BHP

Financial results for the year ended 30 June 2017

Investor and analyst briefing Q&A

22 August 2017

QUESTIONS AND ANSWERS

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

ANDREW MACKENZIE: Hi, Paul.

PAUL YOUNG, DEUTSCHE BANK: Hi, Andrew. And hi, Peter. First question is on the capex ceiling. It's great to see the capex ceiling of $8 billion for FY18 to FY20 and, Peter, great to see the approval of Spence Hypogene at last. Just a question, does the capex ceiling account for only the high returning plus 15 per cent IRR projects? I.e. Does this exclude spend on Jansen over that timeframe?

And then also, I have a question on the cost-out. Can you break down the $2 billion of productivity gains by division? And, just further to that, Andrew, clearly there's a huge opportunity in truck automation and production creep in the Pilbara beyond Jimblebar and also in the Bowen Basin in particular. Can you provide some guidance on your vision for truck automation in both basins and also about the opportunity to creep production particularly in the Bowen Basin? Thanks.

ANDREW MACKENZIE, BHP: Okay. Look, the $8 billion ceiling includes all capital and exploration, Paul. It's not just selected projects. I don't know, Peter, if you want to add anything to that part and then I will come back on the cost-out.

PETER BEAVEN, BHP: Yeah. Just the question on Jansen, it is included, Paul. But as I say, it's just the completion of the shaft that we're assuming at this point in time. Obviously, Jansen won't go forward unless it passes the capital allocation framework and so nothing has changed there.

ANDREW MACKENZIE, BHP: Paul, you're right. Peter mentioned that we see potential to take our costs in the Pilbara to significantly below $13 per tonne and next year – or this year, we expect to do better than $14 per tonne, and there are equivalent benefits that we think will come through over in Queensland as well.

Automation does play a role and we are pushing that hard, not just of our trucks but also of our drills, and we see a steady ramp-up in the use of automation over the next five years which will enable further cost reduction. But the achievements that we have made and we expect to make going forward are much more broad than that. We have set ourselves some very high targets for the availability and utilisation of plant and equipment – truck hours, if you like – and high targets on the cost of maintaining plant and equipment. We have a big drive going on through the way in which we handle maintenance and we also have some new activities in making the efficiency of all capital including some of the minor capital programs more efficient.

But we continue to work on our culture and therefore the approach of our people to their work and their own personal productivity. We work on the efficiency of our supply chain with our new global supply organisation and we have always had a leading marketing organisation, but we believe there are more efficiencies that are possible there. So we've always worked in the areas of equipment productivity, people productivity, supply chain productivity, capital productivity and marketing productivity. And we have renewed vigour in this area, and a lot of that is enabled by the fact that we now have a highly effective enterprise-wide system that we use for almost all functionality of our business, but particularly powerfully in the area of work management. And I would have to add that, of course, above all of that, the most important target we have, beyond productivity and before productivity is to make further improvements in safety and eliminate forever the need for me to start these presentations with the communication of a fatality or a life-changing and serious injury.

PAUL YOUNG, DEUTSCHE BANK: Thanks, Andrew. Andrew, I appreciate all that. Just as far as all those things you're mapping out there, obviously it will lead to production creep in the Bowen Basin in particular, beyond Caval Ridge. You outlined quite a few very high returning projects in May at Blackwater and Goonyella in particular. Where do you think this will all lead as far as your opportunity to creep production and to what level in the Bowen Basin? Thanks.

ANDREW MACKENZIE, BHP: Well, we've given some general production guidance for this year which says that we will increase, on a copper equivalent basis, seven per cent year on year. Now, we had a difficult year just past particularly because of the strike at Escondida and some of the outage at Olympic Dam, although we are having a major shutdown at Olympic Dam this year. I would rather get back to you, or have Adrian get back to you, on some of the details, as much as we're able to provide, on the Bowen Basin itself.

MENNO SANDERSE, MORGAN STANLEY: Yes. Hi, good morning. Two questions. First one on Olympic Dam. Obviously, the opportunity is big, but the company had to deal with some issues of your own making and some issues that you couldn't control. Could you just help us understand how this investment you're going to make is generally going to stabilise this business? And the second point comes back on the $8 billion ceiling. It is quite a significant step-up of over $1 billion versus what the company expects to do this year. What type of projects are included in that? Because for the iron ore, the replacement mines are captured in the maintenance capex. So I'm failing to see what's going to bridge that $1 billion gap.

ANDREW MACKENZIE, BHP: Okay. I will answer the second question briefly and then, as with Paul's question, hand over to Peter for some of the detail. Well, all projects are in there, including, as Peter mentioned in his presentation, quite a step-up on our investment in shale, which we can explain why. But I will let Peter go through all the details as the Chief Financial Officer. Sorry, I've already forgotten. What was the first part of your question again?

MENNO SANDERSE, MORGAN STANLEY: Olympic Dam and how this investment…

ANDREW MACKENZIE, BHP: Yeah, Olympic Dam. We really are determined to put the asset integrity, and therefore the operational efficiency, of Olympic Dam on a different path. Jacqui McGill and her team have made good progress, but still not sufficient, and we are taking a very large – I think it's almost a five-month shut, to correct a number of problems and really get that set for the long term, which will then justify the investment that Peter described, that we go into the very high grade Southern Mining Area, we further improve the efficiency of the bottleneck which, in Olympic Dam is the hoist, so that we can get our production up from, on a good day, 200,000 tonnes a year to nearly 330,000 tonnes a year, at relatively little increase in cost, and as Peter said, most of the costs are fixed.

We think this is still a great opportunity for the short, medium and long-term to grow copper production into a copper market that we think will see quite a shortage of new greenfield projects coming on in the early part of the 2020s and it's targeted to do that. But, as always, Peter may want to add to that as well, but maybe, Peter, if you start off with just a little bit more detailed breakdown of what sits under the $8 billion. I think you will probably say this, Peter, but I just wanted to add, that is not a spend-up-to number, Menno. We will always hope, through our push in capital efficiency, to spend less than that. It's just giving the market medium-term guidance of a limit above which we will not go. Peter.

PETER BEAVEN, BHP: So, Menno, just in terms of the increase on this year's capital guidance, just recall that, in fact Mad Dog 2 will be in full go, SGO will be in full flight as we get forward into FY19 and into FY20, and South Flank, in fact, although it's included in the $4 per tonne, it's still a project and as we said earlier, the $4 per tonne is not smooth. It's actually a lot less than $2 a tonne at the moment, but that will increase as South Flank comes on over the next three years. We will start to spend a bit on it this year. I think the other thing is BFX. As Andrew was talking about a moment ago, this is the expansion of, the big de-bottlenecking of, Olympic Dam. That is a bigger project than some of our other de-bottlenecking. Typically, our de-bottleneckings are about the 200 mark. BFX is going to be bigger than that. There's a fair amount of work that we need to do. It's a great project, no doubt, but nevertheless it's a little bit more than those others.

Assuming that we are going to be exiting shale as Andrew mentioned earlier, but in the meantime, we've got to look after that business and we've got to run it for maximum value so we should continue to spend wisely, judiciously, carefully, but I think we should continue to spend and we are assuming that we continue to spend, certainly this year, and to the extent we still have that business next year we've made some assumption that we will continue to run it well. And then I think the other one maybe just to highlight is that, we've still got to replace Monturaqui as a water source in Escondida, we've replaced Salar Punta Negra. And so we just need to put that extra additional module in the next three years of desal water into Escondida. It's not very much money, but it's part of the increase. As Andrew said a moment ago, it's not that we need to spend up to this, but we're just giving clarity – some guidance, if you like, for the medium term. Hopefully that's helpful.

MENNO SANDERSE, MORGAN STANLEY: Thank you.

ANDREW MACKENZIE, BHP: So, Menno, I hope that answers your question. Just a couple more points from me. Our investments in shale, of course, they pass the capital allocation framework test with flying colours. But they're obviously designed to add value, profitability and marketability to our shale assets. And just on South Flank, we expect a cost per annual tonne of about $30 to $40. Is there anything more we can help you with?

MENNO SANDERSE, MORGAN STANLEY: No. That's good. Thank you very much.

ANDREW MACKENZIE, BHP: Okay. So can I take the next question?

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

ANDREW MACKENZIE, BHP: Hi, Lyndon.

LYNDON FAGAN, JP MORGAN: Hi, Andrew. Thanks very much. And great to see the company addressing a couple of overhangs on the stock, being Onshore US and Jansen, but I'd like to explore those two in a bit more detail. If we start with Jansen. The wording in the presentation says that the project will only proceed if it passes strict capital allocation tests, but we're 70 per cent through a $2.6 billion project. That investment is bigger than Spence. And I'm still a little unclear as to why we're still going ahead with that, and what changes have been made to limit these type of early phase spends.

And, the next one is just on Onshore US. If we look at the three scenarios that the business was being run on, just wondering if they're still applicable or whether you're running it for cash prior to sale. And, if it was to be a demerger, whether that would be the US. Thanks.

ANDREW MACKENZIE, BHP: Okay. Let me deal with the shale one first, Lyndon. Our preference would be, I think, to sell the business through a relatively small number of trade sales. But, there is an execution risk around that. And so, in the interests of making sure we can do things relatively quickly, I don't want to eliminate other ways in which we could exit these businesses – including things like demergers, IPOs, or vending into special vehicles and so on. We look at everything in order to decide what is the right way through this. But, for now, we think that probably trade sales is where we would prefer to – well, we think we have the best opportunity of restoring and maintaining value for our shareholders.

I can understand why you might say that we should run it for cash. But one of the features of shale, which we've grown to like a bit less with time and see it a bit more of a curse, is that the investments that are demanded there are quite pro-cyclical. You have to continue to invest to actually maintain the value of those businesses. In this case, we're very fortunate that we have investments that we can make that we think perform very well in the capital allocation framework, and, as I said, won't just add profitability and value; they will add marketability to these assets. But, as always, we review this very, very regularly through the lens of the capital allocation framework. And, because of the short-term nature of shale, we do that with a much greater frequency right to the very top of the company.

I'd like to give most of potash over to Peter. He handled it in his presentation. It is a capital allocation issue. But I would just point out that once we have completed the shafts, we will have totally de-risked the project. We will have dealt with all the difficult parts of it. And, we will only be three years away from first potash when we think it's appropriate to make the right counter-cyclical investment. And that's the big question, which will be determined by how it looks. And we've said today that we'll wait at least another couple of years, and if we need to wait longer, we will wait longer. And, over to Peter now, there's lots of things that we can do in the interim to add significant value to what we've already done in potash. But, Peter, over to you.

PETER BEAVEN, BHP: Thanks, Andrew. Look, just a couple of things to add. The shafts are underway. In the event that we didn't finish those shafts, what would happen is that they would collapse on themselves and then we would lose the shafts, which doesn't make any sense at all. So we should spend the remaining $500 million or so to finish those shafts probably by the end of 2019, and at that point, we have an option which is good to go, timed well for the market.

As Andrew said a moment ago, we have confidence that the market will balance and there will be additional potash required, and so that's really the basis of that money that we're spending – allocating today and in the next couple of years. In terms of the question about what would we change, let me just say, what we would like to have is options. It's good to have options. The key, though, obviously, in the way we would think is that we would like to have options that are low cost to hold and that have obviously lots of upside potential and so on. So that would really just give you insight – its not insight, its rather obvious – but that's certainly the way we would think about holding and adding options to this organisation today.

ANDREW MACKENZIE, BHP: And let me just stress – it's an option. And if it takes longer, it takes longer. And there are many ways as we wait or we think about the option and we gave a lot of examples on the slide as to how we've done things in the past that we can add value while we wait. I would kind of remind you that both the Spence Growth Option and Mad Dog 2 which were sanctioned this year, we were first ready to consider those projects probably five years ago and we've waited and improved and waited and improved, and over the same period you’ve seen us exit projects like Browse and Yeelirrie for a lot more money than we spent in setting them up, and bring in partners, and I could go further back and show how we’ve done them, and in some cases, of course, you’ve seen on the slide a complete regroup, to some of the things we’ve just been talking about, how we can replace capital with productivity and things like iron ore. Now, that’s not as relevant here, but what I want to say, we will wait as long as it takes and we will look at every way in which we can to maximise the value of this option. There isn’t a commitment to proceed beyond the shafts and there won’t be until it passes our strict capital allocation tests.

We’ve been very disciplined as a management team. That’s why we’re talking today about thriving on capital under $8 billion. It wasn’t so long ago that the thriving capital level of this company was much higher, and we brought it down through the discipline of Peter and his team, and the culture of discipline that comes from the very top, around capital, and that applies with even more rigour as it relates to the potash options, which is still a nice thing to have, given some of the uncertainty in the longer term, and given that we do think some time in the 2020s we are going to see a requirement in that market for some form of new greenfield production, in the same way as we think that’s true for copper.

Next question?

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

ANDREW MACKENZIE, BHP: Hi, Clarke.

CLARKE WILKINS, CITI: Hi, how are you? Just a couple of questions. First off, it’s good the sort of the non-core shale assets being divested. What about the other sort of assets in petroleum that are sort of non-operated and are also quite immaterial to BHP? Is there any sort of proposal or process underway to look at divesting those? Also, just in regards to Olympic Dam, I think back in May you talked about latent capacity of 330,000 tonnes there potentially being unlocked. Is it possible to just delve in a bit more detail about what needs to be done there in terms of the smelter, the refinery, actually the power constraints we have in South Australia and things like that at the moment… how can you unlock that sort of latent capacity of Olympic Dam and what sort of timeframe are you looking at for that?

ANDREW MACKENZIE, BHP: Okay. I’m going to give Peter the second question on Olympic Dam. He used to run copper and it’s very much a capital thing that he looks after through his chairing of the Investment Committee. Let me come back, then, to Conventional Petroleum, Clarke.

This is a great business. It has been a great business for this company for over 60 years. It has phenomenal returns, EBITDA margins at 66 per cent. And we’re good at it. We have some of the lowest costs in the industry – about $10 a barrel. And look at the success of this year in terms of exploration. Potentially two very significant discoveries: one in Trinidad, one in the Gulf of Mexico. And getting to the front of the queue as private industry goes back into Mexico to win the Trion bid. And if you put those three together, then you have the opportunity to provide competitive options to extend the track record of Petroleum within BHP, for a few decades to come.

And I wouldn’t put it more than a few decades because, clearly, one of the questions we ask ourselves is, is the changing market for oil? A year ago we wrote a blog where we signalled – which is now becoming much more widely shared – a more rapid penetration of electric vehicles. And we see that starting to take off, perhaps as early as the late 2020s... and starting to add a lot of uncertainty into the market around 2040, 2050 onwards. But until then, of course, there could be a lot of really good money to be made in conventional oil if you’ve got areas where you can move fast.

And the Gulf of Mexico – both sides, Mexican and US – and Trinidad have been chosen as fast-moving provinces that when we get something like Trion, like Magellan and like Wildling, we can put them quickly onto production and so on. So this is a great business and one that we are good at. And we’ve been pivoting back towards it since we’ve been reducing our footprint in shale for the better part of two or three years. And you see some of the fruits of that pivot today.

CLARKE WILKINS, CITI: Just a very quick extension there, though. I think the question was targeted that conventional side of the business… there is value added in terms of the exploration, etcetera. It would more be your non-operated assets in Australia like Bass Strait, North-West Shelf, etcetera, where there’s not a lot of growth. They’re mature assets, non-operated. Do they really belong in the BHP portfolio rather than your assets in the Gulf of Mexico?

ANDREW MACKENZIE, BHP: Well, they're very strong cash generators, and we like cash. But what I will say to you is that every year we do a thorough review of the portfolio. It starts about now and runs the course of the financial year. And we've just kicked this year's review off, and we start the review with a fairly detailed analysis of what we're good at: if you like, how we play to win; things like productivity and safety and capital discipline; and some very wide-ranging look at future scenarios, out to 2040, 2050 – how the world might turn out. And then, as we get beyond Christmas and through there, we go through the Board cycle. We then – we direct that at the portfolio. And I can assure that the assets that you're calling into question that we will examine very hard, as we will many other parts of the portfolio… some of which may be more controversial than others. But everything will get a good going over to make sure they're fit for purpose for the longer term. And we do that every year. And I expect this year's process to be particularly rigorous in that regard.

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

ANDREW MACKENZIE, BHP: Hi, Glyn.

GLYN LAWCOCK, UBS: Good morning, Andrew and Peter. Just two quick questions. Firstly, just on the balance sheet target, the $10 to $15 billion. One of your peers came out with a target, and it caused them all sorts of grief, because everyone then expects them to keep spending to get back into that range. Just wondering, firstly, $10 billion of free cash flow at spot – admittedly, spot is high – plus if you sell shale through a trade sale for what the market thinks it's worth, you could end up net cash within 12 months. Would you sit there, or would you want to get back to within the $10 to $15 billion? That's the first question.

And then the second question: while you've announced Spence and it was great, I mean, every metric was worse than what it was when we were on site eighteen months ago – capex, production, everything. I know that the capital was 12 per cent higher due to FX. Would you consider hedging the currency? Because, I mean, this is a three-year build. If the currency continues to move against you, that return you talk about of 16 per cent could dwindle and we could end up with another poor investment decision. And, also, would you hedge oil, given the similar payback nature of US oil versus US gas? Thank you.

ANDREW MACKENZIE, BHP: Okay. There was a lot in that. Let me ask Peter to start, because there was a very distinct question on the balance sheet and whether we would run net cash. And he might comment a little bit on Spence, and then I'll maybe add something at the end. So, Peter, why don't you talk about the balance sheet and the $10 to $15 billion, and the net cash?

PETER BEAVEN, BHP: Obviously the capital allocation framework, as always, will be the guide as to what happens in a year's time. If we make, as you say, free cash flow at that spot number that Andrew mentioned a moment ago, whatever proceeds we'd get from whatever assets – in the event that we get – so we will want to sit within the $10 to $15 billion. We wouldn't want to go to net cash, and we think that's not an efficient balance sheet. We don't think that's a necessary balance sheet for a company as strong as BHP. So we're very anxious to ensure that we have a safe balance sheet, but also an efficient one.

So just on SGO, a couple of comments on that. I think the basics of the underlying operating characteristics, the production, the opex, and so on and so forth, I don't think really anything much has changed. Yes, the FX has changed a little bit.

We thought about hedging it and we had a good discussion around that, because we want to open ourselves up to all of these – the conversations we should have on these things. It tends to be, though, that you've got a currency that sort of rolls with copper. I know that there is the variation and the timing on these things. But largely, we felt that it was a natural hedge. But the other thing is, there is a large amount of the costs, in fact, that are in US dollars. And so, there's an amount that you could hedge and somewhat practically was a little less. So interesting questions, but I think that's a strong project. We don't think it is going to have any issues providing very strong returns to shareholders. It's not by any means a marginal project or anything else like that.

Last thing is, just on the oil versus gas, every time we look at a rig – and we do that on a quarterly basis, if not more common than that – we take a look at the hedge position. We've had a position on gas that we should hedge that, and we've done that for the four rigs in Haynesville. On oil it's a little bit more interesting. We're probably trading in the bottom of where we consider the range to be. The curve is a little steeper, so you've just got to be a little bit more careful about giving away upside in order to protect downside, particularly where it's – the bears have had a good run of that market. So that's kind of how we feel about oil. But every time we look at a rig, for sure we have a good robust conversation around this.

ANDREW MACKENZIE, BHP: Okay. Thanks, Peter. I don't think I've got anything to add to that, Glyn. So is there any more questions?

GLYN LAWCOCK, UBS: That's fine. Thanks, Andrew, Peter.

OPERATOR: Your next question comes from Hayden Bairstow from Macquarie. Please ask your question.

ANDREW MACKENZIE, BHP: Hi, Hayden.

HAYDEN BAIRSTOW, MACQUARIE BANK: Hi, Andrew. Just a question on the ROCE chart. I just want to get an understanding – your future capital is all sort of expected to return to 20 per cent. Should we be thinking about a target of all these assets, that you want to get them all to 20 per cent? Or is the cost reduction in WA iron ore sort of lift that bar for your 2022 target of getting the group level to 20 per cent? Because obviously getting rid of shale improves you to about 15 straightaway. But then do you need think about lifting the bar everywhere, or you're going to accept lower returns for some of these assets that just aren't ever going to get to a 20-plus per cent ROCE?

ANDREW MACKENZIE, BHP: All right. Well, I think Peter can handle that a bit more, but I haven't said very much recently, so I'll just make a few comments. We don't have some particular bar, because we strongly believe that there's a lot of variation in risk, depending on the projects we're doing. And so, we do risk weight everything according to what we think is the likely variability of the outcome – and had that discussion just a moment ago on SGO. So that makes coming up with some sort of fixed ROCE very difficult, because we deal with a wide range of risks on our projects. Of course we do want to push them to high numbers, and the capital allocation framework tends to push that. But it is looked at also on a risk-weighted basis.

So, sentimentally, we're exactly where you are, Hayden. We want to be in that area. But we'd rather not, sort of, start going down the languages of "hurdle rates" when we think we have such a variety of risk of the projects that we're considering. And we optimise our portfolio, in the dimensions of risk-weighted return, risk-weighted NPV and risk-weighted capital efficiency. Peter does that from time to time, and then project by project as it comes through the IC. Peter, you can maybe add the detail.

PETER BEAVEN, BHP: I think that's a pretty decent answer there, Andrew. I wish we could have everything well over 20 per cent every single year. But, we have this thing called "price" and it has quite a big impact. We've also got cost bases – accounting cost bases – which are part of the equation here, so we've got to take that into account. Look, overall the important thing is directionally we know what is really good. We know that that's got to get better. We know that – the stuff that's in the middle that really needs to lift – and that's Escondida, in particular, Olympic Dam in the nearer term. And the stuff at the bottom either it's good quality project or it's shale. And, as you say, that's $17 billion out of the $80-odd, and we've got to do better on that and so we need to monetise it. It's good quality ground, but it's worth more in somebody else's hands. And we can deploy that capital better in the capital allocation framework, including, as Glyn said a moment ago, for sure returning that cash back to the shareholders.

ANDREW MACKENZIE, BHP: Peter, it's a good point to add, I've got a pass mark from the CFO – just, I think. And we end on the subject matter of returns to shareholders, which seems very appropriate.

So thank you for watching and listening. I'm looking forward to meeting many of you in the coming weeks.

Thank you.