line with our commitment to working with our Native Title partners on protecting Aboriginal heritage, during the half year we announced the establishment of a co-management framework with members of the Wintawari Guruma Aboriginal Corporation. Fortescue supports the modernisation of Western Australia's Aboriginal heritage legislation and the Aboriginal Cultural Heritage Bill 2021 was passed in the Western Australian Parliament and was proclaimed into law in December. We will actively engage in contributing to the co-design of the important regulations and guidance which will shape the transition from the 1972 Act.

Turning to climate change, during the half year, the momentum of Fortescue's transition to a vertically integrated green energy and resources company continued to accelerate. We are progressing a range of initiatives to decarbonise our operations by 2030 and to remove net emissions from our entire value chain by 2040. Fortescue Future Industries will be a key enabler of delivering on these targets.

FFI is taking a global leadership position in green energy and green technology, leading the effort to decarbonise hard to abate sectors. It was this time last year that we updated Fortescue's capital allocation framework to include the allocation of 10 per cent of net profit after tax to fund FFI. As at 31 December 2021, FFI's unutilised funding commitment is US\$651 million. That's after taking into account first half operating and capital expenditure of US\$242 million.

It's been a busy period for FFI. In November 2021, FFI received planning approval from the Queensland Government for the Global Green Energy Manufacturing Centre in Gladstone, Queensland. The first stage development is an electrolyser manufacturing facility with initial capacity of two gigawatts per annum and an investment of up to US\$83 million.

FFI has also successfully completed the first phase of studies with Incitec Pivot Limited to convert the Gibson Island ammonia production facility to be powered by green hydrogen. Of course, last month Fortescue entered into an agreement to acquire UK-based Williams Advanced Engineering (WAE). WAE will be vertically integrated into Fortescue and managed by FFI. Its critical technology and expertise in high performance battery systems and technology are integral to developing battery electric solutions for our green feet.

FFI is investing to develop a global portfolio of green energy projects to supply 15 million tonnes per year of green hydrogen by 2030 and is rapidly establishing the building blocks which will allow us to fully integrate technologies, manufacturing capabilities, and green energy generation and distribution to deliver across the entire value chain.

So, in closing the team has delivered an outstanding operating and financial performance for the first half of the financial year. The iron ore market outlook has improved compared to late last year. While we anticipate further price volatility, global market conditions remain supportive with an expectation of an increase in activity in China in coming months and constrained global iron ore supply growth.

We have had a strong start to the second half. We are well positioned to deliver on our guidance for the full year which is for iron ore shipments in the range of 180 million to 185 million tonnes, our C1 cost guidance in the range of US\$15.00 to US\$15.50 a tonne which retains our industry-leading cost position, and capital expenditure excluding FFI in the range of US\$3.0 billion to \$3.4 billion.

Guided by our unique culture and Values, Fortescue is strongly positioned to transition to a global green energy and resources company. We will continue to deliver on our strategic priorities of optimising returns from our mining operations and investing in growth and green energy, supported by our strong balance sheet and disciplined capital allocation framework.

As always, I'd like to thank our team members, contractors and suppliers for their contribution to an outstanding first half operating and financial performance.

So, on that note I'll hand back to Darcy to facilitate Q&A. Thank you.

Operator: Thank you. If you wish to ask a question, please press star one on your telephone and wait for your name to be announced. If you wish to cancel your request, please press star two. If you are on a speakerphone, please pick up the handset to ask your question. A reminder to limit your questions to two per person. If you wish to ask further questions, please re-join the queue. The first question comes from Rahul Anand from Morgan Stanley. Please go ahead.

Rahul Anand: (Morgan Stanley) Hi Elizabeth and Ian. Thanks for the opportunity. My two questions - first one is on the Williams acquisition if I may. So, the US\$225 million sits outside the capital budget for FFI. But could you help me understand perhaps what is the current capital draw per annum in terms of salaries or whatever other costs are in the business - or rather for the business? Where will those costs fit for Fortescue? Would that be part of the \$400 million to \$600 million budget that we have for FFI? That's the first one. I'll come back with the second, thanks.

Elizabeth Gaines: Ian might want to comment Rahul, but for Williams, we made it clear the acquisition is actually by Fortescue because it's going to facilitate the decarbonisation of our mining fleet. So, we updated our guidance on capital expenditure for Fortescue excluding FFI to that range of US\$3.0 billion to US\$3.4 billion at the Quarterly. That incorporates the capital for Williams as well.

Ian Wells: Yes, so Rahul thinking about - the publicly available information for Williams would indicate that they made a modest EBITDA profit off the back of the revenues - so obviously there is an indication of their operating costs. We've purchased on the basis that we're going to improve that. Obviously, the vertical integration into decarbonisation is important. So, if we're thinking about the capital expenditure that Fortescue iron ore will incur will be in relation to the development costs of the battery electric solutions for trucks and other vehicles as well which will be a decarbonisation cost for the iron ore business.

So, I think that's how you look at Williams as a standalone. But ultimately, it's going to have a contract with Fortescue to develop those battery electric solutions and integrate it into FFI - as we said - it's going to be managed by FFI. So, it's a reflection of our business becoming vertically integrated and also a little bit more complicated than it has been in the past.

Rahul Anand: (Morgan Stanley) Okay, sure. Look the second one is on the low-grade discounts. They are wider than what they've been. We can talk about perhaps the extra supply that's coming from Rio and also the port stocks. If you can provide a bit of colour if those port stocks are majority low grade or not. But I guess more importantly if we look into the next 12 to 18 months, Elizabeth is there any flex in the system at all whereby perhaps by foregoing strip ratios and benefiting a bit more perhaps, that you can improve the grade at all and try to capture some of that margin uplift?

Or do we have to continue with the mine plan as it sits? I refer to a long time ago, Fortescue had gone the other way, i.e., low graded operations to save on costs. So, I'm just trying to understand if the opposite is perhaps possible in the current environment and if you can provide some colour around the low-grade discount as well. Thanks.

Elizabeth Gaines: Yes, quite a lot in that question. Look, I think in terms of current discounts in the environment that we're obviously seeing some ongoing volatility, but importantly underpinning all of that is strong demand for our products. Certainly, we're supplying products to our customers under our long term contracts. We expect to see a pick-up in general activity coming out of the Winter Olympics.

Steel inventories are low. So, as I said, I guess the fundamentals of the market in terms of demand and supply, there's no major new supply of iron ore. But there might be difference in some of our competitors increasing supply of lower grade product. But the overall fundamentals of supply and demand remain largely unchanged.

In terms of low-grade volumes in port inventory, they have increased. We referenced that at the Quarterly. But our share of port inventories has actually come down a little bit. We've been pretty consistent at around 10 per cent, or now down

around 9 per cent of port inventories. So that really underpins the fact that we see strong ongoing demand for our well-established suite of products.

When it comes to beneficiation, we obviously already beneficiate our ores. We've added the WHIMS at Christmas Creek. The biggest change to our product mix will obviously be Iron Bridge and the addition of a 67-grade magnetite concentrate product. So, we are obviously looking at and looking forward to the introduction of the Iron Bridge product into our overall suite of products. But we don't have any major plans to change our beneficiation or our product strategy. We've got a well-established suite of products.

Importantly, as Ian said a US\$58 EBITDA margin in the half, the average over the last five years has been US\$50. So, throughout this cycle we've demonstrated that we continue to generate strong margins. We do remain focused on keeping our costs low. We have an industry leading costs position and by keeping our costs low that means we can actually still prosper through the various cycles of the market.

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

Kaan Peker: (RBC Capital) Hi Elizabeth and team. I suppose following up on Rahul's question, maybe asking it a different way, but is there an update on Eliwana and when Fortescue can access that higher grade portion of the ore body? I believe you indicated that it won't occur through FY22. But what about FY23? I'll circle back on the second question.

Elizabeth Gaines: Yes, look I think that those discussions and assessments are ongoing. Our product mix for this year has been very stable. In terms of accessing those areas, there's still heightened sensitivity. Access to resources to conduct surveys is pretty challenging for the whole industry at the moment particularly with COVID-19 as well. So, we work closely with our Native Title partners to work with them and certainly getting access to the resources to do heritage surveys. As I mentioned is pretty challenging. But we're very focused on delivering on our existing product mix.

Kaan Peker: (RBC Capital) Sure, okay. The second one - I just wanted to ask about the Global Green Energy Manufacturing Centre. I think previous indication or guidance was that construction for the GGEM would commence in February 2022 followed by approvals and electrolyser scheduled off the production line in 2023. How is this tracking? I think previous guidance was for up to US\$650 million with the initial electrolyser investment of US\$83 million. What does the US\$650 million include and does that US\$83 million mean that the electrolyser would be in production.

Elizabeth Gaines: In terms of the Global Green Energy Manufacturing Centre in Gladstone, we're absolutely on track. We've got the approvals that we needed and we're turning ground. Construction is commencing and our plan is still for first production of electrolysers in early 2023, so no change to our plans there. That initial phase was up to two gigawatts for a US\$83 million investment.

The broader phase is the expansion of the manufacturing capabilities which may include wind turbines and other aspects of renewable energy but the focus at the moment is on the development of the manufacturing facility. That's the capex we've guided to initially, but that's all on track as we had originally guided.

Operator: Thank your next question comes from Lyndon Fagan from JP Morgan. Please go ahead.

Lyndon Fagan: (JPMorgan) Thanks very much. My first question is on the Uaroo Renewable Energy Hub that has been put out for public comment. I can see it's 5.4 gigawatts. If I put US\$2 billion a gigawatt, I'm at US\$10 billion. I'm just wondering if you could maybe talk a bit about that, when it could start construction, and whether that broad capex is about right.

Elizabeth Gaines: I'm not sure that straight extrapolation is correct, Lyndon. At the moment, it is the five gigawatts that has gone to a public consultation process and our submission to the EPA, but it is in its study phase and that timing of

development and ultimate project investment will be determined by detailed studies. So, I'm not sure extrapolating US\$2 billion, because obviously we're looking at lowering our capital intensity and emerging technologies, so that's a real focus for the team. We are currently targeting a final investment decision in calendar year 2023.

Lyndon Fagan: (JPMorgan) Okay, that's helpful. Then I guess while we're on capital intensities, the 15 million tonne hydrogen production target, would you point to a market capital intensity that we should refer to come up with how much that would cost?

Elizabeth Gaines: Not at this stage. As I said, technology is evolving. We're seeing costs come down significantly globally for electrolyzers and we're establishing, and we see our own electrolyser manufacturing capabilities. So, no, I wouldn't point to a number at this point in time.

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

Hayden Bairstow: (Macquarie) Morning, Elizabeth and Ian. Just two from me. Just back on the Uaroo Hub, just confirming, that is the power requirements that you'll need just for the iron ore business or are you looking to have some sort of third-party revenue in there to help justify what the final investment might actually be?

Then the second one is just on Iron Bridge. The project looks like it's going okay but given the cost pressures you're seeing at the moment, and obviously power costs and whatever costs you think are going to be associated with this energy hub. Is there is a likelihood that we'll see some sort of revision to the long-term cash cost guidance for that project at some point?

Elizabeth Gaines: Maybe starting with Uaroo, at that 5.4 megawatts, that's more than we need for our iron ore operations, so obviously we're looking at opportunities where there may be other demand in the Pilbara for renewable energy, so there is the opportunity. As I said, it's the studies phase where your detailed feasibility studies look at that demand profile and scale it accordingly, so that's part of the process that the team are working through.

In the context of Iron Bridge, we are seeing inflation more broadly, and as costs like fuel costs - we've seen a substantial increase in fuel costs in this half versus the same period last year, and those are significant. We've guided to a life of mine for C1 costs for Iron Bridge; there are certain assumptions in there around fuel costs, for example. One of the benefits of Pilbara Energy Connect is, we are adding additional capacity at Solomon for our gas-fired power station and we're adding 150 megawatts of solar generation.

For stationary energy, the strategy is to provide low-cost energy for stationary energy and then obviously there's the mobile fleet. That all goes into the mix. We're obviously entering a cycle of inflation. As I said, it's a life-of-mine guidance. There's no change to the fundamentals is what we anticipate, but it will be subject to the actual costs of fuel, currency - for example, the exchange rates will have a big impact, but we're comfortable where we currently are based on the assumptions that we made.

Ian Wells: What I could perhaps add to that, is that remembering that the FID was done back in 2019, so there's going to be a change to that, and we're coming into first production by the end of this year. Part of our guidance for next year is going to be capital and operating costs for Iron Bridge, and as you would expect, it's always going to start at the start, which is you don't put your whole fixed costs base on but it's pretty close and then you've got a ramp-up period as well.

We're going to be in a better position to provide additional detail but also add that the revenue side of the equation in terms of an expectation of getting value for that higher-grade magnetite, low impurities, firms up every day as opposed to perhaps some of the more conservative assumptions that look in hindsight when that investment decision was made. There's a few balancing items there as well just to consider.

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

Paul Young: (Goldman Sachs) Hi, Elizabeth. Hi, Ian. First question is on iron ore reinvestment and in particular sustaining capex and reinvestment in the mines. Sustaining capex is around \$8 a tonne, double what it was five years ago. Without major investment in new mines - and it's gone up for a lot of participants in the Pilbara. But Ian, we roll into the new year and I guess the question for you is around the five-year mine plan and how you think about the timing on Nyidinghu versus a Flying Fish investment to replace Firetail?

Ian Wells: Yes, I think over that five-year period Nyidinghu is probably at the backend of that, Nyidinghu or the equivalent of Nyidinghu, or a major hub if we just call it that, is that we're going to have to be spending some money at the backend of that period to have that in production, but then we did call out the fleet cycle that we're going into. Obviously, decarbonisation linking into the fleet replacement cycle, that also increased maintenance because coming into the maintenance cycle as well.

So, going into FY23 there's a couple of things which we called out before as a reminder on our ex-hub development sustaining capital, we would expect to be in and around the same level. However, the fleet replacement cycle is changing, we are producing more tonnes, and also mine life costs and capital costs are increasing and then you've got the hub development capital or the smaller satellite hubs continues, and Eliwana is a good example of access to mining areas means investment in other areas.

I think you need to take those into consideration as well, and when you add sustaining plus hub and ops development for this half, which is we put those altogether, yes, you get \$8 a tonne. Noting that there's some ops development capital, which will probably drop off for next year, but in the most part that will just be replaced by reinvesting back in - more than likely the fleet is the major category that we called out and there's probably water from a mine planning perspective, and also we've been investing in resource definition drilling as well over and above what we have in the past for all of the reasons that we've been explaining for quite some time.

Paul Young: (Goldman Sachs) Okay. Great, Ian. With that, maybe moving on to FFI. Just noting the slides in the presentation with the projects you've listed. A bit of ebb and flow, projects coming and going based on what FFI's and now it's MOUs, and I presume that that's all a timing issue with respect to agreements with governments and levels and advancement on studies. The question I have is that you've obviously got the 10 per cent of NPAT number out there but Ian, based on your projections on cash flow, iron ore price forecasts and reinvestment in the iron ore business, what is roughly the theoretical level of annual spend that Fortescue can actually handle in FFI?

Ian Wells: Well, the allocation is the allocation and NPAT to free cash flow aligns, as we've spoken about, depending on working capital and capital expenditure. That's the funds that we're allocating to FFI at that point in time, so depending on your iron ore price assumptions, we'll give you 10 per cent, you can work that out. Then it comes back to the capital expenditure, the reinvestment in the iron ore business through sustaining and decarbonisation which part of that is reinvestment back in the fleet that we're going to spend anyway, but the development costs and the associated energy infrastructure, clearly, we've got capacity in our balance sheet on the basis that we'll continue to be disciplined in it.

It's balancing sources and uses of funds. We've got the levers, and ultimately the math works back to an assumption on the iron ore price, managing our costs, generating strong margins. We're almost at the backend of the Iron Bridge capital and we're very close to free cash flow, so that's also a consideration from sources of funds where we've got returns from Iron Bridge coming in as well, which is an important part of the equation.

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

Peter O'Connor: (Shaw and Partners) Elizabeth, Ian, good afternoon. Two short ones, Elizabeth, that should just need a yes or a no answer. Culture, exco - is the level of turnover at the exco in the past 12 months, is that typical or normal,

and if the answer is yes, should there be a cultural review of that area? Second question: in terms of average selling price or the discounts you receive, has that discount moved higher or lower this current period?

Elizabeth Gaines: I'll start with - it's not so much culture, I think it's people, and we talked about this at the Quarterly. The majority of people and turnover we've seen were people who had been with us for more than a decade, and I think that longevity we've had of people in the Executive team is actually quite unusual, and that's a testament to the strength of the culture at Fortescue that clearly, we're seeing some movement with strong demand for talent.

What I'm really pleased with, is that we've brought in a combination of external talent as well as seeing some really good succession in our people within Fortescue as a result of those movements. Obviously, Dino Otranto has joined us as Chief Operating Officer Iron Ore. Warren Fish recently joined as Director of Aboriginal Engagement, Community and Government. We have a new General Counsel, Paul Shillington, joining us. Adam Meyer was promoted to the Director Health Safety and Environment role.

Really pleasingly, we've seen some movement of our General Managers where Katie Charuga-Andrijasevic, formerly Katie Day, who was a General Manager at Eliwana, has now transitioned to the larger operation at Solomon, and we've just had the appointment of our first Aboriginal General Manager at Eliwana, Rosli Wheelock. We've seen some great talent, we've seen progression, we've seen succession, and I'm really pleased with the composition of our Executive and Leadership team, so we don't need to do a review. I think we're really pleased with the talent that we've attracted to the business and the people who have left, we wish them well and we thank them for their contribution to Fortescue.

In terms of average selling price, look, we've seen some volatility. We saw some improvement in pricing leading into February, but we are seeing ongoing volatility. For us, it's about making sure we're staying close to our customers, delivering under our long-term contracts and making sure that we're integrated across our operations and marketing to make sure we're meeting that demand. We do see strong demand for our products and we're very focused on keeping our cost low as you know Peter. Our core focus is making sure that we generate those very strong margins throughout the market cycles.

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

Robert Stein: (CLSA) Hi Elizabeth and team. Just firstly, congratulations about the strong result. Really strong cost control in this period. So, thinking about FFI and hydrogen and the value chain, are you able to provide us indication of the energy losses across that value chain from generation to transportation right through to customer consumption and of the green hydrogen, including any conversion losses from ammonia?

The basis for the question is I'm just trying to get a handle on how to appropriately size renewable capex and renewable capex intensity for a hydrogen project or a hydrogen business at 15 million tonnes. It would be great to get an energy balance to see capital intensity. I have a second question as well.

Elizabeth Gaines: Yes, look good question Robert. I think that's one for a deeper dive with the FFI specialist folks and certainly we'll work with Andy to make sure we can address those questions. I think that's a subject for a bigger discussion.

Robert Stein: (CLSA) Okay, the reason why I ask, is it's pretty fundamental to, I guess, the capital intensity of the projects that we're trying to all model and put in valuations to justify the gap from the iron ore business to the share price. So, any further disclosure would absolutely help on that.

Elizabeth Gaines: Yes, and I would add that we understand that. Look, technology is evolving and we're investing in technology. So, this is fast moving. We're seeing that huge increase in fuel prices. We're going to continue to see volatility in fuel prices, but that is where we're actually doing a lot to be part of what will be a super cycle of a transition to green energy.

So, Fortescue is very well positioned throughout that entire value chain. It's not just about decarbonisation, decarbonising stationary energy. I understand that you want those level of details and to prepare those models and we can certainly get some of the subject matter experts to give some further guidance on that, but it is evolving and that's why we're investing in technology.

The acquisition of Williams Advanced Engineering will also contribute to that evolution and the manufacturing of electrolysers in Gladstone, that's all part of how we're looking to reduce our capital intensity. Certainly, we can provide some further detail on that in a separate discussion.

Robert Stein: (CLSA) Perfect. The second question I have is more related to the iron ore business. If the thesis on hydrogen and green carbon - and the green premium is correct, and we start to see that flow through to hydrogen and making it profitable and get an economic return, what does that mean for the 58 in business for iron ore because you could see similarly that that business would struggle to have a future in that world.

So therefore, if it does move quickly, how should we think about capital intensity of sustaining production at say 180 million tonnes to 200 million tonnes for the iron ore business? If we shift up to a 65 - 68 magnetite style sustaining profile, then that's going to be significantly more capital intensive than the \$4 to \$5 a tonne in the hub replacements that we've probably all got in the models going forward. Are you able to just provide a little bit of an indication of how we should think through that capital intensity?

Elizabeth Gaines: Well, I think that relies on the basic premise that there'll be that preference for the high-grade magnetite and really it is the work that we are doing around the future of green iron is testing of our existing fines through that process.

There is a lot of emerging technology. We're doing a lot of work internally, as well as working with specialists in the field and others too and looking at the opportunity for DRI. So, there's a lot of work that's underway. That doesn't necessarily mean that the focus will only be on magnetite. The view is there'll be strong demand, ongoing demand for our hematite fines. So that doesn't signal any shift in terms of focus on sustaining our current levels of activity across the entire business.

Ian Wells: Robert, a couple of other points from me to add in terms of your considerations. With our 2030 targets, Fortescue will be producing iron ore that is emissions free. So, it's going to be 10 to 20 years in advance of our competitors. So logically would that be valuable to our customers? It may very well. When you start to work through the economics of that producing at 200 million tonnes per annum adds up quite quickly. A \$5 to \$10 number is large.

The other point is low-cost renewable energy, which clearly will have been done by that point in time, does change the economics associated with iron ore production. We're already doing that right now. We're doing that at Iron Bridge. So, we would expect as we continue to add renewable energy to our network and Uaroo is something that clearly can do that.

Other areas can do that as well, lowering our cost of energy opens up options. It doesn't only provide an economic benefit, but it opens up different opportunities. So, Iron Bridge monetising that ore body, really has boiled down to a lower energy intensity and a lower cost of energy.

So, they're the other parts of the equation that I guess we are certainly thinking about and would encourage you to have a think about that as well.

Operator: Thank you. Your next question comes from Lachlan Shaw from UBS. Please go ahead.

Lachlan Shaw: (UBS) Hi Elizabeth and Ian, and thanks for the briefing. First question is on the Uaroo Renewable Energy Hub. Just interested in your thoughts around funding and the funding model. Is this something that you would look to do

in-house on the balance sheet or perhaps sign a long term PPA and contract it out for someone else to build and run for you?

Second question is just on the dividend payout ratio. Obviously, it's come back a little bit to 70 per cent, just above the midpoint of the guidance range. Is this how we should be thinking about the payout ratio going forward, given that you are further facing into a period in the medium term where there is a bit more capex coming through? Thanks very much.

Elizabeth Gaines: Well, maybe I'll start with the dividend question and Ian might want to talk about Uaroo. Look, in terms of the dividend, especially the payout, is pretty consistent with our FY19 and FY20, where our interim was at the exact middle of the range of 65 per cent, recognising that we're in that from a seasonal perspective around that period, that there can be some volatility.

Then for both of those years, we ended up at 77 to 78 per cent based on the full year net profit after tax. So, you saw a weighting towards the final dividend, but the full year was at that 77 to 78 per cent. That's our target, which is the upper end of the range of full year net profit after tax.

So, 70 per cent, you're right, the Board take into consideration capital investment and we have been funding Eliwana and Iron Bridge from operating cashflows. We've got obviously peak construction workforce on Iron Bridge. So, all of those are taken into account, but certainly 70 per cent is consistent with towards the upper end of that range. Then we look at the full year net profit after tax, as we have done every other year.

Ian Wells: I think in terms of funding, we went through a couple of options, which I suppose there's two parts to it. One part is the decarbonisation of Fortescue's iron ore division, which would be on the balance sheet, I suppose. So, funding that capital, whether it's through a third party PPA or directly, comes back onto balance sheet.

If you're talking about a third-party hydrogen export, into the FFI side of things and a hydrogen production for export, that's a separate funding solution that we've been clear on nonrecourse specific to project financing which obviously takes it to a different level and has its own opportunities and challenges associated with that.

So, the project is interesting because it reaches over both, but if we get back to the clear and present thing of Fortescue decarbonisation then that's Fortescue capital one way or the other and will be funded as part of our existing capital allocation framework, which we've talked about. Obviously having balance sheet capacity is important certainly in the development phase.

Operator: Thank you. Your next question comes from David Coates from Bell Potter Securities. Please go ahead.

David Coates: (Bell Potter Securities) Good morning Elizabeth. Good morning Ian. Thanks so much for the call. Look you've just answered my dividend question. So, look, I've just got a quick one on Iron Bridge. First production is now less than 12 months away. Should we be thinking about that more in terms of replacing or displacing current production and the narrowing - growing quality discount, or should we be thinking about it as over and above the current production rate?

Elizabeth Gaines: Yes, David thanks for the question. Look, we've always said from the outset, this is a growth project, so it's over and above current production. In fact, we've had our licensed capacity through the port of Port Hedland increase from the 175 million tonnes to 210 million tonnes to accommodate Iron Bridge. So, this is incremental volume.

Operator: Thank you. Your next question comes from Glyn Lawcock from Barrenjoey. Please go ahead.

Glyn Lawcock: (Barrenjoey Capital Partners) Good afternoon, Elizabeth. Just two quick ones from me. I note in the half, you had SG&A at US\$125 million, and you make a comment about you've included cost of incentives. Just wondering

if you could give me some thoughts around what I should think about going forward? That's quite a big number at 125 and is that incentives - to the question earlier, I guess, around staff turnover, just trying to keep some of the staff in place.

Then the second question is, I think Ian talked a lot about this already, but I just wanted to clarify you have your capital management framework, 10 per cent FFI, 10 per cent growth, 50 to 80 per cent dividends. Just can you elaborate a little bit, does the FFI 10 per cent spend have to compete on a returns basis or is that 10 per cent fixed such that if you grow the iron ore business, the only bit that gives is the dividend?

I'm just trying to make sure I understand, is it just FFI is 10 per cent and stays and so growth versus returns is the other 90 per cent, because clearly if you're going to keep spending US\$400 to US\$600 million on FFI with people's projected profits, you'll need more than 10 per cent. Thanks.

Elizabeth Gaines: Yes, I'll start with SG&A. I mean, certainly our costs of SG&A have been at around US\$100 million but we did have a cost of an incentive. That's an all of staff incentive, every single person who works at Fortescue that's not part of the executive team, received.

We had a record year, US\$10.3 billion and on top of their existing incentives, we actually had a one-off incentive for everybody across the business, as we did the previous year with a record year. So that's just to recognise and reward the fantastic contribution to what was a record year.

So, nothing to do with executive departures or anything else. It was for every single person who works as a full-time employee of Fortescue.

Ian Wells: Yes, I'd just add Glyn, the US\$125 million is the total SG&A and its sort of disproportionate because the bonus is a material portion of the total in the half, and it's called out in the accounts because the variance is largely the increased dividend.

In terms of FFI, I think it's an important question that you asked. Is that capital immediately allocated or does it compete? I can guarantee you it is - it continues to be competed for and clearly the carried forward amount is a function of what hasn't been spent.

So, we're just saying that's the amount that's available, not 100 per cent locked in and it's subject to a competition at a group level, but I can also guarantee that it's a subject competition within the FFI group as well, and the various managers competing for scarce resources and putting that money to work on the various areas of studies, technology, development and manufacturing and so forth.

So, I guess it flexes with free cashflow or net profit after tax, in and of itself but also the point of FFI and the capitalisation of FFI is to get into free cashflow as soon as possible, and become self-funding and become a business unit. A profit centre in its own right is the longer-term objective, clearly.

Glyn Lawcock: (Barrenjoey Capital Partners) Can I just clarify, there will be US\$100 million per half then? For SG&A. Is that a sort of a ballpark number? Because that's even higher than the last few halves, I would imagine.

Ian Wells: No, it's more like US\$150 million.

Glyn Lawcock: (Barrenjoey Capital Partners) US\$150 million per annum, do you mean?

Ian Wells: Per annum. Sorry, just to clarify for everyone else's benefit as well. That's why we've taken FFI out separately, to separately identify because FFI's costs, whilst they will have a future economic benefit in the future, they get expensed to the P&L until we get a project that it can be capitalised against.

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

Saul Kavonic: (Credit Suisse) Thank you. A quick question, just again on funding for FFI. I'm just trying to understand the 15 million tonne green hydrogen production by 2030, that's going to involve multiple projects? Presumably you don't want to all sequence with them at the end, so you want at least one or two projects relatively soon. Can you just clarify exactly what stage are we at regarding funding discussions and off-take negotiations for the newer term hydrogen projects?

Elizabeth Gaines: Yes, look, we had announced a couple of MOUs for off-takes, so one with JCB and Ryze in the UK and Covestro recently in Germany. So there has been discussions around off-take. They're at MOU stage. A number of projects have been assessed at various stage of studies.

You're right, it won't all be all invested at one point in time, but we've made it clear from the outset that these projects and the major projects, we will need a source of funding and those discussions are ongoing as well. There's a range of opportunities for funding and that could be partnering with others as well as looking at direct project finance without recourse to Fortescue.

So, a range of funding opportunities are being assessed. Off-take arrangements being discussed and progressed. So, you're absolutely right, it's about pulling all those pieces together as we assess each project and advance those discussions.

Ian Wells: But logically the projects are in their early-stage consideration. So, the funding conversations as a consequence, so very early stage as well. Noting clearly, we're all seeing sources of capital for those sorts of investments but you still need to get the investment right, with the right economics to be able to access the various funding sources in the market.

Saul Kavonic: (Credit Suisse) Good, thanks and just a second quick question, actually. Again, just highlighting the distinction on WAE sitting within Fortescue rather than the FFI division. That when you apply that to WAE, you mentioned that there's obviously opportunity for that divisional business to make money beyond Fortescue's internal operations.

To the extent that it is going to make money from third parties, is the benefit and the revenue and the profit from that WAE part of the business going to go into FFI, or is that going into Fortescue's base business? I'm just trying to understand, is there scope for more capital or M&A to be spent by Fortescue in base business, which is going to be giving freebies to FFI or is it very distinct.

Elizabeth Gaines: Fortescue is acquiring Williams Advanced Engineering and it will be consolidated, obviously, into the group results but a subsidiary within Fortescue. The costs associated with it, and revenue it generates will form part of the iron ore business and that's where that entity will sit.

Operator: Thank you. Your next question comes from Adrian Prendergast from Morgans Financial. Please, go ahead.

Adrian Prendergast: (Morgans Financial) Yes, hi guys. Just a follow up on a question earlier from Glyn, I just didn't quite understand the explanation that was given. Just in terms of how iron ore, FFI and dividends compete in the framework for capital.

I could have misunderstood, but I thought the explanation was that while FFI does compete for capital, any amount of the 10 per cent of NPAT not spent is carried forward. So, does that mean it's not competing and really, it's just a fixed amount that remains within that subsidiary?

Ian Wells: No, think about it that you still have got to come up with a business case to spend the money, like any allocation of capital, whether it's operating costs or capital expenditure. So, all that we're doing is identifying what the 10 per cent was, how much you spent and therefore in theory how much is available.

I can guarantee you that every dollar is precious and needs to have its own return metrics on what are we getting for that money. So, in terms of a forward-looking estimation, some folks have taken the 10 per cent of NPAT and assumed that it's funded, which obviously has an impact on the future NPV of the company but that's obviously ignoring any return on investment.

So, it's budgeting 101. When the iron ore division guys come up then we're looking at the operating or capital expenditure for the business, it goes through a rigorous process. Whether it's operating or capital costs. So, I think that's the conclusion you should take from that.

Adrian Prendergast: (Morgans Financial) That's really clear and one final question. I mean, the different parts of our business are very interesting but very different from each other. Just to get some idea, I bet it's not just straight forward return profile but just how you compare FFI versus iron ore growth. Just to get an idea on how you think about these different opportunities that you have in different spaces?

Ian Wells: Yes, well I think it's a bit like - Elizabeth was talking about the question regarding magnetite production versus hematite production or Mining Area A versus Mining Area B. It's our job as the management, is to work out where we get the best return on investment from the group, and we've got a number of different levers to do that.

Delivering on our customer's requirements and maximising margins on the iron ore division and balancing that off with Iron Bridge and balancing that off with FFI is - they're different businesses but the same fundamentals of return on capital employed and so forth for the group is really important for us.

Capital allocation, capital discipline, operating disciplines, it always comes back to the same things, and maximising returns to shareholders is holistic rather than one dimensional.

Elizabeth Gaines: I think it's pretty clear in terms of our capital allocation framework, we've given an allocation 10 per cent to FFI, the benefit of 10 per cent of NPAT, which is variable. It will flex with iron ore price, costs of production. So, it's inextricably link to the results and performance of Fortescue's iron ore business.

The 10 per cent allocation of NPAT, if that's utilised as we've pointed out in the half year results, as a carry forward but every budget they prepare goes through the same scrutiny process and any capital investment will again need to fit within the allocation of that NPAT or if it's a significant project, having identified the source of funding.

So, we've been clear on that from the outset, and I think that's the benefit of that discipline we've shown in our capital allocation framework, and certainly the benefit of a 10 per cent of NPAT that is variable in nature means everyone's more focussed on the cost base and capital of FFI as well as the iron ore business.

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

Kaan Peker: (RBC Capital) Thanks, Elizabeth and Ian, just two quick follow-ups. An accounting one – I think on your balance sheet, there's a non-current inventory entry of around US\$400 million. What does this relate to? Second one is more of a hypothetical. Just assuming FFI was capital constrained, what would be the top three projects? Thanks.

Ian Wells: So yes, that's the non-current inventory, Kaan, is a function of I guess the age of our business now. So, what it reflects is run of mine inventory that's sitting down in the business. So out on the sites, which is not scheduled to run through the plant for longer than 12 months is non-current. So, it's a more accurate representation of the inventories that

we've progressively built over time and that's run of mine inventory will be run through the plant in due course and monetised. So therefore, it's a - I guess an improvement in our systems and processes and tracking of our iron ore units in the system and that just reflects the timing of monetising those assets.

Kaan Peker: (RBC Capital) Does that relate to Eliwana

Ian Wells: No, it's more than just Eliwana. Previously, the reason why there's nothing in the previous half, because we've updated our accounting procedures and its recognition of the same inventory, it's just splitting it between current and non-current.

Elizabeth Gaines: Look, just on FFI, capital constraint or not, its priorities are decarbonising Fortescue's iron ore business is an absolute priority and progressing a domestic project and opportunity and one of the international portfolio projects. So, there's a raft of opportunities to choose from, and it's selecting those that give the best time frame in terms of speed to market, return profile, capital intensity, operating costs – that will be the usual discipline around what gives us the better return. So rather than just saying one or two particular projects, it is - within that category, I think a strong domestic project or an international project. And decarbonising Fortescue is the objective of FFI.

Kaan Peker: (RBC Capital) So no specifics?

Elizabeth Gaines: No specifics.

Operator: Thank you. There are no further questions at this time. I'll now hand back to Ms Gaines for closing remarks.

Elizabeth Gaines: Thanks, Darcy and thanks everyone for your participation today. Appreciate the questions, the interest in Fortescue and obviously we're very pleased with an outstanding set of results including our third highest half year profit and we're very well positioned for the second half in delivering on our guidance this year. So, I look forward to touching base with you again with the next quarterly. In the meantime, stay safe. Thank you.

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

End of Transcript