BMO Global Metals and Mining Conference

1 March 2021

ALEX PEARCE, MINING ANALYST, BMO CAPITAL MARKETS: Welcome to our next fireside chat, where I have the pleasure of introducing Mike Henry, CEO of BHP. Welcome, Mike.

MIKE HENRY, CHIEF EXECUTIVE OFFICER, BHP: Thanks, Alex.

ALEX PEARCE: This is a key topic today. Why don't we start with iron ore and your thoughts on where the iron ore price could be going from here, and also maybe you can give us an update on your business? Obviously, you have a new project that you are tying into.

MIKE HENRY: Okay. Thanks, Alex. If I look at where the iron ore markets are currently, obviously we are seeing very strong prices, importantly supported by the fundamentals. You have seen very strong end-use demand for steel in China, the rest of the world's economies recovering and overall healthy demand for iron ore. We expect that is going to persist. There will obviously be short-term perturbations as different policies are enacted and so on, but overall we see underlying demand for iron ore being pretty strong and likely to remain strong for some time yet. The near-term uncertainties are all going to be around how quickly Brazilian supply returns to market. Even if we see a bit of acceleration in Brazilian supply we think that the underlying demand fundamentals are going to provide a degree of support to pricing.

As we get past the near term into the medium term, our view remains unchanged, which is that probably towards the middle of this decade you will see a plateauing and then a move into the decline of Chinese steel demand. With that we will see some contraction in iron ore demand. That will occur against a backdrop of more supply out of Brazil, some supply out of West Africa and probably some creep out of the Pilbara. And so we think the medium to long-term outlook for iron ore is that we will, of course, see lower prices, which brings me back to our business.

This is a business that is right now firing on all cylinders. We have been increasing the reliability of the underlying business. That has allowed us to produce more just at a time when iron ore prices have been at a high. And we have done a great job of containing costs. We have been the low-cost producer in the industry for some time now. That combination of being reliable, low cost and, importantly, focusing on product quality we think is going to be the winning combination because with the new project that you referenced, South Flank, coming in we will be increasing the average iron content and lump proportion in the mix of BHP's product suite. We are therefore going to have higher average quality, we are going to be the reliable supplier and we will be low cost. We think that is going to allow us to continue to generate great returns out of this business over the longer term.

ALEX PEARCE: You touched on quality there. How do you think the quality spreads are going to change in the longer term? Are there any opportunities in the business to improve that either at site or on the other side? A big part of that is the reduction of CO_2 output right at the steel mill.

MIKE HENRY: Okay, that is a big question but I am going to start with a little bit of a story here, Alex, because it is a really great story. Back when we were looking to sanction South Flank a few years back we were faced with a couple of choices. We had one mine that was going to be lower cost, lower capital but lower quality. The marketing team within BHP had a very strong view that South Flank was the project to go with because based on all of the analysis they had conducted they believed that over time we were going to see an increasing premium for higher quality products, so lower phosphorous and more lump, and that we would see an opening up of the discounts for lesser quality products. Everything we have seen play out in recent times reaffirms that view for us. With the increased focus on decarbonisation, the push towards larger, higher productivity blast furnaces and what we have seen play out with quality spreads over the last couple of years, certainly for the premiums that we are able to get for our better quality products, that reinforces our view that South Flank was exactly the right choice to make and that is going to hold us in good stead in coming years.

As to what more we can do, as I said we will have increased iron content and a higher proportion of lump in the product mix as we bring South Flank in. We will continue to look at other opportunities to further increase our volumes. We have been looking at one particular beneficiation project, for example, at one of our mines, Jimblebar, which is a lower quality product. What I think is really important here is that we are able to deliver reliably to customers and given the strong operational performance we have seen over the past few periods we are increasingly establishing a reputation for ourselves of being able to deliver reliably both volume and product to customers, which allows them, of course, to plan better.

ALEX PEARCE: That is great. Sticking with carbon emissions and thinking about the rest of your portfolio, maybe you can talk about petroleum and how that fits within the business. Is this a more mature sector that you will be looking to draw cash from or do you think it still warrants investment from your point of view?

MIKE HENRY: For the time being, Alex, which I was clear about last year, we see there being really strong value and returns to be created for shareholders over the next decade and likely beyond that through investing in the right oil assets and a select few gas assets. What underpins that view is just how essential oil is to so many of the processes and products that support life as we know it today, and will for some time, coupled with the factor of natural field decline in oil where once you have invested you are on a treadmill of the industry needing to invest more due to the 3-6% per annum depletion that occurs through natural field decline. That measure of resilience in demand and natural field decline mean that more investment is going to be required in the industry. That will support prices. If you have the right assets and the right capabilities we think fresh investment can still generate some pretty attractive value and returns for shareholders.

We are going about that in the BHP portfolio in a balanced way, recognising some of the longer-term challenges to oil. What we have said is that we will look for new opportunities to create value and returns, but at the same time we will step out of more mature assts in the portfolio, and we have committed to divesting ourselves of the Bass Strait asset here in Australia, which has a less long life and has less upside to it. Through doing that we will make sure that we maintain a balanced approach to investment, all the while focused on creating value and returns for shareholders.

ALEX PEARCE: Let us now turn to coal and a focus on metallurgical coal. You spoke about the quality of the iron ore. You have some high quality coal assets too. Maybe you can talk about your long-term thoughts there and also maybe the Australia/China trade relationship and how that has impacted sales.

MIKE HENRY: There are two very different questions there, Alex. In terms of the long-term outlook for metallurgical coal, we believe that at least over the next 20 years there will be pretty strong demand for high quality hard coking coal. In fact, we think the global push towards decarbonisation is going to increase the value that is ascribed to the best of the best coking coals. That is because even as steelmakers look to the very long-term potential to replace blast furnace steel production with green hydrogen DRI or other steelmaking technologies that do not require coal, the widely held view is that that is only going to see significant inroads from the 2040s and beyond. However, addressing climate change needs to start now. If you are sitting there as a blast furnace steelmaker, one of the levers that is available to you is to look at how you can make your blast furnace steel production lower carbon intensity or have a lower carbon footprint. One of the means of doing that is through increasing blast furnace utilisation. That requires higher quality hard coking coal, and BHP is sitting on the world’s best resources and biggest set of resources of premium coking coals. We think there is great value to be generated for some time yet in that business.

Turning, then, to what we have seen in the near term, we have of course seen a ban put in place on all Australian coal shipping into China. Our metallurgical coal book was the most diversified of our commodity books; we were only selling about 30% of our product into China to start with. However, obviously that means 30% of our product now needs to go to other markets. We have a very nimble marketing team and great relationships in other markets so that when the ban was put in place we were very quickly able to pivot to selling all of that volume to other markets. We continue to sell everything that we are able to product, but clearly it has been at lower prices than if the ban had not been in place. The prudent planning assumption for BHP is that the ban will be in place for some time yet. We have seen no indications that that is going to change in the near term, so we will be continuing to ship to other markets. The same focus is in iron ore: we are disciplined on costs, and we are looking at how we can improve productivity and shipping reliably.

ALEX PEARCE: That is great. Maybe we can stick with coal but talk about thermal coal and your plans to divest or at least remove assets from the portfolio. What are your thoughts there? What is the strategy?

MIKE HENRY: Last year I announced that we would be divesting ourselves out of the New South Wales Energy Coal mine, our stake in Cerrejón and the BHP Mitsui Coal (BMC) coking coal asset in Queensland which is less high quality coking coal. There are two mines within BMC, and it is those four mines that we are divesting ourselves of because we do not think they are going to compete well for capital in the BHP portfolio going forward. There is more value to be extracted there but against the other options that BHP has for its cash we do not think these are going to be the right assets to invest in. They are better held under different ownership. How are we going about doing that? We are looking at a range of options from trade sales through to a demerger. Recognising the environment that we are in, we said at the time that I announced this that it would be an up to two-year process and we are about six months into that process now. We are continuing to look at the different options and are engaged with a range of stakeholders externally.

ALEX PEARCE: Maybe we will stick to the specific assets here. I have just had a question come through the app. 'You are set for a go/no-go decision on Jansen by mid-year. Considering project economics and strong agricultural commodity prices is there any reason you would not do it?'

MIKE HENRY: Alex, one of the things I hope we have demonstrated in recent years is a very disciplined approach to capital allocation. If I step back and think about potash and Jansen, we like the commodity. We think that the long-term demand outlook for potash is strong. We think there are relatively attractive supply side fundamentals in the long term; clearly there is oversupply in the market currently. However, we think that with the combination of industry structure and the relatively higher barriers to entry, coupled with the great resources that we have, it is attractive. We like the investment jurisdiction. Investing in potash and investing in Canada would give us a bit more diversification in terms of our geographic footprint and our market footprint, including the drivers of product demand.

However, it is not good enough to like the commodity or the industry. We have to have a good project that we think is going to deliver appropriate returns with the right risk profile for shareholders, and that is still something we are firming up our views on. There are a few things we need to do to firm that up between now and the middle of the year. The other thing is that we need to get a port option locked in, because if we are going to take this project forward we have to have a route to market and we are still in the process of getting that finalised.

At this point in time, relative to what we have spoken to the market about previously, as I have been through the project over the past 12 months, have really unpacked it and brought third party, independent eyes onto some the underlying assumptions, nothing has arisen that is a major red flag, but we have continued to assess whether we should be a little more conservative on some assumptions. We have looked at other things we could do to optimise project economics and we will know in the middle of year whether we have something that does give us that investment opportunity and makes its way through the capital allocation framework (CAF). If the answer is yes then this will be the low-cost mine in the industry. It will be equipped with all of the best operational practices and technology that will allow us to produce sustainably at low cost and reliably, and it will create great options for the future.

ALEX PEARCE: Let us maybe switch gear a little here and talk about capital allocation again. I think I have most presenters this so far today. You announced a pretty stellar dividend recently and there is some great cashflow coming from the operations at the moment. We just touched on some of the greenfield assets that you have within the portfolio as well. When do you think is the right time for companies to start spending more on growth than shareholder returns? When is that point?

MIKE HENRY: You are right. It was a great dividend. It was the best interim dividend BHP has ever paid, supported by very strong operational performance and, of course, the tailwinds of iron ore and copper pricing. When it comes to the right time to invest in growth, what we do not want to do, Alex, is become pro-cyclical. The industry has a great track record of being quite pro-cyclical and that has ended in tears all too often. From a BHP perspective, we want to be really disciplined about how we go about this, always with a first eye on value growth. Chasing production really does not make sense. It all has to be about value. The levers for increasing value are not just increasing production. There will be times when that is the right thing to pursue to create value and returns for shareholders. However, oftentimes, it is just a disciplined focus on productivity. If I look at our iron ore business and our metallurgical coal business, those are two games of productivity – by being reliable and low cost, and through our reliability and getting better every day. There will be a little bit of creep out of those two businesses, and you will see that we have taken steps recently to de-constrain ourselves from the 290 million tonne limit that is currently in place, but there is no intent to invest in major growth in either of those two businesses.

However, we have also been clear that we would like to increase our exposure to future-facing commodities like copper, nickel and possibly potash as we have just spoken about. In the case of copper we already have reasonable growth ahead of us over the next five years based on the increased production we expect to see out of Escondida as we see a bit of an uptick in grade. We have just brought on the Spence growth option in Chile. From a timing perspective this could not have been better – we are bringing it on into very high copper prices and we brought that project in on time and on schedule. And we have more reliable production coming out of Olympic Dam. That increased reliability will lead to a measure of growth.

The next five years are looking pretty strong, but we have to look at more options beyond that, so our focus at this point is on securing longer-term options through a combination of exploration and early stage entry. Of course, M&A always remains something we can consider, but based on what we see currently in terms of asset values, now would not appear to be a great time to be engaging in copper M&A.

ALEX PEARCE: You have just touched on my next question, actually. You brought on the Spence growth option but you recently cancelled the brownfield expansion (BFX) project at Olympic Dam. Maybe you can talk about the rationale behind that and whether it was related to Oak Dam and the potential there.

MIKE HENRY: The short answer is that it is not related to Oak Dam. I think it is a perfect illustration of the discipline that we have when it comes to capital allocation. In stepping back and looking at that project and the risk/return profile for it, none of us felt it would be appropriate to put at risk shareholder capital given the returns that we saw there. Of course, I am not happy that we had a project we could not carry forward there, but it was absolutely the right decision for shareholders and it was informed by some really disciplined assessments and assurance work that we undertook prior to sanctioning a multi-billion dollar project. Where I definitely would not have wanted to have been was, having triggered a multi-billion dollar project, regretting that decision 12 to 24 months into it because we found things were not playing out as intended.

The obvious question then becomes: where do we go with Olympic Dam? The near-term focus is all around reliability, which comes through investing in asset integrity. We have another big smelter campaign maintenance programme underway in the coming year. Through those two things we will be able to reliably produce at 200,000 tonnes plus of copper cathode, and relative to where we have been over the past number of years that will be de facto growth in Olympic Dam. In parallel with that we will look at the longer-term options. The longer-term options will be to creep through a bit of de-bottlenecking and then more significant growth on the decade horizon and beyond will come through, possibly, further expansion of Olympic Dam but also, as you say, how we rope Oak Dam into that equation and whether there are opportunities to leverage Olympic Dam infrastructure for the much higher grade ore that it looks like may be available at Oak Dam.

ALEX PEARCE: I understand. You mentioned nickel in the metals you are looking at. Nickel West was probably seen as a bit of a non-core asset if we go back five years, but it appears have transformed back into the fold pretty well. What are the long-term prospects for this asset? Is there upside opportunity there?

MIKE HENRY: There is definite upside opportunity at Nickel West and for a bigger nickel business, Alex. You are right. A few years ago Nickel West was an asset that was either going to be divested or shut in, and it was losing quite a bit of money at the time. However, the team there has done this amazing job of turning the asset around by instilling more operational discipline, leaning the asset out and transitioning the mines from a set that was depleting into a fresh set of mines that can sustain the asset over the long term. They have created options for the company to invest in a bigger future for nickel. The reality is that today the asset should be seen as a no-cost or a relatively low cost option for the company in a market where the medium to long-term demand outlook is stellar, given what we see playing out with the electrification thematic and the broader push on decarbonisation.

We think in particular nickel sulphides stand to generate great margins going forward, given they will be the low-cost route to battery precursor and with price being set by laterite conversion. Given our Nickel West base of infrastructure we are looking at operating the current asset reliably and how we can expand through de-bottlenecking, and we will look at how we can secure more resource through brownfield exploration in and around current tenements and we also have some greenfield exploration efforts underway in Western Australia, elsewhere in Australia and in Canada.

ALEX PEARCE: Thank you for that. Let me think about a more general question here. If we go forward maybe one or two years, when we are back in Miami and we can see the sun shine and we can everyone at the conference in person, what do you think is going to be the main topic of the day? Let us say it is a two-year timeframe. How are the key topics going to change over that time?

MIKE HENRY: To start with, wouldn't that be lovely. We all look forward to it. I think the topic of the day will increasingly be on two things. One will be ESG. I do not just mean broad ESG as we see it today but rather a real focus on how the ESG dynamic is evolving, how the market understanding of the trade-offs or the priorities in ESG shift over time and then how individual companies, through the way they are set up and the capability they have built, are able to distinguish themselves in the field of ESG. That could be climate change, but increasingly it will be water stewardship, biodiversity, community engagement and indigenous heritage. Then the question is how that ESG backdrop marries up with the world's need for more commodities, because the reality is that for the world to achieve the energy transition that it must achieve it is going to need a lot more of the commodities certainly that BHP produces: copper, nickel, potash and even steel.

On the current path, in order for the world to meet those needs one would have to question whether that is going to lead to unintended sustainability consequences. In order to avoid those unintended sustainability consequences at a local level, it is going to be really important that the right companies are developing those assets. I think that is going to be increasingly recognised by capital markets. There will be an increasing priority on ensuring that the right standards are set and then there will be an increasing discrimination or election on the part of investors as to which companies they invest in and which companies they back to develop those resources so that they know that they are doing the right thing by way of the world, both supporting decarbonisation and so on while also ensuring the other sustainability priorities of the world are met in tandem.

ALEX PEARCE: That is great. Mike, thank you very much for your time today. Unfortunately, we just came to the end of the allotted slot. Thank you especially considering how early it is for you over there. I wish you the very best for the rest of the conference.

MIKE HENRY: Thank you.