Financial results
Half year ended
31 December 2016

Investor and
analyst briefing
speeches
Andrew Mackenzie, Chief Executive Officer

Slide 1: Title page
Welcome everyone. It’s good to be back in London to present our interim results for the 2017 financial year. Peter Beaven, our Chief Financial Officer, joins us from Melbourne.

Slide 2: Disclaimer
Before I begin, please note the disclaimer and its importance to this presentation.

Slide 3: Title page
Today we announce a strong set of results.

Several years of considered and deliberate effort to improve productivity and redesign our portfolio and operating model have positioned us to take full advantage of this period of higher prices.

While the outlook appears more uncertain, our suite of tier 1 assets, strong culture of safety and productivity, and disciplined capital allocation framework give us confidence that we are well placed to substantially grow shareholder value.

Before I talk about our plans, Peter and I will run through our half year performance.

Slide 4: Interim FY17 scorecard
I will start with safety. Over the period, our lead health and safety indicators improved. However, it was with deep sadness that we learnt of a colleague’s death at Escondida. Health and safety is, and always will be, our top priority, and I will discuss this in more detail shortly.

As I said at the outset, our performance over the half year was strong. Our sharp focus on the things that matter most – safety, volume and cost – has allowed us to fully benefit from higher commodity prices.

Unit cash costs declined across major assets and contributed to a 65 per cent increase in Underlying EBITDA to US$9.9 billion, and an EBITDA margin of 54 per cent.

While overall volumes declined, several one-off events and the deliberate deferral of Onshore US activity mask the underlying trend. Substantial work has been done across the organisation to drive productivity, and unlock latent capacity for the years to come.

Improved operational and capital efficiency delivered strong net operating cash flow of US$7.7 billion and free cash flow of US$5.8 billion.

Strict adherence to the capital allocation framework optimised the use of this cash. We further strengthened the balance sheet with net debt at the end the period down to US$20.1 billion. And, after careful consideration, the Board has announced an interim dividend of 40 US cents per share. That includes 10 US cents per share over the amount determined by our minimum 50 per cent payout policy. Our dividend policy allows us to recognise the importance of shareholder returns along with investment and value creation through the cycle.

Now, before I hand over to Peter to go through our financial performance in more detail, I would like to discuss safety and progress at Samarco.
Slide 5: Safety is paramount

The tragic loss of a colleague, Rudy Ortiz Martinez, at Escondida is a terrible reminder to us all of why health and safety must come first in everything we do.

We have renewed efforts to help our people understand our risks and the critical controls that have to be in place to protect everyone who enters one of our sites. Leaders, including myself and the rest of the executive team, now spend even more time in field to engage our workforce on safety and to verify that controls to prevent fatalities are in place and effective.

Of course, our goal is zero fatalities and to that end we are encouraged by improvements in lead indicators for safety performance. Total Recordable Injury Frequency declined in the period to 3.9 for every million hours worked, the lowest on record.

We achieve nothing if we do not achieve it safely.

Slide 6: Progress at Samarco

In Brazil, we are committed to the long-term rehabilitation of the communities and environment affected by the Samarco tragedy. While the impacts continue to weigh heavily, I am heartened by the ongoing effort and, 15 months on, I am pleased by the significant progress made across many fronts.

The Renova Foundation, established by Samarco, Vale, and BHP Billiton in June last year, has assembled a specialised team to deliver social and environmental remediation programs. Their approach is well planned and executed, and focused on engagement.

Each of the communities most severely affected by the dam failure have now voted on their preferred relocation sites, and the residents of Bento Rodrigues have recently approved the design of their new town.

The legal claims are ongoing, and will take years to fully resolve. However, we are encouraged by recent developments. In January this year, Samarco, Vale, and BHP Billiton entered into a Preliminary Agreement to a process, to negotiate the Civil Claims raised by the Federal Prosecutors by the end of June. This constructive involvement of the Federal Prosecutors gives us an opportunity to secure further legal certainty.

We, Vale, and the Brazilian community aim to restart Samarco’s operations. But, as we have said previously, it will only occur if it is safe and makes economic sense to do so. Restart also requires: the restructure of Samarco’s debt; completion of commercial arrangements with Vale, for the use of its infrastructure; and all licences and approvals.

There are many steps to complete and, while technically possible this calendar year, restart will require a coordinated effort from all parties.

With that, I will now hand over to Peter to discuss our financial performance. Welcome Peter.

Peter Beaven, Chief Financial Officer

Slide 7: Title page

Thank you Andrew.

Slide 8: Strong financial performance

What a difference a year can make.

Happily, we saw significantly higher prices, however this strong set of financial results has been many years in the making. We have extended our sector leading margins; generated strong cash flow; reduced net debt; and, in line with our financial performance, increased our dividends.

We delivered an EBITDA margin of 54 per cent. This is our highest margin since 2011 when our commodity prices were on average 50 per cent higher, testament to our productivity efforts.
We reduced unit costs at our major assets and embedded a further US$1.2 billion of productivity gains.

In the half, our diversified portfolio generated EBITDA of US$9.9 billion, up 65 per cent, with strong contribution from all four of our major commodities.

We are proud of the contribution we make to our host countries, and during the half, we paid an effective tax rate of almost 35 per cent. Including royalties, this was over 44 per cent.

Our Underlying attributable profit was US$3.2 billion. Rising prices have clearly helped and coupled with cost savings and further non-core divestments, our return on capital for the half was 9.2 per cent. We have fully captured this increase in commodity prices with a high conversion rate into EBITDA and free cash flow.

Reflecting this strong free cash flow of US$5.8 billion and the importance we place on shareholder returns, the Board approved a dividend of 40 US cents per share. 30 US cents per share through our dividend payout policy and an additional payment of 10 US cents per share, or US$532 million.

Now, let’s look in more detail at our operating performance.

**Slide 9: Group EBITDA waterfall**

After nine consecutive periods of weaker prices, the cycle turned and higher prices improved our Underlying EBITDA by US$3.5 billion. But with higher commodity prices typically come currency and inflation pressures, which combined reduced EBITDA by US$200 million. This was partly offset by record production at Western Australia Iron Ore.

We reduced controllable cash costs by US$1.1 billion and this reflected lower costs across the group and better recoveries at Escondida, which I’ll touch on shortly.

**Slide 10: Productivity lifts margins**

Over the last four years, we have embedded more than US$11 billion of productivity gains. This has preserved our margins as prices have fallen. In fact, without these gains, our margin this period would have been below 30 per cent.

Unit costs have now fallen over 40 per cent since the 2012 peak and we continue to deliver further savings across the group.

At Western Australia Iron Ore, costs fell to US$15 per tonne, a reduction of five per cent in local currency. This included over US$1 per tonne related to the write-off of low-grade stockpiles at Yandi, exploration and additional costs of the accelerated rail maintenance program. We now expect this to complete six months ahead of schedule. In spite of these factors, our iron ore business generated the highest margins in the Pilbara due to best in class price realisations and low all-in costs.

At Queensland Coal, costs were US$56 per tonne, eight per cent lower in local currency terms, reflecting reduced labour costs and increased equipment and wash-plant utilisation. This decrease was despite additional trucking costs to utilise latent capacity at Caval Ridge, while coal prices were high, and the loss of low cost tonnes from the Crinum closure.

At Escondida, unit costs fell 37 per cent reflecting the continued focus on cost efficiencies and two inventory movements. US$275 million related to improved recoveries following completion of the Bioleach Pad Extension project; and US$120 million reflecting a build-up of low strip ratio ore in preparation for completion of the Los Colorados Extension project.

Finally, in Petroleum, Conventional unit costs fell by 10 per cent to below US$9 per boe, due to a decrease in workovers. Meanwhile, in shale, drilling and completion costs were 25 per cent lower, reflecting optimised well designs, operational efficiencies and procurement savings.
However, a stronger Australian dollar and Chileno peso are returning with rising prices. So in spite of progress on costs, in US dollar terms, we have slightly increased unit cost guidance for the 2017 financial year at Western Australia Iron Ore; Queensland Coal; and several of our operated copper assets, where costs are also impacted by the power outage and unplanned maintenance at Olympic Dam.

While it is too early to assess the impact of the current industrial action at Escondida, we have an obligation to protect its competitive future.

Our total operating unit costs are expected to decrease compared to 2016, and as we look ahead, we expect further productivity improvements. These ongoing cost reductions are evidence that our simplified operating model is delivering results. A leaner management structure, supported by integrated global functions, is better leveraging cost saving initiatives, knowledge sharing and capital efficiencies. The changes to the way we operate have built a solid foundation, but we have much more to do.

Now, let me talk more about cash generation and our balance sheet.

**Slide 11: Strong cash flow and balance sheet**

We efficiently converted high commodity prices into cash flow. Our free cash flow was US$5.8 billion for the half and every one of our business segments contributed significantly to this result. Importantly, US Onshore was also free cash flow positive, for the period.

We reduced capital and exploration expenditure by 38 per cent to US$2.7 billion. This reflects significant improvements in capital productivity and our continuous efforts to release latent capacity at low capital cost.

We have strengthened the balance sheet: net debt is now US$20.1 billion; the range of internal credit metrics we use to measure the strength of our balance sheet all moved in the right direction; our gearing ratio is 24 per cent; and we have a solid A rating.

In this half-year, we reduced net debt by US$6 billion. I will go through the net debt reduction in more detail. We generated US$5.8 billion of free cash flow; we paid US$700 million of dividends to shareholders; we recognised US$600 finance lease for Kelar, a gas-fired power station in Chile; with a US$2 billion non-cash decrease in the fair value of our debt book reflecting exchange and interest rate movements. This was entirely offset by movements in the associated swaps, included in "other financial assets and liabilities" on the balance sheet.

Even though our balance sheet is strong, near-term uncertainty is increasing and when we changed our dividend policy, we also pledged to invest more counter-cyclically. And so, with commodities like iron ore and coal trading above long term forecasts, we had a bias towards further debt reduction.

To this end, today we have launched a bond repurchase for up to US$2.5 billion targeting short-dated US Dollar notes, in order to generate higher returns for some of our surplus cash, and extend the maturity profile of our debt.

Finally, looking at our capital allocation.

**Slide 12: Disciplined capital allocation**

This time last year, we first presented our enhanced capital allocation framework. One year on, it’s embedded in every investment decision we make. It drives discipline in how we allocate capital and it links cash returns to shareholders to the performance of the business.

This slide shows the outcome of our capital allocation. Over the last six months: we generated US$7.7 billion of net operating cash flow; we maintained the safe integrity of the business; our balance sheet remains strong in a broad range of potential future conditions; and we paid the dividend determined by our payout ratio policy.

This resulted in excess cash of US$4.4 billion: we invested US$2.1 billion in high returning growth projects; we paid an additional dividend of US$300 million; and as previously guided we had a bias to debt reduction. So we allocated US$4.7 billion to the balance sheet.
Acquisitions and divestments are an important part of the capital allocation framework. And in this period we continued to simplify the portfolio and received US$730 million from the divestments of: non-core shale acreage; half of our stake in Scarborough; IndoMet; New Mexico Coal; and the Caroona lease cancellation.

This half, the total dividend of 40 US cents per share is significantly above the 14 US cents per share paid as the final dividend for the 2016 financial year. This reflects the importance of cash returns to our shareholders and confidence in our current and future performance.

The company is stronger, however rising global uncertainty requires we maintain a conservative bias towards our balance sheet. Having said that, this financial year we expect to allocate US$4.2 billion towards organic growth and exploration, as we progress our rich pipeline of additional growth options. While these projects have the potential to support healthy growth rates in the future, we remain committed to our value over volume approach. All investments must compete for capital, are tested against additional cash returns to shareholders, to make sure we optimise the use of excess cash.

We recognise the importance of cash returns to our shareholders, and at the right time, and in accordance with our capital allocation framework, we will consider additional dividends and buy backs.

I am pleased to say that competition for capital is more rigorous than ever.

Back to you Andrew.

Andrew Mackenzie, Chief Executive Officer

Slide 13: Title page
Thank you Peter.

Slide 14: Near-term uncertainty, attractive long-term fundamentals
Our long-term views on commodity markets are largely unchanged. We are optimistic about the future.

Population growth and better standards of living are expected to drive increased demand for our commodities. The urbanisation of the next generation of emerging markets, such as India, will build new demand centres, and the global transition to lower emissions energy in response to climate change presents both risks and opportunities.

In the near-term, however, challenges remain. After a period of weak prices, several of our commodities currently trade above long-term forecasts. In addition, there has been a marked rise in geopolitical uncertainty and protectionism, which has the potential to: inhibit international trade, the lifeblood of the global economy; weigh on business confidence; and restrain job creation and investment.

The changes we have worked tirelessly to implement allow us to navigate these uncertainties with both strength and agility.

Slide 15: Well placed for anticipated conditions
The demerger of South32 and over US$7 billion of asset sales have shaped a portfolio that is now true to our strategy.

Our assets are large, long-life, low-cost, and provide diverse exposure to a mix of commodities with attractive fundamentals.

The improvements in productivity we have locked in preserve margins and allow us to fully benefit from higher prices.

A strong balance sheet, reinforced by a disciplined capital allocation framework, insulates operations and allows us to invest through the cycle.
And, with vast improvements in capital productivity, our growth options are now more competitive than ever. These options span time horizons and commodities. However, with a focus on value and in line with our capital allocation framework, we always test these against additional cash returns to shareholders, and will only develop when the time is right.

**Slide 16: Progress on our roadmap**

As outlined in May last year, we have a unique set of opportunities and a clear roadmap to improve returns and grow value by 70 per cent. And, since my last update, we have made significant progress.

Our productivity momentum is strong. This half, we delivered a further US$1.2 billion, which follows the US$11 billion of annualised gains embedded over the last four years.

We have released low-cost latent capacity across the portfolio. At Spence, the Recovery Optimisation project has already ramped up; Escondida's Los Colorados Extension will be commissioned in June; and the Caval Ridge Southern Circuit is expected to be approved shortly.

In Onshore US, after the success of our gas hedging pilot in the Haynesville, we have expanded the program; and across all our shale acreage we continue to lower development costs and consolidate our position to profitably unlock the value of these world-class resources.

Our major growth options have progressed. Mad Dog 2 was approved earlier this month; and in December, we were the successful bidder for the Trion discovered resource in Mexico.

In exploration, positive results at Caicos in the Gulf of Mexico give us confidence to accelerate the Wildling appraisal well to establish the scale of this resource; and in Trinidad and Tobago, where we had success at LeClerc, we are now assessing commerciality.

Finally, our Technology function is focused on the identification and execution of a range of integrated programs to unlock resource and lower costs even further.

While we have already achieved much across each of these value drivers, this is just the beginning.

**Slide 17: Emerging stronger from the downturn**

The past several years have presented many challenges for the industry and for ourselves. However, we have remained steadfast in our plans, and used the opportunity to implement and accelerate significant change – change that would have been far more difficult, if not impossible, to make at the top of the cycle.

We have a strong foundation, and while we have substantial work ahead, we are now a far more agile company and I am confident that we have everything in place to build significant value well into the future.

We have the right assets, in the right commodities, with the capability and culture to prosper. Our strong balance sheet provides stability. Disciplined investment in our rich pipeline of options will grow value and deliver returns for our shareholders.

We are on track, resolute in our focus, and see enormous potential ahead.

Thank you.