Transcript

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BHP Billiton

Interim Results

Investor and Analyst Briefing

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Andrew Mackenzie

Okay. Well, welcome, everybody, to our 2015 interim results. I'm speaking in Melbourne at our global head office, and Peter Beaven, our new chief financial officer, is joining us from London. Other members of our group management committee are also here. But, first, let me point you to the disclaimer and remind you of its importance. Our company is in great shape, underpinned by our unchanged strategy. We have the best-quality assets and operating capability, a strong balance sheet, deep understanding of the global market and a portfolio of very high-return growth projects as well as a track record of outstanding cash returns to shareholders. This offering is unique in our sector, and there is no better validation of the effectiveness of our strategy than the robust results we have delivered in the face of substantial volatility and commodity prices.

Over the last six months, we have further improved productivity, increased free cash flow, strengthened our balance sheet and comfortably covered our progressive dividend commitment. In fact, we started to prepare for a sustained period of lower prices almost three years ago by increasing our focus on efficiency and lowering our investment, and since then, our structured approach to productivity has delivered annualised gains of almost $10 billion, and we've reduced capital spending by almost 40 per cent while preserving long-term value. And this push for productivity will continue.

And with future gains harder to win, structural change will be a catalyst for further progress. Our proposed demerger will cut complexity and its associated costs in a single step with no loss of the benefits of scale and diversity, and it will prepare us better to react quickly and take advantage of ever-increasing volatility. I'm deeply committed to increasing shareholder returns. So we do not plan to rebase our progressive dividend downwards should the demerger be approved, implying a higher payout ratio and any dividends from South32 will represent additional cash returns.

Keeping our people and operations safe always comes first, and so while we were encouraged by a further reduction in our total recordable injury frequency to just four for every million hours worked, recent events have, sadly, demonstrated that we can never rest on past performance. We were all deeply saddened by the tragic loss of two of our colleagues at our Worsley Alumina refinery and at Olympic Dam. This is a stark reminder that the health and safety of our teams must always come first – always. And for us, this is far ahead of any commercial challenge. So extensive investigations are now under way to understand how these incidents occurred. We must continue to create an environment free from illness or injury so that everyone goes home safely every day.

The first half of the 2015 financial year was characterised by declining prices for the majority of our key commodities. However, our pursuit of sustainable productivity gains and our flexible approach to investment succeeded in a further increase in free cash flow to $4.1 billion. Underlying EBITDA decreased by 12 per cent to $14.5 billion dollars; Underlying attributable profit by 31 per cent to $5.4 billion. And we reduced capital and exploration expenditure by 23 per cent to $6.4 billion. Return on capital was 11 per cent, and our interim base dividend increased by five per cent to US62c per share and is covered by internal cash flow. Our solid A balance sheet continued to strengthen, with net debt at the end of the period down to $24.9 billion.

Cycles will remain an enduring feature of our industry. So our strategy, the quality of our portfolio and the strength of our balance sheet will make sure that we're also perfectly positioned to capitalised on the expected price recovery for some of our key commodities. But before I say more about this, Peter is going to talk to you about our financial performance in some more detail. So welcome, Peter.

Peter Beaven

Thank you, Andrew. I'm pleased to be here in London to present our financial results for the December 2014 half-year. Our ongoing focus on driving productivity throughout our organisation has, once again, enabled us to deliver an excellent set of results. While our profit over this half-year period has declined due to weaker commodity prices, we have maintained strong margins, we've lowered our capital spend, we've lowered net debt, we've increased free cash flow, and we've increased cash returns to shareholders.

So let me share some of the numbers that underpin this report card. Today there are four areas I will cover. I will start by presenting our usual EBIT waterfall charts for the group and for each business. I will identify specific items included in our accounts to assist with your analysis. I will show the progress on our productivity efforts and disciplined approach to capital allocation and, critically and finally, how this has underpinned our strengthened balance sheet and increased returns to shareholders.

As we have done in the past, we've divided our EBIT waterfall chart into uncontrollable factors on the left and controllable factors on the right. From this chart, it's clear that we have achieved very good results in the things that we control. In total, these factors contributed $2.7 billion to Underlying EBIT. However, the things that we don't control have been tough. Weaker commodity prices alone reduced Underlying EBIT by a considerable $6.1 billion. Putting this number into context, it's close to 50 per cent of the Underlying EBIT in the comparative period. Andrew is going to speak about the outlook for each of our key markets shortly. While inflation reduced Underlying EBIT by a further $359 million, this was offset by a favourable exchange variance related to the strengthening of the US dollar. I would like to point out, however, that the majority of this exchange variance is based on an average US dollar to Australian dollar exchange rate of 89 cents, and that's compared to 92 cents in the comparative period. Of course, this is quite a way from where we are today.

So, on to the things that we do control: the volume and the costs. A nine per cent rise in copper equivalent production increased Underlying EBIT by $1.9 billion. We reduced controllable cash costs by $1.8 billion. Our productivity efforts are substantially improving the bottom line. Each of our businesses has contributed strongly, and there's more to come. An increase in non-cash charges reduced Underlying EBIT by $938 million and it includes a number of items I will cover later in this presentation. Let me also remind you that we continue to generate very strong margins, 32 per cent, at this point in the cycle. This is a tangible demonstration of the benefits of diversification, high-quality, low-cost assets and the impacts of increased productivity.

Now to each business in turn. Petroleum and potash contributed $2.1 billion to Underlying EBIT, and margins remain high at 31 per cent. While price weakness, particularly in relation to crude and condensate products, reduced Underlying EBIT by $754 million, record production, which included a 71 per cent increase in Onshore US liquids, helped offset this. We continued to improve operating productivity in our petroleum business, with unit cash costs at onshore US declining by eight per cent compared with the prior corresponding period. Our productivity efforts in production and costs have allowed us to maintain EBIT year on year, excluding non-cash items. We've continued to streamline the Onshore US portfolio, and we sold two non-core positions in this period. The increase in non-cash items was mainly due to impairment charges arising from these divestments.

Capital productivity is a key driver of value for our shale business. We invested $1.9 billion at Onshore US and expect this to reduce to $1.5 billion in the second half of the financial year as a result of a reduction in drilling activity. We will progressively reduce our rig count, by 40 per cent, to 16 rigs by the year end. But we're not just reducing overall activity; we're drilling and producing at lower costs. Black Hawk drilling costs have declined by 17 per cent in this period to $3.7 million per well. Drilling time has improved by 11 per cent to 21 days per well. We're now one of the lowest cost producers in the fields we operate and improvements continue to be made. Now, copper. The contribution from our copper business was $2.2 billion despite the impact of weaker metal prices. The strength of this business is clearly demonstrated by margins of 38 per cent in this period and like petroleum, productivity improvements largely offset the price falls in this period. Lower costs added $677 million to Underlying EBIT. Lower grades which were expected as part of the mine plan were offset by improvements in throughput and recovery at the operations.

Despite the first half, which was affected by region-wide power outages, strikes and water supply shortages, Escondida reduced unit costs by 13 per cent. The key driver of this reduction was the 14 per cent improvement in truck utilisation. Pampa Norte's unit cost fell by more than 30 per cent on the back of sharply improved recoveries and cost savings. Non-cash charges were higher and they reflected a lower capitalisation rate for the deferred stripping at Escondida and Pampa Norte, again, consistent with mine plans.

Now, turning to iron ore. Our iron our business contributed $4.2 billion to Underlying EBIT, notwithstanding the 38 per cent fall in average realised price. Margins remain outstanding at around 50 per cent. Western Australia Iron Ore achieved another half yearly production record as the ramp up of Jimblebar continued and productivity improvements were realised across all the mines. Growth volumes added $734 million to Underlying EBIT, with productivity volumes delivering an additional benefit of $483 million. Sales volumes were also a record, as our strategy of increasing the percentage of direct-to-ship ore unlocked further port capacity.

During our site tour to the Pilbara in October last year, we outlined our plans to reduce unit cash costs to below $20 per tonne in the medium term and this assumed an average exchange rate of US91 cents. We're making exceptional progress in this regard, having reduced unit costs by 29 per cent to below $21 per tonne this half. Moving on to coal. Once again, given the significant impact of lower prices, a $312 million improvement in volume and cost efficiencies was fundamental to maintaining a positive Underlying EBIT. With regard to volume, Queensland Coal and Illawarra Coal both achieved record production during the half year which underpinned a $65 million increase in Underlying EBIT.

Queensland Coal's unit cash cost declined a further 15 per cent during the period to $71 per tonne. The operations benefited from increased equipment, and wash-plant utilisation and a continued emphasis on labour, contractor and maintenance productivity. As you know, margins are low across the entire industry. Our focus on improvement has allowed all our coal operations to remain cash-flow positive. Finally, let's look at our Aluminium, Manganese and Nickel business.

This business has delivered a significantly higher EBIT period on period, increasing by nearly 400 per cent to $716 million. This strong result, while largely attributable to higher average realised prices for alumina, aluminium and nickel, was also supported by record production at a number of assets and further productivity-related gains. Nickel West's business transformation project is a great example of this, having helped restore its profitability and its free cash flow during the period.

Let me now highlight our continued improvement in productivity. In November, we committed to delivering a further $4 billion of annualised efficiencies by the end of the 2017 financial year. As we have seen, we made great progress towards this during the half. We expect to deliver in excess of $3 billion of productivity gains by the end of this financial year. So just to remind you, this will bring the total gains to almost $10 billion since we began our productivity journey back in 2012.

Importantly, these are sustainable gains that will continue to deliver value every year. These outcomes are the result of the investments we've made over recent years in the standard processes, systems and structures in each of our assets. Strong fundamentals have allowed us to improve rapidly, but will also ensure we do not fall back in future years. The South32 demerger will support the critical impetus to drive the next wave of productivity benefits.

Now, I will draw your attention to a few items included in our financial results for this period. Included in Underlying EBIT are a $325 million favourable revaluation of monetary items on the balance sheet due to exchange rate movements and impairment charges of $361 million, of which $328 million relates to the divestment of non-core Onshore US acreage I mentioned previously. Included in Underlying attributable profit is a $174 million foreign exchange rate benefit within net financing costs and that's offset by a $290 million unfavourable exchange rate impact on tax expense for the period.

As previously highlighted, our Attributable profit for the period included two exceptional items. We recognised an impairment charge of $290 million after tax in relation to Nickel West following the conclusion of the strategic review of this asset. And, lastly, the repeal of the Minerals Resource Rent Tax in Australia took effect on 30 September 2014 and, as previously flagged, resulted in the derecognition of the associated deferred tax asset. This had a negative $809 million impact on our profit line. While on taxation, I should also highlight that our adjusted effective tax rate, excluding the effects of exchange rate movements and exceptional items, was 31.3 per cent.

Let me now discuss how this all comes together in the balance sheet in free cash flow and, critically, cash returns to shareholders. While I have discussed the significant benefit our early focus on productivity has had on profitability, this chart clearly highlights the success we have also had in lowering capital expenditure. While we need less capital to execute the projects, the portfolio remains intact and exceptionally high quality with an average rate of return in excess of 20 per cent expected from our preferred development options. Our share of capital and exploration expenditure declined by a further 23 per cent over the December 2014 half year to $6.4 billion.

With further improvements in capital productivity and lower shale investment to come, we now expect capital expenditure of $12.6 billion in this financial year and $10.8 billion in the 2016 financial year. So in spite of a $6.1 billion reduction in EBIT from price alone in this half, we have actually delivered increased free cash flow. The $4.1 billion of free cash flow we generated during the period was $709 million, or 21 per cent higher than the corresponding period. It is our ability to exercise these levers in order to protect free cash flow in the face of weaker commodity prices and our strong balance sheet which underpins our commitment to our progressive dividend policy.

Off this result we can see it has increased our cash return to shareholders. Our half-yearly dividend will be US62 cents per share, five per cent higher than our previous interim dividend. This equates to a distribution of $3.2 billion and represents an Underlying payout ratio of 62 per cent. Now, I would like to remind you that we do not plan to rebase our progressive dividend following the proposed demerger of South32. So, in addition to this, South32 will also adopt its own dividend policy and any dividend it pays will represent yet a further increase in cash returns. Our balance sheet is strong. Net debt declined to $24.9 billion at period end, and gearing reduced to 22.4 per cent. Our A plus credit rating with stable outlook was recently reaffirmed by Standard & Poor’s, and S&P noted our portfolio diversity, and our flexible capital expenditure, as two key strengths.

We have many levers at our disposal which provide strong support for maintaining our progressive dividend, and our solid A balance sheet. You should expect us to continue to monitor conditions, and exercise these levers as necessary to protect our position and, even as we do so, we will also continue to grow our business, through discipline, selective investments in a high return debottlenecking projects, and longer-dated options. In conclusion, we delivered an excellent set of results. Despite significant falls in the prices of our key commodities over the last six months, we have strong margins. Free cash flow has increased, and we have strengthened our balance sheet. We will continue to grow. We will remain disciplined. Shareholders can be confident that we will maintain our progressive dividend policy. Back to you, Andrew.

Andrew Mackenzie

Thank you, Peter. Let me now return to what we believe are some unique insights that we have into the world’s economy and the outlook for major commodities. Over the first half of the 2015 financial year global economic growth eased slightly. China experienced a moderate slowdown. While other large, emerging economies – notably Brazil and Russia – saw periods of contraction. Among the developed economies the United States and the United Kingdom, supported by expansion in monetary policies, saw solid growth. In contrast, as deflationary pressures increased, Europe lost some momentum and the April sales tax increases hindered Japan’s recovery. So for the remainder of the calendar year we expect strong growth in the United States, monetary policy easing in Europe, and a lower oil price, to drive a mild improvement in global economic activity. In China we expect consumer demand will continue to assume a greater role in economic growth activity and ongoing, well-placed economic reforms will underpin more sustainable growth.

Over the longer term, rising population, wealth creation and urbanisation, remain the primary drivers of commodities demand, and the transition to consumption-led growth in emerging economies is expected to provide particular support for industrial metals, energy, and fertilisers. Notwithstanding this positive longer-term outlook, strong supply growth, most notably in iron ore and petroleum, have led to weaker commodity prices in the current period. Chinese demand for iron ore was flat over the period and as low-cost seaborne supply continued to rise, increased imports displace high-cost domestic Chinese supply. Over the medium term, as new seaborne supply continues to exceed growth in demand, we expect iron ore prices to remain subdued. Longer-term the increased availability of scrap steel in China will impact pig iron demand and, therefore, for iron ore. These developments are consistent with the outlook that we have held and talked about for a number of years and it led us to step away from investing in major iron ore growth projects, such as the Outer Harbour development, and it shifted our focus to maximising returns from our installed infrastructure and resources.

In metallurgical coal, Chinese seaborne demand declined, after an increase in domestic supply. Outside of China the volumes removed from the market have been less than anticipated. But, in the short-term, a stronger US dollar will benefit Australian supply margins and place further pressure on high-cost North American suppliers. Longer-term, increased Indian steel production will support growth in demand, and China's scarcity of high quality metallurgical coal will increase the market for BHP Billiton's suite of superior products. Copper prices trended lower during the period, where increased supply was compounded by concerns over Chinese demand. However, demand and supply fundamentals remain broadly balanced in the near-term. In the 2015 calendar year expenditure on the Chinese grid and US housing construction are expected to rise. With demand growth anticipated to continue over the longer-term and supply depletion due to lower grade ore, a structural deficit is envisaged later in the decade. And in copper new developments will continue to remain challenging.

So, in combination with the above, this will support higher long-run prices and provide robust margins for incumbent producers such as us. We will continue, therefore, to progress our suite of high quality brownfield development options, to provide our shareholders with the further exposure to the exciting outlook for copper. Crude oil prices fell dramatically over the period as OPECs decision to maintain its production targets, despite growth in US supply, led to a market surplus. An oversupply of crude oil is likely to persist throughout the 2015 calendar year, but with capital expenditures reduced, particularly in the US shale sector, we're now seeing a slowdown in the rates of supply growth. Longer-term, with new supply required to offset natural field decline, the outlook for a cyclical recovery in liquids prices is positive and so this supports our recent decision to preserve the value of our Onshore US acreage. I'm going to say more about this in a moment.

The world of commodity prices have become, and will remain, more volatile. And our strategy, plans, and actions all embrace this new paradigm and provide us with unrivalled flexibility to adapt. So we have reacted quickly to market volatility and strategically flexed various levers to maximise free cash flows. We took a leadership position with our productivity agenda, which has to date, as Peter said, delivered almost $10 billion of sustainable cost savings and volume efficiencies, and we're only partway through this journey, as we run our operations even more efficiently. We remain confident in our ability to continue this momentum forwards and we have exercised supply discipline where appropriate by shutting in operations that were not cash positive. So, for example, in metallurgical coal, we responded to their sustained lower prices and closed 7 million tonnes of high cost Queensland coal capacity in 2012, and our investment plans going forward remain flexible.

In our petroleum business we've moved quickly to maximise value in a more volatile pricing environment, and we will reduce our operating rig count at Onshore US by 40 per cent. This decisive response exemplifies our value-focused approach to the development of our tier 1 shale resource base, and shows the flexibility that we have to respond to external market conditions. For example, in the event of a sustained ore price recovery, we are ready to increase onshore development fast. So this combination of levers will continue to maximise free cash flow and underpin our enduring capital management framework of our solid A balance sheet, progressive base dividends, investment in high return/low risk projects, and excess cash returns to shareholders. In the first half of the 2015 financial year we delivered production records at eight of our operations across five commodities and, as a result, group production increased, on a copper equivalent basis, by nine per cent, and the capabilities of our core business will carry our momentum forward.

While an unplanned outage at Olympic Dam will result in marginally lower copper volumes, all other businesses remain on track to meet production guidance. We're leading the industry in the pursuit of sustainable productivity gains and, as a result, we're reducing unit costs faster than anticipated. In Western Australian Iron Ore we reduced unit costs by 29 per cent to under $21 per tonne and we're quickly advancing towards our objective of being the lowest all-in cost supplier to China. In Queensland Coal we reduced operating costs by 15 per cent, to $71 per tonne. And at Escondida, we lowered unit costs there by 13 per cent – excluding treatment and refining charges – to $1.06 per pound. And lastly, in our Onshore US business, unit costs declined by approximately eight per cent.

These are outstanding results of our unrelenting focus on productivity and costs. We operate with a disciplined capital allocation framework and test all investment decisions against challenging criteria, that include buying back our own shares. And, as we reduced spending, we've increased competition for capital and our teams have pushed to lower the capital intensity of our growth. So in the 2015 financial year, our capital and exploration expenditure will decline to $12.6 billion and in the 2016 financial year, to $10.8 billion. In aggregate, against original guidance, we have reduced planned capital expenditure in those two years by $5.4 billion. And importantly, operating in this disciplined manner has preserved value. We have excellent security of tenure across our long-life, diversified resource portfolio, and this allows us to allocate capital when, and to where it delivers the greatest value.

And for our preferred development options, we continue to project an average rate of return, as Peter said, in excess of 20 per cent. Our long-standing capital management framework will continue to guide our priorities for cash flow and we will pull even harder on the levers of improved operational performance and capital productivity. We're committed to maintaining a strong balance sheet and a solid A credit rating through the cycle. And we see that as a precondition to uphold our commitment to at least maintain, or grow our progressive base dividend in every reporting period, and to invest selectively in high-return, diversified opportunities – again, through the cycle. I repeat: all development opportunities will continue to be tested against investment in our own shares. So this consistent and enduring capital management framework has transformed our continual improvement in operational performance into superior growth in shareholder returns.

Our track record over the last decade is impressive and unmatched. Our progressive dividend was unbroken and increased at a compound annual growth rate of 16 per cent. We returned $64 billion to shareholders including $21 billion in the form of buybacks. And as we look ahead, while this period of subdued commodity prices has limited excess cash generated, we remain committed to steadily increasing, or at least maintaining, our dividend per share. In fact, should the shareholders approve the demerger, we do not plan to rebase or lower the dividend and this implies, all other things being equal, a higher payout ratio than the current 62 per cent.

The South32 assets are performing well and the proposed demerger remains the logical next step, which has the potential to unlock even more value than the alternative – like maintaining today's portfolio, or selling non-core assets through trade sales. South32 will have its own bespoke strategy, aimed at maximising the potential of its quite different type, but nonetheless high quality assets. And subject to final board approval, we continue to expect all shareholder documentation to be released in March, which will include a BHP Billiton shareholder circular, and the South32 listing documents. And this will be followed by a general meeting in May 2015, for BHP Billiton Limited and PLC shareholders both to vote on the demerger. Subject to shareholder approval, the new company would begin trading in the first half of the 2015 calendar year.

This restructuring process is complex; however, once complete we will deliver an incredible level of simplicity for our scale, at a much more accelerated pace. We continue to believe that simplifying our portfolio to include fewer assets with a greater proportion of common characteristics is the right strategy to drive higher and higher levels of productivity. We will become a company which will be further differentiated from our minerals and energy peers, and we'll operate just 12 very large, upstream-focused, long-life core assets, yet be sufficiently diverse, resource-long and option rich. This simpler portfolio will cause us to focus even more on lifting operational performance, with everyone liberated to do their job better, simpler, and more productively each day, and we'll be able to identify and deploy best practice a lot quicker. We'll further de-layer and streamline our organisational structure, and right-size functional support to reduce overhead costs. And by concentrating our focus on our largest and most profitable assets, we will deliver a step-change improvement in BHP Billiton's performance, and more value to our shareholders.

So, in the past six months, we have delivered productivity gains of $2.4 billion and continued to act proactively to reduce investment and still preserve long-term value. Despite weaker prices, we've delivered more free cash flow. Our solid A balance sheet continued to strengthen and our dividend commitment was covered by cash flow. We'll remain disciplined, selectively invest in high-return growth options and maintain our progressive base dividend policy. And with the group divided into two distinct portfolios, management processes will be optimised for each group of similar assets, so as to enable higher levels of performance in both entities than if possible if managed together. The building blocks of our strategy are correct, and shareholders should be confident that our company is in great shape. Thank you.

So I would like to take questions. We're going to have them from the phone, and Peter and I will obviously share the answering process. And then, as well, we'll obviously take them from here in Melbourne. So anybody like to start in Melbourne? A couple, and then we'll go to the phone.

William Morgan

William Morgan, Intrinsic Investment Management.

Andrew Mackenzie

Hi, William.

William Morgan

Andrew, shareholders care very much about safety, and it's with great sadness we hear about the deaths of the staff, so please understand shareholders care about that. Just – you talked about well-placed economic reforms, and I saw the huge gains you've got in productivity and cost out. With respect to Australia, if you were to divide potential productivity gains into modest, stretch, and impossible, what quantum of further gains could we expect to gain if we could get modest reforms done?

Andrew Mackenzie

I've always said that I'm reluctant to give strong guidance too far forward, mainly because, to your last point, we can actually make the impossible possible; but we'd like to try that and then very much be judged by our track record. But I would just simply say that with what we plan on the demerger, and what we're still working on, there is an awful lot more to come, not just in Australia, but in Chile, and in North America, and everywhere we produce – and, indeed, through the whole supply chain that we administer globally. Hi, Craig.

Craig Sainsbury

Craig Sainsbury, Goldman Sachs. To questions for you; one's probably a little bit of a follow-on question on productivity and costs out, with this $10 billion since 2012 on productivity gains, which is a fantastic effort. $1 billion from 2015 through 2017, is that conservative, is it? Or is that just the fact that we're starting to get a bit more of a grind out in costs? So just a bit of a view of why such a low figure going forward. And then the second question, if I can paraphrase your economic outlook, pretty much all the commodities you talk through, short-term weakness, long-term positiveness is sort of how I read it. Yet we're in a phase where pulling back on capex, a lot of focus in the presentation on balance sheet, free cash flow, dividends – there wasn't really any focus on any of your growth projects, in terms of what's there. So, giving capex has come down, countercyclical investment, why cut capex now as hard as you are, if you are of such a view that the economic long-term is as well and as robust as you put it in the slides? Just a bit of a view about, sort of, countercyclical investment.

Andrew Mackenzie

Yes. Okay. So, I mean, Craig, first of all, on the productivity projection, you know, we've been pretty good, I think, at putting things out there during each reporting period. This is only the half-year. I would rather come back and answer your question when I talk to you at the full-year for now. Obviously, with the demerger done, our plans more complete as BHP Billiton – you can talk separately to South32 – it may be possible to be a little bit more concrete than I would like to be today. I think on "are you forgoing growth capex", I mean, just look for a moment at the FY16 capex. It's roughly $11 billion. Okay? And that $11 billion – nine billion is dedicated to growth. We haven't spoken an awful lot about that. Only two billion is concerned with the maintenance of underlying plant and equipment and everything that you understand follows from that. The other nine is growth, and let me just break it down roughly.

1 billion is exploration. That's a very long-term activity. Predominantly petroleum liquids and a little bit of copper. And then we have, if you like, four sets of two, very crudely. So we've got two billion, sorry, but more than that going into shale, predominantly into the Eagle Ford high return, greater than 20 per cent – somewhat greater than 20 per cent even at these prices – project going into shale. We have two billion going into projects that have been under way for a little while and some which may be under way for a bit longer, mainly in copper, things like OGP1 and the Escondida water system, but also Jansen. Then we have two billion in a range of relatively small projects that all are about pushing growth and incrementing at very high productivity the supply from our core assets, and that includes some very attractive in-fill drilling projects in our onshore business even at these prices, which have returned significantly greater than 20 per cent going forward.

And then, finally, we are spending about two billion already and thinking about that in many of the things that we're thinking about for the longer term. Now, some of it's engineering studies, and some of it's getting going, so things like the further debottlenecking of the Port Hedland port and the concomitant expansion of Jimblebar so we can run everything up at a consistent, sustainable and high productivity basis - 290 million tonnes per annum on a hundred per cent basis. We have the Los Colorados expansion. We're working on that. We have two projects at Spence: one, a new approach to leaching which lifts recovery by about 14 per cent, and then the hypergene which gives us 50 years more life based on that. We have Mad Dog 2, again, a project that, even at these oil prices, still works pretty well for us and BP that we continue to work on. We have the early stages of Olympic Dam expansion and the heap leach trial. I've probably missed a couple, but I mean, the point is there's an awful lot of that going on.

I think the other thing I would say is when you look, relative to the earlier guidance when we had 15 billion for this year and 14 billion for next year. Peter said – I think the number is right – the reduction is around 5.6 billion. Some of that reduction is about deferral principally of oil opportunities, oil liquid opportunities in the shale, and we're doing that because we think the price is going to be higher later, and it's worth retaining those liquids to a point where we can get those 20-plus returns and not now. But the remaining part of that compression, apart from about 0.6 billion on FX, is through capital efficiency, because when you look at what we've achieved over the three years, we've actually made our capital about 30 per cent more efficient. And so as we go forward, the attractiveness for us is can we actually sustainably grow this company, at what might be quite remarkably low levels of capital but very much investing for the long term. So I think we are investing counter cyclical and as we build real strength in our balance sheet for our productivity campaigns and so on, we have potential to continue doing so and look after progressive dividend and stay solid A.

Operator

Your first question.

Andrew Mackenzie

I will take one, Andrew, I will take one from you and then we will go to the phones.

Andrew Hines

Thanks, Andrew. Andrew Hines from CBA. Can you give us a bit of an update on the medium-term outlook on the US onshore? You're cutting the capex back next year now to 2.2 billion. Production guidance for this year is unchanged, but when we were there 18 months or so ago, I think the medium-term projections were cash flow break even in FY16 and then about 3 billion of free cash flow by the end of the decade. What are your expectations now over the next two or three years for that asset?

Andrew Mackenzie

Well, clearly, it's very volatile, both what we choose to invest and the prices, and riding that volatility wave is very important to maximise value for shareholders. A little bit in the way I explained to Craig, when you were with us whenever it was, December 2013, of course, that was at a time where we were going to invest 4 billion and project – and we were using the forward strip to give the numbers that you're talking about. We will come back in the June operation report and give more details as to what we think we're going to invest going forward, so I've not much more to say now, but, clearly, with the huge gains that we've had in the productivity of the capital since then, probably about 30 per cent, we can do quite a bit of that for less capital than we saw at that time.

So that would help us a bit and let's see where price comes out, and then we will have a better instinct as to just where we will be relative to cash in FY16. But in the half-year just reported, we have increased EBITDA from the shale by over 60 per cent to 1.4 billion, and we still project for this year, year on year, a 50 per cent increase in liquids, so we haven't stopped and we have a lot of things that we can do in the meantime to promote cash generation in the shale business. So can I have a question now from the phone?

Operator

Your first question comes from Paul Young from Deutsche Bank. Please ask your question.

Andrew Mackenzie

Hi, Paul.

Paul Young

Yes. Good morning, Andrew. Good evening, Peter. I have some questions on your US onshore strategy. On my numbers with spot oil, your Black Hawk wells are generating returns of less than 20 per cent, so I'm curious as to why you're continuing with completions in this field, unless you think the oil price will strengthen over the course of the year in line with the forward curve. That's the first question. And then, also, your partner, Devon, they're 55 per cent hedged in 2015, but you, as operator, remain unhedged. Are you reviewing this policy considering, we all know that world economics are largely determined by the cash on the first 18 months? Thanks.

Andrew Mackenzie

Okay. I mean, I'm not sure about your calculation, that's a level of detail. But the possibility that you hint about, Paul, of actually drilling the well and not completing it - so effectively leaving the oil behind the pipe and then being able to come in quickly at a later date when the price recovers and frack and produce a lot of oil is certainly something that we are thinking about - possibly as we're now seeing prices certainly at Brent close to $60 and WTI above $50. That's something we have to evaluate, but it's our belief going forward and looking at the prices at the moment, that we are getting greater than 20 per cent returns from the Eagle Ford development.

I think on the issue of hedging, no, we're not looking out for our policy. This company is unequivocal. As we said in our annual report, we buy spot and we sell spot and we leave it to you as investors, to understand that profile and to hedge accordingly if you have a different view. We take the same – in the way in which we buy money as well. We do that spot. We have enough resilience in our portfolio, we can do that. But, actually, when you have the conversation we're having, Paul of the extreme flexibility that we can demonstrate in our shale business, it would be great if we could have that in some of our other businesses and we're working towards that. It means that that's our hedge and the sorts of things that we're talking about – it's what we, as operators, can do in order to ensure that we do the best we can in a volatile situation, but we're not likely to buy financial hedges. Another question from the phone?

Operator

Your next question comes from Lyndon Fagan from JP Morgan. Please ask your question.

Andrew Mackenzie

Hi, Lyndon.

Lyndon Fagan

Morning, Andrew. A couple from me. Firstly, just on iron ore costs, great outcome there. I'm just wondering what changed between the site visit in October and the end of the year when you were guiding to sort of 23 bucks a tonne for FY15. Obviously excluding the currency, I'm just interested in, I guess, how those costs were achieved and any colour on the strip ratio there. And I guess the next question is just on the US onshore business in terms of the carrying value of those assets, how, I guess, you managed to avoid an impairment charge, what sort of oil prices did you run through to sort of test that. Thanks.

Andrew Mackenzie

I will ask Peter to take the question on impairment and how we handle that, but if I just answer your question on iron ore. Well, I mean, we had a visit from a bunch of people like you and maybe it inspired us to go further faster. I mean, there's a lot of things that we continue to learn about how we can be more productive and we continue to surprise ourselves on the upside, particularly by the response of people, on the front line, as they step up and seek to do their jobs better each day and we think there's a lot more of that to come. I think there's some details there that we might be able to fill you in a little bit, away from this and just contact the guys in investor relations and they might fill in a little bit more. But what you're seeing is true right across our company with people stepping up to higher levels of performance. We are exceeding what we thought was possible in the short term and we intend to continue that track record. But, Peter, maybe you can say something about the shale impairment or the lack of.

Peter Beaven

Thank you, Andrew. I mean, like all companies, I'm sure, we run a very structured process to every half year reporting period on carrying values and whether we do or we don't need any impairment. We ran the process exactly the same as we always would running up to this. There's a large number of assumptions that go into that impairment and carrying value evaluation process and what I can say is, at this point in time, we've got very high quality assets, costs are coming down and we didn't see any need to make any impairment at this point in time.

Andrew Mackenzie

Okay. Another question from the phone.

Operator

Your next question comes from Glyn Lawcock from UBS. Please ask your question.

Andrew Mackenzie

Hi, Glyn.

Glyn Lawcock

Good morning, Andrew. Look, Andrew, by your own admission, you've talked about unit cost coming down faster than expected and I guess we're seeing that across the industry with cost curves flattening. But I was just wondering if you could talk a little bit about – I know you can't disclose assumptions, but I'm just wondering where you see risks to some of your longer term price assumptions, maybe to the upside and the downside and just talk a little bit around the discussions you're having with the cost curves flattening. You know, yourself and the industry is doing a great job, because, I mean, obviously that goes to impairments, which you just talked about, but also investment as well. Thanks.

Andrew Mackenzie

Yes. I think we're leading the charge, but it's certainly true that, you know, nobody is remaining static in what's possible. Yes, I guess what you're asking is what are our long-term views on some of the price decks going forward. I mean, very quickly, when I take iron ore, for example, where I think the cost reduction imperative is even more extreme. I think we have a number of players in that market who, unlike us, have much less choice about where they might invest and I think have a desire to invest quite a lot more than is currently available and therefore to add significantly to the supply of low cost direct-ship iron ore. And I would say that is almost certainly going to push iron ore to the low side for a while and then we will have the issue, as I mentioned in my talk about Chinese scrap so that makes the cost imperative in iron ore and our determination to be the lowest cost supplier to China absolutely critical to continue the track record we're talking about today.

I think in metallurgical coal we can perhaps be a little bit more optimistic to the upside, partly because we have, longer term, the possibility of growing – growth in demand from India who don't have their own metallurgical coal, you know, and huge pressure, on North American suppliers who really can barely compete at the kind of – with the strong dollar and their inferior resources. And then for us, relative to the Chinese, we have the hard coking coal that you know is desired by some of the best modern large blast furnaces and they're running out of that quality. So a little bit of a risk to the upside there. Copper, I think we covered well in the talk and you understand that the challenges of making good for the inevitable decline in copper is very hard and, we, in particular, have a wonderful suite of really secure growth projects that we think can drive us lower down the cost curve as a consequence, but that may be aided and abetted by rising prices.

I think finally petroleum, the more difficult one. I mean, clearly, there's a sense of almost a global glut of gas and so I would be fairly modest about my long-term views on gas. And oil is the most difficult one and one why I'm being a little bit less forthcoming in answering things. I mean, obviously, what we've seen is that OPEC have successfully transferred the role of swing producer to the higher cost US shale oil and, of course, we are lower cost US shale. That, I think, will be quite short-lived, because we don't think US shale oil is going to last for a very long time and obviously as that comes out, then there will be further choices to be made. But it's an interesting world where in most of the markets we've operated, it was never the low cost producer that a swing producer even though some people suggest we should do that. I wrote, I think fairly strongly, in The Australian this weekend as to why it's not a good idea for iron ore, it's not a good idea for coal, it's not a good idea for copper, dah, dah, dah, it's not a very good idea for oil either - OPEC have figured that out.

But I would particularly say that once the impact of shale oil is less strongly felt, I think that will cause iron ore – sorry, oil prices to rise up. By how much will really depend on the momentum of demand attrition that you have for energy driven by the desire to take out carbon, and so on and so forth and I will be watching that hard. So probably a longer answer than you wanted but it just gave me a chance to give you a few views of our house views on price. Let's have a question now from Melbourne and then I will come back to the phones. Yes, go ahead.

Ian Keys

Hello, Andrew. Ian Keys at Morgan Stanley. I've just been reading recently about a new technology, high specific strength steel. It just appears to be a very low, you know, high strength product as it's sort of described, but an alternative to titanium, but obviously with a lot of your products involved, and especially those from South32, have you thought about it, or has anyone discussed it internally?

Andrew Mackenzie

Not that one specifically, Ian, but we look at the threats of substitution both ways, either increasing markets or reducing markets, all the time as part of the process that Peter referred to earlier when we look at our price protocol. And we always have a technology input to those things, so I'm absolutely certain that those sorts of considerations will be included in what we want to think about. You know, obviously, we're not in the titanium business. We sold that at the top of the cycle, so we will be looking as to whether or not that continues to benefit the iron versus aluminium. So, yes, we do that sort of stuff. Okay. Let's take some more questions from the phone.

Operator

Your next question comes from Paul McTaggart from Credit Suisse. Please ask your question.

Andrew Mackenzie

Hi, Paul.

Paul McTaggart

Hi. Look, a couple of – an easy question; Zamzama. Can you give us any sense of the kind of scale of that sale process so that we should keep an eye out for the next half? And just wanted to follow up – you've talked, Andrew, a little about - - -

Andrew Mackenzie

Paul, can I just ask – it may be that it's an easy question, but it was hard to hear, so…

Paul McTaggart

Sorry. Zamzama. Zamzama.

Andrew Mackenzie

Just say again. Give us an idea of the scale of what was it?

Paul McTaggart

The sale proceeds from Zamzama.

Andrew Mackenzie

The Pakistan business.

Paul McTaggart

Yes, yes.

Andrew Mackenzie

Well, that sale has been done.

Paul McTaggart

So it went through in this half? Can you disclose the proceeds?

Andrew Mackenzie

No, no, I can't. And it didn't go through in this half, sorry.

Paul McTaggart

Okay. All right. Not disclosed. I just want to follow up; philosophically, how do you contrast, say, shale in the US where you're happy to go slower on production and leave oil in the ground because it might have value further – more value later – how do you contrast that with, say, Met Coal, for example, where, clearly you've gone to drive down unit costs and taken that slightly different approach? How do you think about the two and what are the key differences?

Andrew Mackenzie

The key differences is that the ability to stop and start capital is much easier in the oil business than it is in the Coal Business or in the shale business and, therefore, we stop capital clearly when we actually change our forward projection for price if we think it's worth leaving the oil in the ground to a time when the price is higher. I think the second thing is that, clearly, although I think we have a little bit of optimism about the way in which we're going to stretch the margin in coal through our productivity program and maybe a little bit more upside in price, we're much more confident of a quicker recovery in oil price than we would be on coal price and that obviously affects some of our capital decisions, but once capital is installed – and, remember, everything in the shale business is capital, including the completions that we talked earlier about with the other call – we maximise production. And the only time we take production offline, as we have done in coal, is when the variable cost production exceeds, if you like, the price of the material that we're producing and that's why we shut-in those sorts of operations in Met Coal even though we've committed the capital. Is that helpful? Maybe. Okay. Another question from the phone.

Operator

Your next question comes from Clarke Wilkins from Citi. Please ask your question.

Andrew Mackenzie

Hi, Clarke.

Clarke Wilkins

Hi, Andrew. Listen, just going back to the capex side, and you, sort of, gave us that breakdown, which is great. When you look at what's true stay-in-business capital for this business – like, you mentioned the $2 billion, sort of, maintenance of equipment number, but when you consider, you know, some of the projects, in copper to offset grade decline, and, you know, decline in petroleum, you know, what's the true, sort of, stay-in-business capex number of that $11 billion, versus what is really, sort of, growth and production?

Andrew Mackenzie

Yes. We don't have that number because we don't look at it that way. We have no compulsion to maintain the level of production in copper or oil. So, as far as we're concerned, any new project, whether it's replacing declining production, or adding to existing production, has to compete on a returns basis. So as far as we are concerned, all of those capital things are looked at in the same way, and so the only capital that we say you're compelled to spend, it's about, sort of, what you would say stay-in-business, is the maintenance capital, which we put at around $2 billion.

Clarke Wilkins

So I suppose you turn it the other way then. What – you know, the $11 billion or just under $11 billion – what level of production quotes that are on a copper equivalent basis will actually keep you going forward?

Andrew Mackenzie

Well, in the medium-term, clearly, this year we're going to do nine per cent, but in the medium-term, with this level of investment, we expect to be able to grow production at around five per cent per annum. Another question from the phone?

Operator

Your next question comes from Jeremy Sussman from Clarkson Capital Markets. Please ask your question.

Andrew Mackenzie

Hi, Jeremy.

Jeremy Sussman

Yes. Hello. Congrats on the solid result, and thanks for taking my question.

Andrew Mackenzie

Thank you very much.

Jeremy Sussman

You noted in the release that 2015 copper guidance is under review, but at the same time you gave a pretty precise, I guess, expectation of what you expect Olympic Dam to be reduced by. So I'm just trying to get a sense, should we read anything into that, in the sense of maybe you're trying to offset that somewhere and, if so, maybe what can you – I know it's not a big impact, but what can you, kind of, do to mitigate some of the impact?

Andrew Mackenzie

Well, I mean, current guidance is, if I'm right, is 1.8 million tonnes, you know, and we've talked about the loss – of 50 to 60,000 tonnes because of the Olympic Dam outage. You know, within the remaining – if you like, 96/97 per cent of that, we still are confident of, clearly there's a bit of opportunity there to continue to do a bit more, and to make good some of the difficulties we have at Olympic Dam. We will watch that, and we will obviously update you with our operations report for the third quarter. Another question on the phone?

Operator

Your next question comes from a caller from Morgan Stanley. Please ask your question.

Andrew Mackenzie

Hello?

Menno Sanderse

Hi there. Can you hear me?

Andrew Mackenzie

Yes, we can hear you. We didn't…

Menno Sanderse

Hi. Hi, Andrew. It's Menno at Morgan Stanley in London

Andrew Mackenzie

Okay. Yes, I thought it was. Yes. Okay. Go ahead.

Menno Sanderse

Evening, Yes. Two questions. One on South32. Obviously, a good free cash flow again in in the half, about $900 million annualised. Is that amount of savings that we should think about that BHP can generate after South32 leaves the company, to be able to plug the gap for your dividends? And secondly, I'm a bit surprised still by the 20 per cent IRR and the fact that you still most of your projects hitting that number. I mean, copper has come down quite substantially. Iron ore has come down quite substantially and, as you said, it will come down further. So has that portfolio now shrunk, the – of 20 per cent IRR projects, or basically has the buffer totally disappeared, and are they now all on the cusp of that 20 per cent?

Andrew Mackenzie

Well, I mean, yes, I mean, obviously, we continue to recalculate things in line with our new price protocols. All that work is very much underway. I mean, the only thing I would add is that we are continuing through working the projects that we have yet to really get into executions, to improve their capital efficiency. So, at a minimum that will compensate for some of the price declines, if we believe that they're going to be sustained. And that's still something we will think about, and copper, I would argue, they're unlikely to be. And, if not, they may even drive returns even higher than the 20 per cent number, and that's the whole basis of how we force productivity in capital. What was your first question again? I'm sorry. I was just thinking too much in light of…

Menno Sanderse

Annualised free cash flow in the first half, obviously, you're going to lose all of that.

Andrew Mackenzie

Yes. No

Menno Sanderse

So you will have to plug that gap.

Andrew Mackenzie

Well, we're going to give a bit more guidance about some of the savings that are possible when we separate South32 in the circulars that are going to come out next month. I mean, I would point out that as things stand at the moment, I mean, you know, a couple of things. First of all, that the benefits, exceed the costs of doing this transaction, as you would expect. But, equally, both companies will be able to generate more productivity, separate, than they would together, and in that sense they should prosper more as a result of that. The actual number and whether it transfers over, I mean, without giving – being trapped into some forward guidance, all I would say to you is, we're very confident that with the productivity that will continue within BHP Billiton, that that will allow us to maintain the progressive base dividend policy, and to invest in the high return growth projects that we have in studies and on this execution phase at the moment. Okay? Another question from the phone?

Operator

Your next question comes from Chris Drew from the Royal Bank of Canada. Please ask your question.

Andrew Mackenzie

Hi, Chris.

Operator

Please ask your question

Chris Drew

Hi. Thanks. Just a further point of clarification, I guess, on the FY16 capex guidance falling from $14 billion down to the $10.8. You talked about the 30 per cent capital efficiency, and a bit of a benefit from FX. So when we consider the volume growth implications of that cut, is the thinking that really, outside the impact on petroleum, no real change at all as a result of that fall in capex? And, as a follow-up to that, you know, if the price environment does stay weak, as you're perhaps alluding to, in iron ore and oil, do you see much further flexibility at all in that FY16 capex figure, or are we getting down to having done as much as you can now? Thanks.

Andrew Mackenzie

Look, there's infinite flexibility. I mean, that's the benefit of having that. And so if we – you know, if it's appropriate to do so, then we can do that, but, I mean, at this stage we're not planning to. I mean, I think in going back to the causes of the thinking, I think what you, sort of answered your own question about, absent the slight reduction that you might see, say, from, you know, in the near term of production from some of the areas that we've reduced the drilling activity in, then I think, as a first assumption, that's not a bad thing. Just as an example, I mean, we spoke earlier with Paul Young about the possibility of delaying the completion of certain wells to cut capital further if we thought oil prices were lower, and going lower still, as an example. But there are other things we can do to increase the flexibility of that spend if we need to, and we think it's appropriate, and it's the right balance of absolutely looking after solid A and the progressive dividend, and investing for the future. Another question from the phone?

Operator

Your next question comes from Peter O'Connor from Shaw Stockbroking. Please ask your question.

Peter O'Connor

Good morning, Andrew. Two questions.

Andrew Mackenzie

Peter.

Peter O'Connor

Firstly, thoughts on capital management and how you will look to monetise your franking balance in Australia – I know that's a very quirky Australian domestic issue – but are there thoughts on how you could use that growing balance? And my second question, looking at the second half of fiscal year '15, and thinking through the cost details that Peter gave us, and looking at where the currency is trading today versus last half, diesel price today versus last half, and to the general conditions in the Australian environment for labour, could you give me some granularity about where I should be thinking about those key drivers of the dollar – the diesel price and the labour market, etcetera – and how they'll be reflected in costs in half two '15, please?

Andrew Mackenzie

I'm wondering, in the second part of your question, it might be easier if you just get with some of our Investor Relations people to break it down like that. I mean, I don't as you can appreciate, have all those numbers in my head, and I'm not sure if Peter does either. But, I mean, all these elements, clearly, are the things that we're working on. I think on the first one, on the franking, maybe Peter might want to say something, but I do assure you that we're very conscious of our growing franking balance, and we're always open to ideas and ways in which we can actually share more of that with the shareholder. Peter, I don't know if you want to add anything.

Peter Beaven

No, not very much. I mean, I think just to, of course, remind everybody that we've got, a number of shareholders across the world who have different tax positions and so on and we have an underlying need in the DLC to treat all shareholders equally. Having said that, obviously we continue to listen to all and generate all the ideas that we can and, at this point in time, you know, we've got nothing more to say, but surely we keep thinking and looking at this very hard.

Andrew Mackenzie

And some of you may have seen that we've been quite fortunate in finding a new head of tax Jane Mitchie, who many of you might now from Macquarie, and we will certainly be having this very firmly at the top of her inbox when she arrives. One more question from the phone.

Operator

Your next question comes from Brendan Fitzpatrick from Morgan Stanley. Please ask your question.

Brendan Fitzpatrick

Thanks and good morning. It's a balance sheet question. I was just looking at the current assets; the inventories have been steady, slightly increasing over the last couple of half year periods. Is there not some opportunity there to run down some inventories that we may not yet have seen come through?

Andrew Mackenzie

Well, Peter is the king of the balance sheet, so he will answer that question.

Brendan Fitzpatrick

Thanks.

Peter Beaven

Yes. Look, we're very comfortable where our inventories are. We keep a very, very tight rein on those inventories. You know, we have got a very good system 1SAP which covers all of our inventories, at whatever stage of the value chain and I think we're very tight on where we are. As you say, the movement has been quite minimal this half versus the last half. I'm not very surprised to see that, and we also try not to build up buffers and stocks ahead of bottlenecks. We try and manage our value chain according to the most efficient approach. I think just the other thing just to mention is that we did see, in fact, a reduction in our payables for this half versus the previous half, and that was, in fact, due to lower costs. So as we've driven more and more costs out of our business, so our payables fell in line with that.

Additionally, a large amount of provisions were reduced for employee benefits and so on, again in line with the impact of productivity gains. So I think it's just worth mentioning that. Again, very comfortable where we are on day-to-day; very comfortable on payable days, and very comfortable on inventory days. Having said all of that, obviously it's a very important thing for us to check every single day, and we will continue to monitor these things very, very carefully.

Andrew Mackenzie

Yes. I mean, just to add, despite that slight increase in working capital over the period for the reasons that Peter just described, some of which we expect to reverse over $1.4 billion, we still were able, even with the lower prices, to increase free cash flow as a consequence of our strong delivery on productivity. Any questions here in Melbourne? Okay. Well, I think, if there are no more questions I will probably just close now.

I hope you've enjoyed these results. I would just say in summary that in the space of less than three years we have improved the efficiency of our operations investments by our estimate of around 30 per cent, and that's why we've been able to secure this increase in free cash flow I just covered, despite the price fall, many of which we saw coming and therefore anticipated, and that's why we've been able, as a result, to secure the progressive based dividend and continue to invest selectively in a large number of our long-term growth projects from a really quite extensive suite.

The next time we talk to you we will be, I think, talking to you about the demerger. It is absolutely on-track, and we believe this is a key enabler and differentiator, that will allow, among many, to make this a rather special company. That will help us maintain the momentum of these efficiency gains by running both new companies even better, than will be possible by keeping together and therefore, to continuing the track record announced with these sets of results. So thank you very much. Look forward to talking to many of you in the coming weeks. Thank you.