FINANCIAL REVIEW

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HD	**Lingering doubts dampen FMG's run**
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Fortescue Metals Group shares enjoyed a strong run in the **lead**-up to Christmas amid a healthy **iron ore** price and focus on repaying debt. However, lingering concerns about its operational culture and the long-term outlook for **iron ore** has somewhat divided the market on the stock.

The Western Australian-based group is pushing to expand its **iron ore operations** to 155 **million** tonnes a year by March this year.

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Fortescue maintained its full-year guidance to produce between 127 **million** tonnes and 133 **million** tonnes in October last year.

While its large debt nearly crippled the **company** when the spot **iron ore** price in September 2012 fell to approximately $US88 a tonne, Fortescue chairman and BRW Rich Lister Andrew Forrest indicated the group may repay debt faster than the market is expecting. It currently holds $US9.9 **billion** ($11 **billion**) in net debt.

Fortescue announced it would repay $US1 **billion** out of $US2.04 **billion** in senior unsecured notes in December 2013 in a move that will save an estimated $70 **million** a year in interest.

Mr Forrest, who is also Fortescue's largest shareholder, said management were focused on repaying debt "so don't be surprised if in the next several weeks to several months we do another $US1 **billion**".

While many metrics for FMG appeared to be moving in the right direction, a contractor death at its Christmas Creek mine in August last year and another at the end of December have called into question the group's safety record. Fortescue chief executive Nev Power defended the group's workplace procedures following the second incident, adding that safety was a core value at the **company**. It has not quashed lingering concerns about the operation's practices.Shares rebound from June low

Despite these concerns, a robust **iron ore** price of $US130 a tonne and FMG's debt reduction efforts so far have seen its shares rebound 78 per cent from a 12-month low of $2.92 a share in June to close at $5.20 a share on Friday.

Sixty per cent of **equity** analysts have a "buy" recommendation on the stock, while 28 per cent have a "hold" call, according to Bloomberg. Three analysts have a "sell" recommendation on Fortescue.

The average 12-month price target is $6.13 a share, while some analysts have price targets much higher at $7.50 and $8.

Bell Potter managing director Charlie Aitken named Fortescue in his top three picks for 2014. He said the number one variable in successful stock selection is management, particularly when they have a lot of personal wealth invested. Mr Forrest owns 34 per cent of Fortescue.

Mr Aitken reckons Fortescue will be a major beneficiary of a falling Australian dollar and a "reaccelerating **Chinese** economy", which will fuel ongoing demand for **iron ore** and keep prices elevated.

Royal Bank of Canada named Fortescue as one of its preferred picks on expectations the **iron ore** price will be underpinned by **Chinese** demand and predictions the **company**'s gearing could fall to 36 per cent.

In addition, the world's largest resources investor, BlackRock Group, emerged as a significant shareholder of Fortescue for the first time in December last year.Teck sells $503m **stake**

But uncertainty around the impact of additional **iron ore** supply on the spot price and **Chinese** demand means some analysts believe the stock is fully valued.

China's **iron ore** futures fell more than 2 per cent to near-record lows last week, according to Reuters, which flagged weaker appetite for the raw material.

While some shareholders have increased their positions, Canadian **mining company** Teck cashed in on a rise of Fortescue's shares and sold its $503 **million stake** in November last year.

Prior to the **sale**, Deutsche Bank analyst Paul Young downgraded his call on Fortescue to "sell".

He said Fortescue is expensive on a net present value basis when compared to fellow **iron ore** producers BHP and Rio.

While Fortescue is cheaper versus the majors on a price-to-earnings basis, Mr Young said that could likely be attributed to the group's high gearing, operating risks and lower margins.

With the **iron ore** price likely to come under pressure, Fortescue's debt repayment strategy was not enough for a positive recommendation.

"On our forecasts, it will take four years to reduce gearing to that of the majors," Mr Young wrote in a note. "The de-gearing story is not compelling enough for us and they are certainly not out of the woods yet.

"Looking at free cash flow on a post-sustaining capital expenditure and debt repayment basis, Fortescue has a lower free cash flow yield than the majors."

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