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Transcript

BHP Billiton
Interim Results
Investor and analyst briefing
18 February 2014

Interim Results

Investor and analyst briefing

1. Performance Overview –Andrew Mackenzie

Welcome to our interim results. I'm speaking to you here in Melbourne – which is the first time at our new global head office. And Graham Kerr joins us from London. Other members from the GMC are here or have joined by telephone.

First, let me point you to the disclaimer and remind you of its importance to this presentation.

I will now provide you with an overview of the last six months. Graham will then take you through our detailed financial performance, and I will discuss how our focus on productivity has increased return on capital in a sustainable way. I will also cover how our continued focus on our major resource basins will further differentiate us.

Our commitment to produce more tonnes and more barrels from existing infrastructure at lower cost is delivering. We've achieved an increase in production of 10 per cent. We've embedded productivity-led volume and cost efficiencies of \$4.9 billion. Full-year capital and exploration expenditure is expected to decline by 25 per cent, and this sharp reduction has increased competition for capital and driven investment returns higher. At the period end, our net debt position was \$27.1 billion. Our solid A balance sheet is strong. We've delivered substantial growth in free cash flow. But there is more that can and will be done to maximise the value of our high quality portfolio, so as to consistently grow shareholder returns.

Our people are the foundation of our success, so their health and safety must come first. Safety continues to improve, and this is demonstrated by a reduction in our total recordable injury frequency rate to 4.4 per every million hours worked. This is a record low for our company. And as we strive to create an environment free from illness, we will not become complacent. We must identify, understand and manage the material risks within our business to make sure our people and the communities in which we operate are safe.

First-half financial performance benefited from a substantial improvement in productivity and from the volume growth delivered by our largely low-risk brownfield investment program. Underlying EBITDA increased by 16 per cent, underlying EBIT by 15 per cent to \$12.4 billion. Underlying attributable profit increased by 31 per cent to \$7.8 billion, and net operating cash flow increased by 65 per cent to \$11.9 billion. Free cash flow has grown by \$7.8 billion. Our disciplined approach to investment has increased our underlying return on capital to 22 per cent. Our interim base dividend is comfortably covered by our internal cash flow. By the end of the financial year, our net debt of \$27.1 billion is expected to approach \$25 billion. We are well placed to extend our strong track record of capital management.

We delivered record production at 10 operations for three commodities.

For the half-year, our Western Australian iron ore business produced a record 108 million tonnes. Early production from Jimblebar and volume-led productivity initiatives, including the use of relocatable crushers, contributed to this result. As a consequence, we've already increased our full-year guidance for iron ore to 212 million tonnes.

The best example of our productivity agenda in action was at our Queensland coal business. In the December quarter, it ran at an annualised rate of 68 million tonnes. This is an outstanding result, given that Daunia is not yet fully ramped up and that we removed seven million tonnes of high-cost production when we closed Norwich Park and the Gregory open cut.

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Copper production grew by six per cent. Antamina achieved record copper volumes and Escondida, our leading copper asset, increased production by seven per cent. And, in the 2014 financial year, Escondida remains on track to produce 1.1 million tonnes.

In our petroleum business, liquids volumes increased by nine per cent to 50 million barrels, and this includes an increase in Onshore US liquids of 72 per cent. Because we prioritised drilling away from predominantly gas areas towards the high-return, liquids-rich Black Hawk region of the Eagle Ford, gas declined by seven per cent.

We have retained full-year production guidance for all our major commodities: iron ore of 192 million tonnes, our share; petroleum of 250 million barrels of oil equivalent; metallurgical coal of 41 million tonnes; energy coal of 73 million tonnes; and copper of 1.7 million tonnes. We project that over the two years to the end of the 2015 financial year, our low-risk, largely brownfield projects and productivity-led gains will deliver production growth of 16 per cent.

I'm sure you will agree this is a very strong set of half-year results. I would like Graham, now, to talk to them in more detail.

Welcome, Graham.

2. Preliminary Financial Results – Graham Kerr

Thank you, Andrew.

It's a pleasure to be here in London to present our financial results for the December 2013 half-year. As Andrew mentioned, the group's strong operating performance and productivity-led gains underpinned a significant increase in profitability, and we have remained disciplined. Our dividend is now comfortably covered by free cash flow. Our solid A balance sheet remains strong. And, importantly, the outlook for our business and our shareholders is exciting.

In order to summarise our financial performance, I would like to focus on five areas: first, the identification of specific items in our accounts, to help you with your analysis; then, our usual earnings waterfall analysis; also, the substantial cost and volume efficiencies that we have embedded over the past 18 months; and, our capital allocation framework that is applied within the context of our value-maximising strategy; lastly, our determination to strike the right balance between selective investment in our high quality portfolio and a commitment to extend our strong track record of capital management.

I would like to remind you that our results are being reported on the basis of new accounting standards and interpretations that came into effect from 1 July 2013. Our accounts now include the full consolidation of Escondida, whereas we previously consolidated our 57.5 per cent equity interest. Entities that no longer meet the definition of joint control, such as Antamina and Cerrejón Coal, or those that are classified as joint ventures, such as Samarco, are now equity-accounted. IFRIC20 also required a change in the accounting treatment of production stripping.

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In every period, a number of items affect the underlying financial performance of our business. As you can see, costs in our petroleum business were elevated because of three specific charges. At Onshore US, we optimised our drilling program to focus on our Black Hawk acreage. The associated termination of rig contracts reduced underlying EBIT by \$75 million. In turn, the group also incurred a \$103 million charge for underutilised legacy gas pipeline capacity, primarily in the Haynesville. Petroleum also recorded a \$115 million charge associated with its UK pension plan.

These charges were offset by the restatement of monetary items in the balance sheet which increased underlying EBIT by \$345 million. You may recall our functional currency requires us to take mark to market differences for monetary items through the profit and loss statements.

Now, turning to taxation, we paid \$2.9 billion of income and royalty-related taxation, and \$1.4 billion of other production royalties during the period. The group's adjusted effective tax rate was 32.5 per cent. This rate is expected to remain in the range of 31 to 34 per cent for the 2014 financial year. As illustrated on this slide, the remeasurement of deferred tax assets associated with the Minerals Resource Rent Tax reduced the group's statutory tax expense by \$491 million.

I will now turn to our strong financial result. Underlying EBIT for the December 2013 half-year increased by 15 per cent to \$12.4 billion. This increase in profitability was largely driven by factors within our control. Production growth associated with the ramp-up of major projects and the continued success of our productivity agenda increased underlying EBIT by \$2.2 billion.

In contrast, the relief that we received as the stubbornly high Australian dollar weakened against the greenback was largely offset by lower commodity prices and inflation. For instance, lower prices for each of the major metals – copper, nickel and aluminium – reduced underlying EBIT by \$937 million. A strong rebound in metallurgical coal supply led to an 18 per cent fall in our average realised price, and this reduced underlying EBIT by \$520 million. Strong growth in Chinese crude steel production was underpinned by a significant increase in fixed asset investment, and this created unexpected tightness in the seaborne iron ore market, despite the addition of low-cost supply from Australia and Brazil. So as a result, iron ore prices increased underlying EBIT by \$964 million. Within our petroleum business, a five per cent increase in the average realised price of natural gas offset a two per cent reduction in the average price of both oil and liquefied natural gas.

Now, I will focus on the factors within our control, volume and cost. As Andrew mentioned, production records at 10 of our operations contributed to a 10 per cent increase in copper equivalent production. The ramp-up of several major projects, and strong growth in liquids production, from Atlantis in particular, also increased underlying EBIT by \$705 million. The early delivery of production from our new Jimblebar iron ore mine, the commencement of metallurgical coal production at Daunia, and the completion of the Macedon gas project were notable achievements during the period.

Now, moving to productivity. After almost a decade of strong growth in demand and margin expansion, we recognise that value has been eroded by broad-based industry inflation and low productivity, and we decided to take a hard line on all facets of our cost base. This disciplined approach delivered cost and volume efficiencies of \$2.7 billion and \$1 billion respectively last year, and we ended the period with strong momentum.

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As you can see on our waterfall chart, our productivity agenda increased underlying EBIT by \$1.5 billion during the period. Volume-related efficiencies increased underlying EBIT by \$542 million as several de-bottlenecking initiatives in the Pilbara added valuable tonnes at one of our highest margin operations. In addition, controllable cash costs declined by \$1 billion in the period. Improved equipment utilisation and availability, an increase in the proportion of planned versus unplanned maintenance, and the continued optimisation of our contractor activities were important contributors to this strong result.

While these metrics relate to half-yearly variance analysis, I now want to discuss the productivity-led gains embedded over the 18-month period since the end of the 2012 financial year. On this slide, we have defined three broad categories to describe our achievements in a simple waterfall chart. As you can see, sustainable operating cost efficiencies of \$1.8 billion, a \$1.6 billion reduction in exploration and business development expenditure, and productivity-led volume efficiencies of \$1.5 billion have now been embedded. While Andrew will discuss productivity in more detail shortly, I can confirm that this sustainable \$4.9 billion gain is expected to grow to \$5.5 billion by the end of our 2014 financial year. This includes a projected \$3.9 billion in productivity-led cost efficiencies and reduced exploration and business development expenditure. This is a significant 11 per cent of the \$36 billion baseline operating costs we reported in the 2012 financial year.

Our strategy has worked well for our company and for our shareholders. This remains our platform for success. The quality of our assets and adherence to this strategy will differentiate our performance, and we will maximise shareholder returns by allocating capital in a disciplined manner.

A company's success can be measured in many ways, and judged on the basis of multiple criteria. The ability to generate value and return capital is a great place to start. Over the last 10 years, BHP Billiton returned \$62 billion to shareholders. While we don't target a specific payout ratio, this equates to approximately 50 per cent of underlying earnings over the period. The company's more diversified, and higher margin portfolio delivers a higher return on capital, with lower volatility when compared with peers. So, as a result, we have been able to return substantially more capital to shareholders.

Let's now look at the factors that influenced our decision-making. We remain committed to our solid A credit rating. It provides substantial flexibility and access to debt capital markets at attractive rates throughout the economic cycle. In this context, we are in a strong financial position. Net operating cash flow increased by 65 per cent during the period. We received divestment proceeds of \$2.2 billion, and net debt declined by six per cent to \$27.1 billion. Should the external environment remain supportive, net debt is expected to approach \$25 billion by the end of the financial year. In the period, we further optimised our debt maturity profile with the issuance of a four-tranche \$5 billion US bond. These funds, and capacity on the balance sheet, will be used to meet a series of financing commitments in the second half of the financial year. For example, the redemption of Petrohawk Energy Corporation senior notes just completed, and upcoming debt maturities.

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Our progressive base dividend is the minimum annual distribution that a shareholder should expect. It is comfortably funded by internal cash flow, and is expected to grow broadly in accordance with the growth of our business. It has been maintained across several economic cycles, and distributions have increased at a compound annual growth rate of 17 per cent, for a total distribution of \$39 billion over the last 10 years. A half-year dividend of 59 cents per share was unchanged from last year's final payment, consistent with recent practice. We will consider the trajectory of our progressive base dividend at the end of the 2014 financial year.

Now, let's talk about investment. We will continue to invest selectively in those projects that meet our demanding criteria. Our capital and exploration expenditure will reduce by 25 per cent this year, and a further reduction is expected again next year. By reducing annual expenditure, we are more focused, and we are driving returns higher. We also delivered on another major commitment as free cash flow increased by \$7.8 billion during the period.

As many of you know, in the past, we've supplemented our progressive base dividend by returning excess capital to shareholders. In fact, we returned \$23 billion in the form of buybacks during the last 10 years, which is almost 40 per cent of total capital returned. With strong free cash flow being generated by the business, production growth of 16 per cent projected over two years, and further simplification of the portfolio planned, we are well placed to extend our strong track record of capital management.

To summarise, we have four broad buckets to which we direct our cashflow: our solid A balance sheet; our progressive base dividend; selective investment in our portfolio; and, when in surplus, additional capital returns to shareholders. Many of these options are clearly interconnected. So, how do we make critical capital allocation decisions. In simple terms, we test each decision against a range of short and long-term criteria across several scenarios. Amongst other things, we aim to optimise the net present value, return on capital through the cycle, IRR and margin whilst remaining mindful of portfolio construction and cashflow at risk. No single metric dominates the process, and alternatives – including an investment in our own shares – actively compete. Let's look at how this works in practice.

Our opportunity-rich portfolio remains a key point of difference. By reducing annual expenditure we have sharpened our focus on our core commodities and our higher-margin businesses. Fewer projects now pass through our toll gates. Design inefficiencies are exposed and re-engineered, and this has raised the bar and lowered capital intensity. As a result, you can see that the average rate of return for our favoured major growth projects has increased; increased to the point where an average, ungeared, after-tax rate of return of more than 20 per cent is achievable. We also consider the value of future options very carefully, as we must preserve their value at low cost. Our long-life ore bodies are predominantly located in the OECD. This combination allows us to defer investment where appropriate so that we can optimise performance on the basis of our investment criteria.

Now, in conclusion, we have delivered a significant increase in free cash flow. Our capital and exploration expenditure will decline by 25 per cent this year, as planned. An average, ungeared, after-tax rate of return of more than 20 per cent is achievable for our favoured major growth projects. Our progressive base dividend is comfortably covered by free cash flow. Continued simplification of the portfolio will further strengthen our balance sheet. Net debt of \$27.1 billion is expected to approach \$25 billion by the end of this financial year and, with strong free cash flow, selective investment and continued simplification, we are well placed to extend our strong track record of capital management.

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With that, I will hand back to Andrew.

3. CEO Address – Andrew Mackenzie

Well, thank you, Graham.

It states in our charter that we are successful when our people start each day with a sense of purpose, and end each day with a sense of accomplishment. There is no better illustration of this than the company-wide adoption of our productivity agenda, which is now fully underway. It's our responsibility as management to provide the necessary tools and support so that our people feel empowered to identify, implement the many improvements that maximise the value of our high-quality ore bodies. Our commitment to improve productivity across the organisation has the potential to create more value than anything else we do. So we're working our assets harder to generate additional value and to lower costs. Our many actions are individually tailored to the different opportunities and challenges at each of our operations.

At our briefing in December we described how our teams benchmark the fastest drilling times for individual well segments, and this work has now reduced the days to drill a typical Black Hawk well by 35 per cent. At our Queensland coal mines, the truck fleet in the pre-strip operations is a bottleneck, and over the past 18 months the teams there have, through less downtime on shift change, in-pit refuelling and better planning, increased truck performance by an impressive 40 per cent. At Western Australian Iron Ore, the bottleneck was at the mines, and our no-cost and low-cost de-bottlenecking will now move it to the port. By increasing throughput and improving reliability, we have raised the overall performance of the mine ore handling plants by four per cent. With an EBIT margin of 57 per cent, every additional tonne produced from existing infrastructure like this creates significant new value for our shareholders.

The ultimate benefit of our productivity agenda will be measured in dollars and cents, and for our coal business, this translates to cost efficiencies of \$1.7 billion. This has significantly increased our return on net operating assets. I recognise, however, that a seven per cent return on our coal business is just not acceptable. Coal will not receive another major investment beyond the projects in execution until we see a marked improvement in those returns.

At Western Australian Iron Ore our productivity agenda, as you've heard, is in full swing. We're focused on costs, but recognise that the addition of high-margin volume at low cost can create substantial value. So we installed relocatable crushers, despite the increase in operating costs, so as to increase our volumes. Our productivity agenda has delivered an increase in return on net operating assets, which is a true measure of our capital efficiency. While we're committed to drive down costs in iron ore, as in coal, iron ore's 57 per cent return means we should invest in such low-cost opportunities that add such valuable tonnes.

To repeat: not all businesses are the same, and our productivity initiatives must reflect the context in which we operate in order to generate the best overall results for our shareholders. At the group level, the success of our productivity agenda is ultimately reflected in our underlying return on capital, which has risen to a competitive 22 per cent. Further discipline and the completion of several major projects will continue to increase these returns further.

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So, let me now turn to our outlook for the global economy. Global economic conditions improved over the first half of the 2014 financial year. The stronger than expected performance of major developed economies means that the uncertainty in outlook is now, if anything, skewed to the upside. The US economy accelerated as housing and manufacturing sectors improved, unemployment declined and confidence and consumption grew. Europe has experienced a period of relative stability; conditions for corporate investment have become better, and growth is now likely to re-emerge. We, however, remain cautious, since underlying debt and economic imbalances are yet to be fully resolved. China remains the primary driver of demand. In the 2013 calendar year its rate of growth has stabilised, but still remained strong. It is expected to remain about seven per cent. The government continues with its reform agenda, which will move China towards the mature consumption-led economy – there's some indications of this on the bottom right-hand side of the slide.

Over the next 15 years, we expect the demand for our coal products to rise by up to 75 per cent. Each commodity is, however, different. For example, in iron ore we expect significant growth in low-cost supply that will exceed increases in demand from China and elsewhere. The cost curve, as you see, will flatten as higher-cost marginal supply is displaced, and this will lead to lower prices and lower volatility.

In the near term, copper inventories are expected to remain at reasonable levels. But in contrast to iron ore, the long-term fundamentals are attractive. Rising strip ratios and grade decline and the lack of high-quality opportunities ready for development now will steepen the cost curve.

To allocate capital, we used our well-researched and strong view for each of our core commodities. As you can see on this slide, over the last five years we steadily shifted investment towards high margin iron ore, copper and petroleum projects. At Western Australian Iron Ore, after a decade of investment in major infrastructure, our emphasis has now moved to low-cost expansions to 270 million tonnes.

Given our confidence in the outlook for copper, we continue to invest in high-return projects at Escondida that will maintain production at elevated rates.

Similarly, in petroleum we're increasing our investment primarily in our high-return Black Hawk acreage, as well as in the development of low-risk brownfield opportunities that maximise the value of our conventional business. These shifts in how we allocate capital are aligned with our commitment to maximise shareholder value.

We will continue to demonstrate a superior ability to discover, develop and operate large-scale low-cost ore bodies in order to meet the world's requirements for decades. We will deliver products safely and sustainably at the lowest possible cost, so as to maximise the benefit to local communities, broader society and, above all, our shareholders. More competition for capital has boosted the returns of our major projects – our preferred major projects. The range and quality of our portfolio make all this possible. We have more choice than anyone else to direct capital to the most appropriate returns across steel-making materials, metals, energy and food. We are the only company with exposure to all energy commodities, oil, gas, coal and uranium, as well as to the metals used in renewables and energy infrastructure, most importantly copper. So this positions us very well to respond as the world makes its energy choices.

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We will focus our efforts with greater force on fewer basins, on those basins where we can generate our highest margins and greatest value: iron ore in the Pilbara, metallurgical coal in the Bowen Basin, copper at Escondida and the Andean copper belt, petroleum in the US and potash in Saskatchewan.

We aspire to be recognised as much for our best-in-class operating performance and developments as for our great ore bodies. Our unique, simple, yet diversified footprint will accelerate our journey towards best-in-class performance. Greater focus will lead to lower capital expenditure and more selective investments. A simplified portfolio and largely brownfield opportunities will generate higher rates of growth, superior returns on investment and stronger free cash flow. This will strengthen our differentiated offer of strong growth in both capital and capital returns. They're not mutually exclusive, and we must get this balance right. We have delivered strong production growth and productivity gains of \$4.9 billion while continuing to improve safety. We acted early to significantly reduce our capital spend. This has increased internal competition for capital and raised the average return of our major preferred projects to over 20 per cent. The group's continued pursuit of productivity combined with further simplification of the portfolio will sustain strong margins and deliver more free cash flow.

Thank you.

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4. Questions and Answers

Andrew Mackenzie

So, I would now like to take your questions. I'm going to start here in Melbourne, and then we will move to the phone lines.

Craig Sainsbury, Goldman Sachs

Thanks. Morning, Andrew. Craig Sainsbury here, from Goldman Sachs.

Very impressive numbers that you've delivered. So two questions from me. One is just how far do you think we are through the productivity cycle for you, ie, how much more do you think you can, sort of, drive out of these assets over the next two or three years.

And the second question from me is, just looking at some of the ramifications that can come out into the market from those productivity gains. I mean, you point towards better returns. Costs are down 11 per cent. Flattening of cost curves – we're certainly seeing the coking coal market – you still stay profitable with costs coming down, but that has driven the coking coal price down. So, what do you think the ramifications are going to be, in terms of longer term commodity prices from this productivity-led cycle that you're embarking upon, and some of your peers out there? And has that forced you to, sort of, start to think about changing some of your medium to longer-term commodity price decks because of those productivity gains you've been driving through the business? Thanks.

Andrew Mackenzie

Okay. We will review our price decks during the course of the next few months, as part of the planning exercise that we report some of the results of at the full-year. So we will certainly take account of that. But, of course, as much will depend on what our peers are doing as what we are doing, and we do think what we're doing is quite distinctive, you know, that we have actually grown returns at a time of, broadly speaking, flat to slightly falling prices, if you look at our whole basket. As we look forward, we've given you the guidance that we will embed, if you like, a further \$600 million by the end of the year.

Most of that costs out to get to \$5.5 billion. You know, this is about the whole culture of the company, about the whole way we look at it and how we simplify our focus. You know, I think there's a lot more to go. But my message has always been, I will give a little bit of indication as to how you can extrapolate. But we're learning as we go. We're ambitious. And I stick with my mantra of track us, don't trust us. But it's exciting, the possibilities that we see going forward, and we're just getting started. And I think there's a lot more to come.

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Craig Campbell, Northcape Capital

Andrew, Craig Campbell, Northcape Capital – good result.

A question relating to coking coal – unfortunately, it is one of the weaker aspects of the results and, probably, one of the weakest results we've seen out of coking coal for a while, where there hasn't been weather-related events or anything like that impacting. And, I'm just wondering, given the surplus in the market and – you know, it doesn't look like backing off, would you approach a strategy that was undertaken by BHP in the early 2000s, in copper, where BHP took an industry-leading position – backed off copper production when there was a very high amount of surplus. Coking coal price – sorry, copper prices were at their weakest point. Could you back off, maybe, your coking coal production to bring the market back to balance and push prices back up, and get a better return that way? There's a strategy.

And the second question from me, with regards to some non-core assets, particularly in petroleum – I imagine, given the strength of petroleum prices globally, at the moment, you could probably release some capital through sale of those non-core assets. Is that something that's being actively explored at the moment, and we could expect some release of capital through that?

Andrew Mackenzie

Okay. First of all, to your question on metallurgical coal, it is not our policy to adjust production in order to achieve price results. Once we've installed something, we believe in the interests of productivity and stability, and our support of open markets, and to satisfy our customers that we maximise production. Of course, as you've heard me talking about it, because of the margins in coking coal and the return, we're unlikely to invest in further increases in production. But we will complete those underway and we will ramp them up to the maximum extent possible.

I don't have quite such a negative outlook, going forward. I would like you to think more positively about our results. I mean, we've pulled out, you know, a substantial number of costs. And Brendan's behind you. He can give you a lot of details about that. That, I think, has moved us up considerably. There has been a lot of recovery in the market, and in the production, I should say, from Australia, because of the recovery from things like floods. That's coming to an end and, as we look forward, there's less growth in the next few periods. We've seen some announcements, just overnight, about some of the cost challenges that are being faced from competition in North America – some evidence of that slowing. The pick-up in markets, particularly in the developed economies, and the growth in their demand for steel will almost certainly benefit metallurgical coal. And we're starting to see some quite good steel numbers coming out of India which, in the long term, has no metallurgical coal, and will have to import.

We think, under those scenarios, we've got the best basin in the world. We've got the best quality of hard coking coal, you know, and we will continue with our productivity agenda to open up even bigger margins and allow us to make decent numbers, even at these prices. So we're in for the long term.

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I think on assets and petroleum assets, you know, you've heard my mantra on focus. That focus is partly on our coal basins, but it's also on tier 1. So anything that we have out there that we feel does not pass a very high challenge to be tier 1. Clearly, we look at whether other people may be better at owning that and would pay us a decent return for that. It's best if it's something that is undeveloped, and we don't think we're going to develop for a while. So we're looking at all of those things. But until I'm much closer or have concluded a transaction, I can't say any more today.

Paul Young, Deutsche Bank

Okay. Just great to see the comments on the plus 20 per cent project return target, but – I do know that's an average – but I have some questions about your higher returning copper projects. There appears to be the potential for production surprise over the medium term, and just some more information on that. The Escondida OGP1 project appears to be six months early. Considering it was 60 per cent complete at the end of December, in my view, this means the Los Colorados concentrator could be run in parallel with OGP1 for a period of time, and also the Bechtel construction team could be rolled onto the Spence Hypogene project as soon as early 2015. Can you comment on the timing of OGP1, and also, could we see a decision on Spence this year? Thank you.

Andrew Mackenzie

Okay. [...] spoken to someone who used to work at Escondida. You have all the details there. Look, Paul, I think on the first question, about the Los Colorados concentrator, and whether we would continue to run that in parallel with the new concentrator at OGP1, sure, that's an option. You wouldn't have a productivity agenda like ours with not wanting to look at that. We certainly, from the investments that you know we're making in power and in water, have more than sufficient to run three concentrators. The considerations that we have to bring to bear, though, before we make that decision is, clearly, we would be moving a lot more dirt, and that means a lot more trucks. Can we do this optimally and safely, is point 1. And secondly, as you know, the Los Colorados concentrator sits on top of some quite high grade ore, and although we can nibble around it and look at some of the pushbacks, and so on, you know, the delay in getting to that is something we have to look at in a value sense. But I can assure you, that's an option, as part of productivity, that we take very seriously indeed, and it's certainly feasible.

I think, as to what we might do with the project team at OGP1, and whether they go forward, really, we only have one project team in base metals. That's the one area where we do everything centrally in a hub for all our copper assets, and absolutely, you know, our prime candidate for a possible further investment beyond OGP1, sorry, is the Spence Hypogene, you know, and certainly, I would expect us to say a bit more about that, you know, in the coming months, possibly at the end of the financial year, because, as you are aware from the business there, it is a reasonably high-return project. It has got even better through some of the things we've spoken about, and would certainly fit within our desire to drive a basket of projects, you know, into IRRs, you know, north of 20 per cent.

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Clarke Wilkins, Citigroup

Hi, Andrew. Clarke Wilkins here.

Listen, just in terms of the capital management side, is there a target for getting the net debt down to before – back on the agenda, and also in terms of the former – or the form for capital returns in the future, is there a preference at the Board level between, you know, buybacks versus special dividends and mechanisms like that for returning excess capital?

Andrew Mackenzie

So, Clarke, you know, the important thing we have to do is that we have to get to a point where we feel our balance sheet is robust, and robust at a solid A, and then, everything that you then talk about has to be debated about by the Board. These are Board decisions, and they're decisions that will be made, you know, when we're ready to consider them in a deep way. And we've certainly not really debated, you know, the form of additional, if you like, cash distributions to shareholders. If the Board then decides to do that, you know, clearly, the time for that, as we said, and has been, you know, in general, our practice is at the full year, and hopefully by then, we are at the level of debt we're targeting, and those conversations will be real, and we will give you the feedback on it.

Lyndon Fagan, JP Morgan

Hi, Andrew, thanks.

Look, my questions are on the iron ore division. I guess at the quarterly, we found out that strip ratios had risen, and I'm just wondering if you can perhaps give us some more colour around that. What, perhaps, what are they, and how long will they stay high, or is this a permanent shift upwards, or just related to the mobile crushers, just to help us, I guess, extrapolate that out.

And then the next question is that there's certainly a lot of promotion around moving to 270 in iron ore, which has been the case, now, for well over a year. And I'm just wondering when we're likely to see some more project approvals or, you know, now that the port is the bottleneck, I guess just to get a feel for the timing of that production coming on? Thanks.

Andrew Mackenzie

Lyndon, I don't exactly know the kind of – the development of the strip ratios, and not just at Jumblebar, but also at Whaleback, that you're referring to, but I think, through the detail of the presentations, even though we've incurred slightly higher strip ratios, given the kind of returns we get in this business, it was worth, you know, continuing in those directions, in the mining sense. Later this year, we are having an investor tour to the Pilbara, and I'm sure we will be able to unpack that for you in quite a lot more detail.

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As regards the journey to 270, you know, we're doing so well with productivity, as we talk about the sort of no-cost, low-cost debottleneck, a lot of these things are passing through without us having to make announcements. We talked about renewing two of the oldest shiploaders in the port, you know, partly for operation and safety reasons, but it also lifts a little bit of the production from that port as well. The more we can do that way, the higher the capital efficiency of moving to 270, and, you know, we're taking our time, but as soon as we think we're ready, and we need to make a more substantial investment in the ports to get to 270, of course, we will talk to you. And clearly, the better job that we do through low and no-cost de-bottleneck, the higher the capital efficiency goes, and the more attractive these things become. But some of them, if we do good debottlenecks at the port, may become redundant. So we will keep you posted, but nothing more today. So, questions from Melbourne? Yes, we will keep going from the phone, then.

Paul McTaggart, Credit Suisse

Hi, Andrew. A pretty quick and easy question. The take-or-pay contracts that related to the onshore gas business, just trying to reconcile those with the Petrohawk accounts. Did that charge go through in the fourth quarter, or – well, sorry, in the fourth quarter, December, or in the first bit? I presume it happens late in your half, obviously, because Petrohawk was loss-making in December. Would that be correct?

Andrew Mackenzie

Graham, did you hear the question?

Graham Kerr

..... quarter, but we can get Brendan to confirm that after and circle back.

Andrew Mackenzie

Yes, Graham, you probably need to say that again, because we only heard about the last three or four words from you.

Graham Kerr

Look, Andrew, I'm pretty certain that actually occurred in the second quarter, but we can just, after this call, I will get Brendan to circle back and confirm that.

Paul McTaggart, Credit Suisse

Thanks, guys.

Graham Kerr

Yes, thanks, Paul.

Andrew Mackenzie

Thanks, Graham. Anything from Melbourne yet? Next – go to the next question from the phone.

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Glyn Lawcock, UBS

Good morning, Andrew, just two quick ones. You've said fiscal '15 capex will reduce, and you have previously said, you know, you think the right spend is up to \$15 billion. Can I nail you down to a more definitive target, like your peers have provided? Because, I mean, it does help us understand what sort of free cash flow generation you may have next year.

And then the second quick question is, just on the productivity measures, you know, you've done a lot in coal. You know, strip ratios have gone up in iron ore. Are you – is there any deferral of capital or lowering of strip ratio going on in coal? I know some of your peers are doing that to try and, you know, get unit costs down at the moment, to battle the falling price. Thanks.

Andrew Mackenzie

I think that the – the simple answer to your first question is, probably not, Glyn. You know, I think we've made it very clear that we think we can run this business for a long time optimally at or around current levels of capex, \$16 billion. I've said, you know, that it would be our intention to let it drift down a bit. We will be much more specific at the full year.

I think, on the answer that you – the question that you asked on coal, we might need to get you a bit more detail than I'm able to provide right now. But in general, you know, we've been working very much on the costs of running our operations rather than changing our mine plans to deliver the returns that you've seen – but we will get you back some more detail on that, because there may be some things at the margin that you might be interested to know.

Another question from the phone?

William Morgan, Intrinsic Investment

Thank you. Andrew, you logically continued to comment about the long-term trend in China, and about the supply response. However, with respect to iron ore, I wonder if you could please give us some colour about your measure of risk of shorter-term shocks to demand, notably given solvency risks with the Chinese steel mills, and the supply of capital to those mills?

Andrew Mackenzie

Well, I can only speak broadly. There's a lot of people who look at that. I think we would say, if anything, in the next quarter, probably, the risks are maybe slightly to the upside. But then we take a longer-term view going further quarters out, and certainly to the end of this calendar year, where the – you know, the very strong growth in supply is more than enough, if you like, to create a bit of an excess, and therefore to drive price lower.

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Now, whether that's aggravated by the things you're saying or not, I'm not sure. A lot of things go on in China at the moment that don't always eventuate in quite the same reduction of steel production that you think. I mean, there's a lot of work that the government is doing, in some cases using their control of the debt markets to lead to some form of restructuring of both the iron ore and the steel industry. That, ultimately, we think, will actually improve their move towards being a middle income economy, more competitive, and more growth, and will therefore attract, in the medium term, more iron ore from us and other suppliers outside of the country, which means that, you know, I don't think we're looking at big shocks, if you like. But we can have our economist talk to you a bit more, if you're interested.

Take another phone call from the phone.

Adrian Wood, Macquarie

Yes, hi, Andrew. Just a couple of questions.

First of all, on Jansen, could you please just give us a bit of an update on progress, both in terms of just how deep we are in terms of the shaft sinking, and maybe, perhaps, a little bit of discussion around why you chose to delay drilling in what would have seemed to be the most productive drilling period of the year. But also, progress on bringing in a partner. There has been some scuttlebutt coming out of Canada that perhaps you're closing in on partner negotiations, and just wondered if you were looking at, sort of, customers, or whether you were looking at other potash producers to bring into that.

And second, just on costs. You seem to have now, for the first time, given a cost-cutting target for FY14, so at least looking six months out. Why can we not roll that over into FY15, and give us any guidance there as to just how low costs could go?

Andrew Mackenzie

Okay. I will probably deal with them in reverse order, then, when I forget the first one, you can remind me. But, I mean, we're now almost two months into the second half of the year. I think all I'm doing, as I said I would at the outset, is help people what – extrapolation of a relatively short-term nature. We're learning how to retool the whole company, and how to deal with – and how to deliver productivity. It's much more than a costs-out program, it's about energising everybody, you know, to do their jobs better each day, to make equipment more efficient, you know, using our new systems and so on. You know, as I said in – I think, in response to an earlier question, you know, I think the potential is large, and we're only beginning a lot of the things that we want to do. But I'm not really at liberty to start giving big, long-range targets yet. You know, I would rather deliver, show you and help you a little bit with shorter-term extrapolation, as I've done today.

So I'm now speaking from memory. I've already forgotten the – let me talk about Jansen first. I mean, you did mention that you – you said this was the right season to do more. That only really applies to things like seismic and drilling, not for sinking shafts. I mean, that's not such an issue that's seasonally dependent. So you've obviously picked up that we're taking our time through the early sections of both shafts. You know, this is not on the critical path. We haven't even decided when we want to even add a lot more investment to create a mine there. We always said we'd kind of wait and be ready to move quickly when the market was ready, probably some time in the next decade.

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You know, we're using a bit of new technology to create these shafts, and we were a little concerned that we weren't getting it quite right in the earlier part with some of the temporary liner. Nothing serious, so we said, "Let's stop, think about it, figure out how we can do it better." We've done all that, and we expect to recommence sinking the shafts, you know, within a matter of weeks, if not days, you know, having taken stock. No real impact at all – actually, costs will be lower, because we've been moving at a slower rate – no impact on schedule. Sorry, what was the middle part of your question?

Adrian Wood, Macquarie

Just on the progress with potential partners, that was, I think, delineated last period of the - - -

Andrew Mackenzie

Yes. Yes, you asked whether we were considering customers or competitors and so on. Yeah, we would consider them. We're talking to a number of players at the moment, but quite a few of them, you know, are not in that category; there are people who would like to invest strategically alongside us in developing this operation.

Adrian Wood, Macquarie

Great. Thanks very much.

Andrew Mackenzie

Anything more from Melbourne? Good.

Craig Campbell, Northcape Capital

Craig Campbell, Northcape Capital again. One for Graham. On the Mining Resource Rent Tax, Graham, you had a net benefit to the P&L in the current half just reported. Is that going to be repeated in this half? Or is there a reversal of that? If you could give us some guidance, please.

Graham Kerr

Look, obviously the guidance on the MRRT is always difficult, because it's very much dependant on price, and iron ore price expectation and coal expectation, but also on FX. I think the other challenge, obviously, is where do we end up with the MRRT, you know, is the actual law repealed or not. So I think at this stage, you know, we will give guidance when we get to the August full-year result, but nothing really to add at this stage; other than to say, as I said in the past, it's a volatile tax.

Andrew Mackenzie

Thanks, Graham. Next question from the phone.

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Myles Aillsop, UBS

Yes, just a couple of quick questions. First of all, could you give us a sense if you expect to see some major divestments in the calendar year 2014? Because obviously you've talked about what's core, what's not core, but is it actually possible to sell assets in the current environment of a scale that would be material to BHP?

And also could you give us a sense as to what's your, sort of, longer-term growth target is? Are you still thinking around sort of five per cent growth per year for the business? And then with these favoured major projects, you've kind of hinted they include Jansen, the inner harbour and Spence. Do they include any other projects, like Cannington?

Andrew Mackenzie

Okay. So let me – what was your first part of your question again? Sorry, I was – divestment, yes.

Myles Aillsop, UBS

Well, just on major divestments, yes.

Andrew Mackenzie

So – well, I mean, I think – look, well, there's \$2.2 billion of divestment proceeds in these results, so we are able to continue in this market. I mean, clearly you're right, that some of the things that maybe are less core to our business are at relatively low stands in price, and therefore there's always the concern that we wouldn't realise their full value by taking the whole cycle into account if we tried to sell things too quickly. You can see from the strength of our cashflow we don't need the money, you know, so we can play the long game in order to do things. But even within our portfolio we talked earlier about non-tier ones are – there are plenty of things that we can consider, but I've nothing further to announce today.

Second question again? Just one word will remind me. Growth. I'm not going to comment any further on the growth target beyond that, you know, we're on track to deliver over this year and next year a growth in copper equivalent terms of 16 per cent. Was there anything else?

Myles Aillsop, UBS

- - - as to what's included there.

Andrew Mackenzie

Sorry? Sorry, Myles, did you have anything else you wanted to ask?

Myles Aillsop, UBS

Which projects do you include as favoured major growth projects?

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Andrew Mackenzie

Projects, yes. Well, no, you mentioned some of them. You know, I mean, I presume you're talking about the relatively small possibility of an open-pit or an expansion at Cannington. You know, that's not – there's several others there which are in there that are being considered, but we have a very strict set of criteria to move things forward and to fit into what we think is an affordable level of capital. There's others there that are in there, but I'd rather not go into too much specifics at this stage. I mean, clearly in there is our continuing development of the shale, continuing, as we said in the talk, brownfields expansion of our conventional oil and gas business. Some of the others you mentioned are in there for sure.

Take the next question from the phone.

Menno Sanderse, Morgan Stanley

Yes, good morning. Two brief ones, please. One on working capital. There was quite a significant outflow of about \$1.4 billion, just trying to get a sense if this will be reversed in the second half. And secondly, on the US onshore operations, it states in the release that it should be profitable in the second half. Is that on underlying operations, or are there some one-off gains in the second half that will drive that to profits?

Andrew Mackenzie

No, no. You were in the tour, - - -

Menno Sanderse, Morgan Stanley

Absolutely, yes.

Andrew Mackenzie

- - - and you know, we still expect it to be EBIT positive for the second half, as we announced on the tour, and cashflow positive by FY16, building into FY20 to about \$3 billion of cash per annum. I'll get Graham to answer the question on working capital. Graham.

Graham Kerr

Andrew, look, about \$1.5 billion negative variance for the half-year on half-year, predominantly driven by timing of payables, receivables and build up of inventory, predominantly around Jimblebar. Probably worth noting that in January about \$700 million of that \$1.5 billion unfavourable will be variance reversed. So we do see it reversing.

Andrew Mackenzie

Okay?

Menno Sanderse, Morgan Stanley

Perfect. Thanks a lot.

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Andrew Mackenzie

Next question from the phone.

Peter Harris, JCP Investments

Thank you for the presentation, Andrew. Just two questions. You mentioned potential productivity gains. Are you targeting in the medium term real cost deflation or inflation, and does that vary between your basins? I imagine it's probably more easy to achieve in iron ore versus copper, given the declining grade that you're facing in South America.

And also you mentioned you like copper. On slide 27 you've got – you talk about the refined copper market, but it seems to me people always overlook the scrap market, and as that market goes into deficit that magically scrap appears from nowhere and fills that gap, but at the same time people have falling copper prices. So can you just talk about the role of scrap and also any comments you've got on the shape of the copper scrap cost curve and the impact that might have on the long run copper price.

Andrew Mackenzie

Sure. Well, Peter, I expected to have you here in the room in Melbourne. You know, we've come here to your own city and you're phoning in.

Andrew Mackenzie

But good to hear from you nonetheless. Just on scrap, first of all. Of course that acts as a bit of a buffer in the system, as you described. But clearly, if price starts to rise because of a lack of supply of primary copper from mines, often, you know, that's enough to create more scrap. But it works the other way as well, and I think it sort of smooths some of the price variations, and we certainly handle that in our own projections in the way you describe. Quickly remind me of your first question?

Peter Harris, JCP Investments

Just on whether you're targeting real cost deflation or inflation, and does that vary between your, you know, basins, or your primary focus commodities.

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Andrew Mackenzie

Well, we're targeting that everywhere, and I think there are, as you say, opportunities that we're still working on and expect to do more with in iron ore. I wouldn't rule out copper either, despite some of the challenges you mentioned. Bear in mind that in the case of both Olympic Dam and where we currently are in Escondida, you know, we aren't facing, for the next few years, any sort of grade decline. But there is a variation between the basins, but less driven by, if you like, the nature of the operations and more driven by the market. You know, where we have relatively low margins then it's less attractive to retain costs to grow volume than when we have high margins. You've seen that contrast that I've drawn in the presentation between coal and iron ore. That doesn't mean that there aren't low-cost expansions available in coal that we'll go after, and that there aren't significant cost out. targets in iron ore that we'll go after. Of course we'll do both. But there is an individual tailoring, depending on the margins, obviously, with a slight bias towards more volume in high margins, and the other way round in low margins.

Peter Harris, JCP Investments

Thank you very much.

Andrew Mackenzie

Anything else from Melbourne? Okay. We'll take one more question from the phone, then.

Andrew Hines, CBA

Thanks, Andrew. Perhaps a question for Graham. On the new capital allocations that – of processes and being focused on generating the best returns from the capital, can you talk a little bit more about how you rank capital returns in terms of buying back BHP equity, compared to projects? It seems to me that, you know, with the share price a lot higher today than it was six months ago, or even 12 months ago, we're heading back to an environment where, you know, potentially BHP is going to be doing a buyback at the top of the market, which is what happened last time. If we've got new investment in projects generating 20 per cent-plus returns, is that not going to be a better use of capital than buying back shares? And can you talk a bit about how you've changed the structure so that we don't continue to end up in environments where we ended up with buybacks happening when the share price is high and not when the share price is low.

Andrew Mackenzie

Okay. I mean, I think I sort of answered that earlier, but maybe Graham can give a little bit more detail, but not much.

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Graham Kerr

Look, the comment I would make is, you know, over the last 10 years we've done buybacks in excess of \$20 billion, and the buybacks on an average have had a share price of around \$25. But I think more importantly, when we look at our portfolio we look at all the options, as I spoke to earlier, and rank them on a number of different criteria such as NPV, IRR, return on capital, you know, how the portfolio looks, cashflow at risk. But understand that a lot of those decisions are interconnected, and shares buyback certainly come as something we consider, but as you rightly point out, a lot of our projects they are located in OECD basins, they're brownfield expansions, they have very high returns. So you know, we go through that constant process every year we do our planning cycle. But the other piece is as well, look, when we have excess cash, at that time we'll decide what is a right mechanism to look at returning cash back to our shareholders. So there are a number of different mechanisms.

Andrew Hines, CBA

Yes. The trouble, though, is the excess cash always seems to come, you know, top of the cycle; so in other words, at a time when the BHP share price is high. Is there some way that you've thought about of breaking that disconnect between, you know, having the excess cash and the capital returns?

Andrew Mackenzie

Can I just jump in. We're not actually at the top of the cycle. Andrew, this result that you've seen is primarily driven by, you know, our own self-help and our own productivity. It doesn't negate from the challenge you've said, but clearly with the ambitions that we have now for other performers of our company, you know, the guidance that I've given you is happening, then we certainly don't feel that as things sit at the moment we're finished with our productivity gains, or that we're operating at the top of the cycle. So that would be my only other colour I would add. Is there anything you want to add to that, Graham?

Graham Kerr

No, nothing more to add, Andrew.

Andrew Mackenzie

Okay. Okay, anything else here? I think we'll call it a day.

Thank you very much.