SE Drilling Down Under; Blog

HD **Shareholders want answers on Fortescue's backup plan if iron ore price sinks further**

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Fortescue Metals Group Ltd. shareholders questioned the Australian producer at its Nov. 12 annual general meeting on how it plans to weather the falling iron ore price, suggesting diversification could be a means of "fortifying" the company against continued volatility.

However, Chairman Andrew Forrest made it clear that Fortescue will not diversify just because of low iron ore prices as the company is still capable of making adequate returns to shareholders.

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"It's incumbent on the board to not distract our precious capital and even more precious leadership resources toward those industries and investments which can't deliver a similar return, and even at low iron ore prices you're still getting a solid return on equity out of iron ore in the Pilbara," he told shareholders.

"To diversify out just for the sake of diversification doesn't really make sense. You're already in the cream of the resources patch," Forrest later told reporters.

While Forrest reiterated a number of times that a low iron ore price will not drive Fortescue to diversify its portfolio, he did say that in the long term, the company would not rule it out.

Fortescue currently has in place a small team reporting to executive director Peter Meurs that have been investigating potential acquisitions across six other commodities.

Forrest revealed that the company had even run the ruler over a possible investment in a new steel mill in the Pilbara region of Western Australia, close to its iron ore operations.

Fortescue engaged in talks with Russian steel giant Magnitogorsk Iron & Steel Works regarding a potential joint venture, but the economics just did not stack up.

"We were able to roughly calibrate the costs around [US$1 billion] per [1.0] million tonnes of steel capacity," he said. "So at 7.5 billion tonnes, which is still not a great size steel mill, it's consuming less than 20 million tonnes of iron ore. We'd be up for at least [US]$7.5 billion and counting, and the returns weren't great."

One of the key problems with operating a steel mill in the Pilbara was the high cost of domestic gas, which prevented the investment from going ahead.

"While we studied it and continued to keep an eye on it, the returns to shareholders just were not there," Forrest said. Instead, Magnitogorsk settled for taking a 5% stake in Fortescue.

The company has also been investigating potential oil and gas opportunities.

"It is one of about six different commodities which we review all the time and we have plans both immature and mature in several different industries," Forrest said in response to a shareholder question, but refused to elaborate further.

Fortescue may also consider a foray into nickel, with Forrest saying the company would consider BHP Billiton Ltd.'s Nickel West operations at the right price. "Nickel West will only be worth buying if it's at the right price," he told reporters.

BHP Billiton has abandoned its efforts to sell the business due to the lack of suitable offers received by the **company**.

The **iron ore** price has wiped off almost 45% in 2014, hitting fresh five-year lows of US$76 a tonne, but Fortescue remains unfazed.

"We're not at all concerned at this current **iron ore** price," CEO Neville Power told reporters following the AGM. "It'll be low for as long as it takes high cost production to go out of the market."

Power said Fortescue continues to deliver **iron ore** to **China** at "very low costs" and will continue to cut costs further.

The **company** shipped **iron ore** during October at C1 cash costs of US$29 per wet tonne.

Power also rejected analyst comments that Fortescue will need to take on more debt if the **iron ore** price remains below US$79 per tonne and the Australian dollar remains weak against the greenback.

"We're not intending to take on any more debt," he said. "In fact, we're intending to continue repaying debt as we go forward. We are generating strong cash margins at today's **iron ore** price and we're continuing to reduce costs to improve those margins going forward."

Fortescue has paid off more than US$3.6 **billion** in debt in 2014 as it works toward its goal of achieving an initial gearing level of 40%.

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