Fortescue's green expenditure could put pressure on dividends

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Body

Fortescue's dividend could come under pressure as the company ramps up spending on its green energy projects, analysts say, despite the wave of redundancies flagged by the company.

Fortescue said in its quarterly production report on Thursday that it still intended to spend $US1.2bn ($1.83bn) on its green energy arm in the current financial year, including operating and capital costs.

The company has a policy of paying out 50 to 80 per cent of its net profits in dividends, delivering a river of cash to shareholders as the iron ore price held up in recent years, with Andrew and Nicola Forrest's family interests the biggest beneficiary.

But ***Fortescue*** flagged an increase in spending on its green hydrogen and energy ambitions this financial year, despite the company's decision last week to shed about 700 jobs as it looks to cut costs and reduce duplication of back-end functions in its energy and mining arms.

Fortescue is also forecasting capital spending of $US3.2bn to $US3.8bn in its iron ore operations - including $US700m to $US900m on decarbonisation spending - and this week said cash production costs could run close to $US20 a tonne this financial year, with the company giving a guidance range of $US18.50 to $US19.75 a tonne.

Combined with widening discounts for lower-grade iron ore exports, the spending could put the company's dividend policy under pressure, analysts say, with Macquarie suggesting ***Fortescue*** may have to extend its borrowing to maintain dividend payouts.

"Whilst management spoke of a lean focus and 700 jobs were cut across the business, under our price forecasts ***Fortescue***'s minimum 50 per cent payout ratio comes under pressure. To sustain the dividend policy, we believe FMG may need to increase gearing," Macquarie said in a client note on Friday.

Goldman Sachs analyst Paul Young noted the company's capital spending was increasing to maintain production at some of its older mines, and it may need to ramp up spending again if new green hydrogen projects in Norway and Brazil - now going through feasibility studies - are given the green light by the company's board.

"We continue to think ***Fortescue*** is at an inflection point on capital allocation, and to fund the ambitious strategy, we assume the company reduces the dividend payout ratio from the current 65 per cent in the second half of FY24 to about 50 per cent from FY25 onwards - the bottom end of the 50 to 80 per cent guidance," he said.

Fortescue narrowly missed its annual export targets, shipping 191.6 million tonnes for the year, below the bottom end of its 192 to 197 million tonne guidance range.

But after ***Fortescue***'s troubled Iron Bridge magnetite project again missed expected export rates, the company only came close to its overall export target after shipping far higher quantities of a lower-grade product known as super special fines, which made up more than half of its record June quarter exports.

The iron ore major says it expects Iron Bridge to ramp up production rates of 5 to 9 million tonnes this financial year, after shipments of only 1.2 million -tonnes in the year ending June 30.

But ***Fortescue*** has also wi-dened its overall export guidance target, flagging shipments of 190 to 200 million tonnes.

That suggests shipments from some of its hematite mines could taper off this year, according to Morgans analyst Adrian Prendergast. "Management denied this view, commenting that changes in FY25 will only be minor, but the facts are hard to dismiss," he said.

"The lack of commentary makes it hard to identify the drivers of the change, but it is clear that FMG has been pushing some of its ageing mines hard with strip ratios rising and the need for increased mine replacement invariably -increasing." While Mr Prendergast said he still expects ***Fortescue*** to maintain dividend yields above those of its competitors, softening iron ore prices could put pressure on shareholder payouts. "***Fortescue*** maintains a healthy balance sheet, but its capex-heavy mine replacement, decarbonisation, and sustainability investments are placing an increasing load on its base iron ore business in terms of capital requirements," he said. ***Fortescue*** shares closed up 21c at $20.35 on Friday.

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