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# Fortescue Metals Group (FMG)

## FY21 dividend set for record

### Recommendation

**Hold** (unchanged)

### Price

**\$25.72**

### Target (12 months)

**\$24.06** (previously \$23.96)

### GICS Sector

Materials

### Expected Return

Capital growth	-6.5%
Dividend yield	17.9%
Total expected return	11.4%

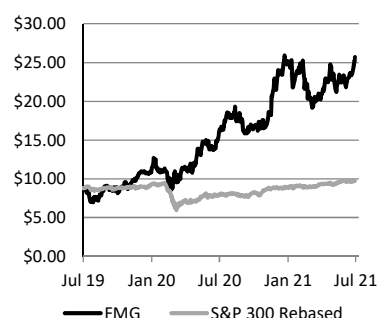
### Company Data & Ratios

Enterprise value	<b>\$80,538m</b>
Market cap	<b>\$79,191m</b>
Issued capital	<b>3,079m</b>
Free float	<b>55%</b>
Avg. daily val. (52wk)	<b>\$206.8m</b>
12 month price range	<b>\$15.62-\$26.40</b>

### Price Performance

	(1m)	(3m)	(12m)
Price (A\$)	23.22	20.89	14.85
Absolute (%)	10.8	23.1	73.2
Rel market (%)	10.5	18.2	48.7

### Absolute Price



SOURCE: IRESS

## Iron ore stronger for longer – but still set to drop

We have updated our commodity price and foreign exchange rate forecasts, including the mark-to-market for FY21 of our benchmark iron ore price. For the June 2021 quarter we measured the 62% Fe benchmark price at US\$200.40/dmt which was 5.5% ahead of our US\$190dmt forecast. We continue to see downside risk to the iron ore price as a result of lower Chinese steel production, increased iron ore production, the ongoing disruption of COVID-19 and maintain our forecast for it to drop in 1HFY22. However, the price has remained stronger than expected and we reflect this into FY22 and FY23, with increases of 9% (to US\$143/dmt) and 5% (to US\$100/dmt) respectively. We also continue to forecast a lower AUD:USD exchange rate, which we view is consistent with a dropping iron ore price, global interest rate differentials and Australia's (relatively) lagging COVID-19 vaccination rates.

## Record dividend, bumper yields

These updates have a positive impact on our financial forecasts for FMG. Our key focus in the near term remains the dividend payout and yield. Our FY21 dividend increases 1.3% to A409cps, inclusive of a fully franked final dividend payment of A262cps (from A257cps), a 10.2% yield on its own. Our forecast prospective 12-month dividend payouts lift 5.7% to A460cps (from A435cps) as 1HFY22 captures our higher iron ore price forecast, for an interim payment of A198cps and forecast 17.9% fully-franked yield. In our view FMG's fully franked dividend yields remain a key price support for the stock, even in our forecast environment of a declining iron ore price.

## Investment thesis – Hold TP\$24.06/sh (from Hold, \$23.96/sh)

Our NPV-based target price increases incrementally to \$24.06/sh and our FY21 and FY22 earnings forecasts increase 1% and 12% respectively on this update. The dividend remains a compelling price support, offsetting the recent share price appreciation to maintain a forecast total shareholder return of 11.4%. We retain our Hold recommendation, in conformity with our recommendation structure.

### Earnings Forecast

Year ending 30 June	2020a	2021e	2022e	2023e
Sales (US\$m)	12,820	22,425	20,843	14,141
EBITDA (US\$m)	8,312	16,727	15,196	9,033
NPAT (reported) (US\$m)	4,735	10,849	9,908	5,450
NPAT (adjusted) (US\$m)	4,735	10,849	9,908	5,450
EPS (adjusted) (UScps)	154	352	322	177
EPS growth (%)	49%	129%	-9%	-45%
EPS (adjusted) (Acps)	229	471	438	242
PER (x)	11.2	5.5	5.9	10.6
EV/EBITDA (x)	7.3	3.6	4.0	6.7
Dividend (Acps)	176	409	338	169
Yield (%)	6.8%	15.9%	13.1%	6.6%
Franking (%)	100%	100%	100%	100%
ROE (%)	36%	58%	56%	30%

SOURCE: BELL POTTER SECURITIES ESTIMATES

# Fortescue Metals Group (FMG)

## Iron ore stronger for longer – but still set to drop

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Our updated forecasts are summarised below:

**Table 1 – Bell Potter iron ore (Fines) CFR @ 62% price forecast**

	2HFY21	1HFY22	2HFY22	1HFY23	2HFY23
Old	179	153	110	95	95
New	184	165	120	100	100
Change	3%	8%	9%	5%	5%

SOURCE: BELL POTTER SECURITIES ESTIMATES

Our latest forecast compared with the latest consensus range is shown in the chart below:

**Figure 1 - Updated iron ore price forecasts vs latest consensus**



SOURCE: CONSENSUS ECONOMICS AND BELL POTTER SECURITIES ESTIMATES

## Marginally offset by stronger AUD:USD

We also apply a marked-to-market AUD:USD exchange rate for this update which results in an incremental lift (<1%) compared to our previous AUD:USD forecast and an EPS decrease of just A2cps for FMG.

## Changes to our forecasts

We have made no major changes to our modelled assumptions beyond updating our forecasts for our latest marked-to-market iron ore price and currency exchange rates. These flow through to our dividend and earnings forecasts which are upgraded on our latest price assumptions. The net impact to our production and earnings estimates are summarised overleaf.

Table 2 - Changes to earnings estimates

Year ending June 30	Previous			New			Change		
	Jun-21	Jun-22	Jun-23	Jun-21	Jun-22	Jun-23	Jun-21	Jun-22	Jun-23
Iron ore (Fines) CFR @ 62% Fe	152	131	95	155	143	100	2%	9%	5%
AUD/USD	0.75	0.73	0.73	0.75	0.74	0.73	0%	1%	1%
Total production (Mt wet)	180.0	179.0	180.0	180.0	179.0	180.0	0%	0%	0%
Costs C1 (US\$/t)	13.58	13.63	13.39	13.57	13.72	13.49	0%	1%	1%
Revenue (US\$m)	22,227	19,196	13,434	22,425	20,843	14,141	1%	9%	5%
EBITDA (US\$m)	16,540	13,696	8,403	16,727	15,196	9,033	1%	11%	7%
NPAT (adjusted) (US\$m)	10,714	8,823	4,989	10,849	9,908	5,450	1%	12%	9%
Adjusted EPS (Ac/sh)	465	393	223	471	438	242	1%	12%	8%
PER (x)	5.5	6.6	11.5	5.5	5.9	10.6	(0.1)	(0.7)	(0.9)
DPS (Ac/sh)	404	301	156	409	338	169	1%	12%	8%
Yield (%)	15.7%	11.7%	6.1%	15.9%	13.1%	6.6%	0.2%	1.4%	0.5%
Net debt (cash) (\$m)	(1,725)	404	(125)	(1,849)	(219)	(642)	7%	-154%	416%
ND / (ND + E) (%)	-10%	2%	-1%	-11%	-1%	-4%	-1%	-4%	-3%
Valuation (\$/sh)		23.85			24.06			1%	

SOURCE: COMPANY DATA AND BELL POTTER SECURITIES ESTIMATES

Our higher forecast iron ore price is the primary driver of our earnings, dividend and target price increases. The higher iron ore price is incrementally offset by a higher AUD:USD forecast. This flows through to our dividend forecasts, for which we maintain our assumed 80% payout ratio. This is at the top end of FMG's 50%-80% payout policy and in-line with guidance. Our FY21 dividend increases 1% to A409cps, inclusive of a final dividend payment of A262cps, fully franked (for a 10.2% yield on its own). Our forecast prospective 12-month dividend payouts lift 5.7% to A460cps (from A435cps) for a forecast 17.9% fully-franked yield. Our NPV-based target price increases incrementally to \$24.06/sh.

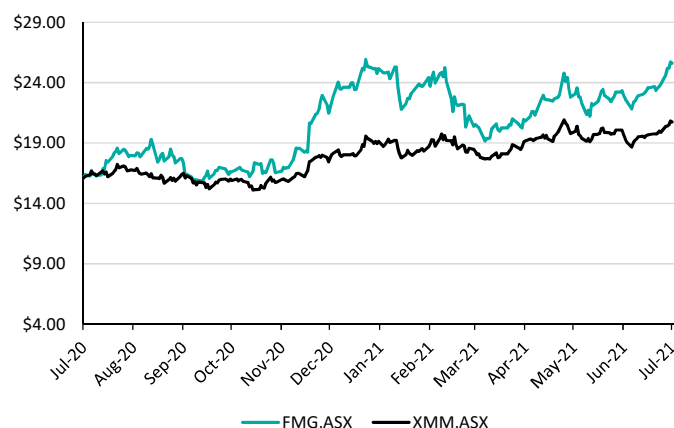
## Upcoming catalysts

Key near term catalysts for FMG include:

- The sustainability of favourable market factors through FY22, primarily an elevated iron ore price but also a weakening AUD:USD exchange rate;
- Improved grade and quality discounts being sustained in the market;
- The June 2021 quarter report, scheduled for release on 29 July 2021;
- Production and development updates from the Eliwana project (now in ramp-up), Queens Valley at Solomon Hub and the Iron Bridge Magnetite project; and
- Progress updates in relation to the investments being made into FFI.

## FMG vs the ASX Metals and Mining Index

Figure 2 - FMG relative share price performance vs ASX Metals and Mining Index (XMM)



SOURCE: IRESS

# Fortescue Metals Group Ltd (FMG)

## Company description: Iron ore major in the Pilbara, WA

FMG is an independent iron ore producer in the Pilbara region of Western Australia. The company is currently achieving its targeted ~175-180Mtpa production rate, following ten years of development and expansion. It has successfully reduced its debt and built a strong balance sheet. FMG is now targeting the production of a +60% Fe product and has become more active in exploration for other commodities.

## Investment thesis – Hold TP\$24.06/sh (from Hold, \$23.96/sh)

Our NPV-based target price increases incrementally to \$24.06/sh and our FY21 and FY22 earnings forecasts increase 1% and 12% respectively on this update. The dividend remains a compelling price support, offsetting the recent share price appreciation to maintain a forecast total shareholder return of 11.4%. We retain our Hold recommendation, in conformity with our recommendation structure.

## Valuation: \$24.06/sh

Our FMG valuation incorporates DCF models of FMG's Chichester and Solomon production hubs, including future production from the Eliwana and Iron Bridge projects. We also make an estimate of exploration/expansion upside and an estimate of corporate overhead costs. We calculate a 12-month forward, NPV-based valuation for FMG's assets of \$24.06/sh on this basis.

## Risks

Risks to resources sector equities include, but are not limited to:

- **Funding and capital management risks:** Funding and capital management risks can include access to debt and equity finance, maintaining covenants on debt finance, managing dividend payments and managing debt repayments. Exploration and development companies with no sales revenues are reliant on access to equity markets and debt financing to fund the advancement and development of their projects.
- **Operating and development risks:** Mining companies' assets are subject to risks associated with their operation and development. Risks for each company can be heightened depending on method of operation (e.g. underground versus open pit mining) or whether it is a single mine company. Development of mining assets may be subject to receiving permits, approvals timelines or weather events, causing delays to commissioning and commercial production.
- **COVID-19 risks:** Mining companies' rely on freedom of movement of workforces, functioning transport routes, reliable logistics services including road, rail, aviation and ports in order to maintain operations and get their products to market. They also rely on liquid, functioning markets to sell their products. Measures being put in place to combat the COVID-19 pandemic are posing risks to these conditions.
- **Operating and capital cost fluctuations:** The cost and availability of exploration, development and mining inputs can fluctuate widely and cause significant differences between planned and actual operating and capital costs. Key operating costs are linked to energy and labour costs as well as access to, and availability of, technical skills, operating equipment and consumables.
- **Commodity price and exchange rate fluctuations:** The future earnings and valuations of exploration, development and producing Resources companies are

subject to fluctuations in underlying commodity prices and foreign currency exchange rates.

- **Resource growth and mine life extensions:** The viability of future operations and the earnings forecasts and valuations reliant upon them may depend upon resource and reserve growth to extend mine lives, which is in turn dependent upon exploration success, of which there are no guarantees.
- **Regulatory changes risks:** Changes to the regulation of infrastructure and taxation (among other things) can impact the earnings and valuation of mining companies. NIC's assets are located in Sulawesi, Indonesia, which has in the past implemented regulatory changes related to mining project ownership, fiscal terms and mineral export requirements.
- **Sovereign risks:** Mining companies' assets are subject to the sovereign risks of the jurisdiction within which they are operating. NIC's assets are in Indonesia, a G20 country with one of the largest economies in SE Asia. Its sovereign debt is rated investment grade by the major ratings agencies.
- **Corporate/M&A risks:** Risks associated with M&A activity including differences between the entity's and the market's perception of value associated with completed transactions.



**Recommendation structure**

**Buy:** Expect >15% total return on a 12 month view. For stocks regarded as 'Speculative' a return of >30% is expected.

**Hold:** Expect total return between -5% and 15% on a 12 month view

**Sell:** Expect <-5% total return on a 12 month view

*Speculative Investments are either start-up enterprises with nil or only prospective operations or recently commenced operations with only forecast cash flows, or companies that have commenced operations or have been in operation for some time but have only forecast cash flows and/or a stressed balance sheet.*

*Such investments may carry an exceptionally high level of capital risk and volatility of returns.*

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