No sugar hit from Fortescue backflip; Closing Bell

Australian Financial Review

July 19, 2024 Friday

Print & First Editions

Section: COMPANIES AND MARKETS; Pg. 23

Length: 904 words

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Body

Three things scare Australian fund managers and sell-side analysts off ***Fortescue***. Andrew Forrest removed one of them, yet no one's paying attention.

The most surprising thing on the ASX yesterday was the way investors overlooked ***Fortescue***'s big news. Its promise to get back to its leaner and meaner roots and ease off its green energy expansion had the stock down 1.2 per cent in afternoon trade, while brokers barely mentioned it in their morning notes.

Having heard sell-side analysts consistently poke holes in the hydrogen story - the technology, the rollout, the cost - and listened to fund managers talk about ***Fortescue*** spending iron ore cash flows on an unproven business and watching its cost base grow, we thought the wind-back would be welcome.

In theory, it's a reset that could return ***Fortescue*** to its glory days in 2018 and 2019, when just about every extra $1 million in revenue fell through to the earnings before interest and tax line and its dividend machine started.

The job cuts and statement could also dispel fears about ***Fortescue***'s energy unit spending $1 billion or so a year in the near term with no clear path to revenue or earnings.

Instead, it was met with crickets and yesterday's share price drop. There were nervy buyers in early trade, and no instant gratification for what we thought was a pretty significant announcement.

Perhaps the most telling thing was the way sell-side analysts largely ignored the news. Macquarie's team had a close look, and upped its near-term earnings per share forecasts by 20 er cent, but none of the other 15 analysts in Bloomberg's survey had re-cut the numbers by lunchtime. UBS, not in Bloomberg's survey for the past few years and which called the hydrogen news "unsurprising", published a brief 1-pager.

So what's going on? It's either something simple or much more serious, depending on who you ask.

The simple theory is that the school holidays have sucked plenty of money managers and analysts away from their desks, significantly cutting active fund domestic institution trading volumes and quant money that factors in things such as broker earnings upgrades/downgrades.

That is true, but we still see share prices go up and down on small volumes, so while it may explain the lack of analyst interest, we're not sure if it explains the muted share price response.

Worse for ***Fortescue*** would be if it shows institutional investors and all those analysts with hold/sell recommendations (all 16 of them in Bloomberg's survey) are materially more concerned by the company's other big issues. Time will tell. One day's trade does not make or break ***Fortescue***'s strategy, but the muted response can still be interesting.

The two other issues are the iron ore price - a perennial question that has flared up given what's going on in China and the arrival of Rio Tinto-backed Simandou into the market from 2026 - and ***Fortescue***'s leadership team which, while under executive chairman Forrest and his co-CEOs Dino Otranto and Mark Hutchinson, has experienced a lot of turnover.

Both come up in our talks with Australian fund managers, including the big industry funds and the domestic long-only crowd, and are long-term issues that cannot be addressed or overcome with one announcement.

The price of iron ore is ***Fortescue***'s core earnings driver, while its leadership team and governance framework is important to its long-term value creation for shareholders. Wednesday afternoon's announcement had three more executive team appointments: Apple Paget to chief financial officer (from acting CFO), chief corporate officer Shelley Robertson to chief operating officer and Navdeep (Mona) Gill to company secretary (from assistant company secretary).

In the short term, the other thing on fund managers' minds is whether there may be some residual selling from long-time ***Fortescue***-backed Capital Group, a US funds management giant that was a substantial shareholder for close to a decade.

Capital sold a monster $1.1 billion line of ***Fortescue*** shares in June, and dipped below the substantial mark days later. It still has at least a few billion dollars invested in the $70 billion iron ore miner.

Sometimes investors hold off from buying after these blocks, thinking there may be more stock to shake loose at discounted prices. The block also showed there was not a lot of domestic interest in ***Fortescue***; brokers reckon the stock was largely acquired offshore.

Whatever the case, Forrest and Co have more work to do selling this story to the institutional investor community. While they're the sort of pack that likes to prove the doubters wrong, it does not hurt to have a few friends out there or at least ones that take notice of potentially meaningful strategic pivots.

From the muted reaction, we cannot help to think it's a bit of a "damned if you do, damned if you don't" when it comes to green hydrogen.

While investors bagged it when Forrest was trying to ram it out, they seem to be paying little attention now he has taken his foot off the accelerator. They're more interested in the iron price.

What's the long-term sustainable iron ore price? You'd be hard-pressed to find too many reputable markets people to say it is materially more than yesterday's $US105 a tonne.

If it does go south, absent this green hydrogen business we've heard a lot about recently, where does ***Fortescue***'s share price go? That's why there are so many "sell" calls on the stock and the problem today.

Load-Date: July 21, 2024