Exane BNP Paribas Basic Materials Conference: Interview with Vandita Pant

24 March 2021

Interviewer

Good morning, everyone. Welcome to day two of the 15th edition of Exane BNP Paribas' Basic Materials Conference and to today's presentation with BHP Group. During this call, all participants will be on 'listen only' mode for the duration of the meeting. But of course, this is your meeting and we would like you to participate through questions. By all means, send in your questions and I will relay them to Vandita.

It is my pleasure, on behalf of Exane BNP Paribas, to welcome Vandita Pant, who is Chief Commercial Officer for BHP Group. We have James Bell from the IR team on the line as well. Thanks very much for joining us. It is always a pleasure to welcome you. At this stage, Vandita, I think you would like to start with a couple of opening remarks, and then I will follow up with some questions. The floor is yours.

Vandita Pant, Chief Commercial Officer, BHP Group

Thank you, Sylvain. Welcome, everyone. Thanks for joining us today. Maybe I will reflect very briefly on the results we published for our first half of financial year 2021. They were a great set of results, and I would classify that into three buckets. The first one, as always, is safety. We have had two years of fatality-free operations globally, which is something we are proud of. It is a very big milestone, but we will never get complacent about it. Remaining focused on that is a priority across the company, as always. Along with safety, if I go into operational performance, there is really reliable performance coming through across our assets with some record productions being hit in our iron ore assets as well as record throughput in concentrators in Escondida, against the really challenging backdrop of COVID, as you will be familiar with. There is good production volume guidance being met across almost all of our assets for the first half.

While that is the BAU, if I can say that, for our operational performance, the other part of that is our project delivery. In the first six months, our projects across geographies and across commodities are right on schedule and on budget, be it Atlantis Phase 3 in Petroleum or the Spence Growth Option project in Chile. Against specific challenges and against COVID challenges, both are on schedule, on budget. The third project, which is tracking well and going exactly as per plan, is South Flank in Iron Ore in Australia, which is trending towards first production in the middle of this year, as was expected. There is really good performance on project delivery as well.

All of this from an operational perspective comes into play with the financial results, which are now out, and resulted in $15 billion of EBITDA and a 59% EBITDA margin, our second-highest margin in the last two decades. Return on capital employed (ROCE) was 24%. The balance sheet is really strong. We are at the lower end of our Net-Debt range. All of this resulted in an outcome that we are very pleased about: we declared more than $5 billion of dividends for the first six months. That is 101 US cents per share. If you look at free cash flow generated in the half and take out the free cash flow due to our minority partners, our joint venture partners, the payout ratio works out at 116%, which is a fantastic result for our shareholders. We are very proud to be able to do that.

While this was happening on the operational end in the first six months, we also, as you will know, announced our climate change-related targets and mid-term targets as well as our goals. There has been real momentum since then on real actions around it. That includes even more new renewable PPAs being done – this time for 50% of the power footprint of our Queensland assets – and three big partnerships with our customers across the largest steel mill in China, the second-largest steel mill in China and the second-largest steel mill in Japan, across a range of low-carbon technologies in the landscape. We are really proud to be putting a lot of momentum behind the Scope 3 partnership phase. We also announced the world's first LNG-fuelled dry-bulk Newcastlemax charter award, which would take our commodities from Australia to our customers, reducing the emissions footprint by more than 30% and reducing NOx and SOx, the pollutants, almost to zero. Our scale in that industry, as was our hope and wish, has accelerated the change in the whole of maritime, with many other people following that, which is fantastic as well. That is on the social-value front, if you will.

From the backdrop of commodities, we did have real tailwinds with iron ore prices and copper prices in the first half, but equally some of our commodities like met coal and petroleum products were at the lower end, so it was the full range. The positive China demand story in the first half is now continuing from here on. The positive constructive outlook remains, and the tailwind from rest-of-the-world demand is picking up and coming in as well. From where I sit, in the short term and medium term there is really positive momentum and a constructive outlook. The megatrends around not just the traditional demand drivers but decarbonisation, which play very well into our portfolio, give us a positive outlook for the long term as well. With that, Sylvain, I will hand back to you.

Interviewer

Thanks very much for this overview. I might start with a question on the cycle for you, with your commercial officer hat on. Obviously, this cycle was quite unique, in the sense that supply got impacted early because of lockdowns in a number of key mining locations. The stimulus measures are huge and inventories are very light, if I compare that to the previous crisis we saw in the mining space before, so it is quite unique. Even if not all commodities, as you said, are under the same dynamic, would you say there is a case for a supply-driven cycle, this time around, for some of these commodities?

Vandita Pant

Sylvain, I would say my positive view there is twofold. It is based on some supply but also the strong fundamental demand dynamics happening. I think both need to be looked at. For example, if I were to take the steelmaking industry, there was remarkable demand last financial year from China, 1.05 billion tonnes in a COVID year. There was a year-on-year increase of 5% in steel production in China. It is quite remarkable to think of that. That momentum is continuing. End-use demand in China is very strong. Equally, India went very low in terms of industrial activity for three or four months, and that is picking up now. Japan and Korea are fully back on. As the rest of the world starts to come back in terms of demand – it was double-digit negative on steel last year – you can see why the constructive outlook on demand stays. Of course, the supply disruptions for iron ore have played a part, as they have been for the last two or three years, since the tragedy, which means that supply disruptions are there and will get ramped up over a period of time, but demand fundamentals are strong.

If I were to move to copper, you are absolutely right: really tight inventory. Copper concentrator inventories are very tight. We can feel the tightness of it almost every day. Demand last year from China for copper was flat, which again, I would say, is quite remarkable. We had almost double-digit negative growth in the rest of the world. As that demands starts to come back in, as we are already seeing, the dynamics of demand are there. Supply disruption for copper is on an average usually 3% to 4%, as a rule of thumb. We would see that being slightly higher, perhaps, overall. However, on copper our project has just come in. This is the Spence concentrator project. What a good time to have that project come online. There is a clear window for that. There are then a few projects that you know are going to come in from 2022 onwards. In the second half of this decade the jaws around deficit open up again quite significantly.

The constructive outlook is based on some demand disruption, but not overly, I would argue. From here on, China remains positive and the rest of the world is really starting to come back. The blast-furnace rates in India are trending around 90%. We will expect to see that come up through the year as well.

Interviewer

Do you have a perception of how customers are engaging at the moment? Do you sense that there is still some restocking going on? Is it genuine demand that we are seeing? A bit more broadly, in the aftermath of the crisis, would any customer that you talk to have a different approach to how they manage their inventory after the supply-chain disruptions we saw during the worst months of the pandemic?

Vandita Pant

That is very interesting, Sylvain. I will tell you what I have seen from the ground up, as we have done our contracting for the year recently. From our perspective, our customers are asking for more volume in their contracts. If I were to think about how I could read that, it could be in two or three ways. One is that the confidence in end-use demand of their product is high. Otherwise, you do not do that kind of an increase. That is one that is positive. The second is that, as you know, last year, over the full calendar year we had record production in our iron ore assets. We had record production for the full year. The way I read that is that we have the badge of being a reliable supplier of commodities to our customers. When you have high growth and high demand for your own product, it is really critical that you align with the suppliers that are seen to be reliable. We are getting the positive impact of that. That is really strongly coming out in our commercial discussions around that.

If I were to take copper, you can see that the TC/RC prices that we are getting through are quite low. That points to the fact that there is tightness in supply coming through. We can see it in different ways in the commercial discussions.

Interviewer

You touched on projects before. As you said, in commodities like copper there are a handful of them. Given the supplier response in the mining space over recent years – you were looking more on the financial side of these things in your previous role as Treasurer – would you agree that these projects have become more difficult to bring to the market? Now that miners are evaluating these projects through the lens of ESG criteria as well, is this simply raising hurdles? How is that looked at, at BHP?

Vandita Pant

You are right, Sylvain. The supply behaviour of inducement has been quite disciplined in the last few years in the industry. If I look at it from here on, the dynamics and the projects are such that it does require that kind of inducement price to happen. If you take copper, for instance, the attractiveness of copper is not something I have to go into detail about. There are traditional drivers. With decarbonisation, the long-term view on attractiveness is clear. That is why we call it a future-facing commodity, which we want more of. If you look at that over a period of time, the mines are getting deeper and the grades are declining. If you need to induce supply, you can do it in high-risk jurisdictions with greenfield projects or good jurisdictions with brownfield projects. Both will not come cheap. That is an absolute issue to look at.

Equally, there are other ways to look at supply. When we look at copper, for example, we look at all the toolkit of measures that we can have, which is inducement of new projects like SGO, which we have done, or innovation or technology. We have a lot of copper in Escondida and elsewhere. The point is to be really focused on how we can extract that cheaply and economically over a period of time as it gets deeper and the grades decline. That is a good problem statement to tackle. Then there is exploration and early-stage from a company perspective. That is absolutely the right way to look at it, yes.

Interviewer

On copper, you touched earlier on projects as well and the disruption rate for copper. We know that Escondida and a number of large mines have their wage agreements coming up for renewal this year. Have you guys already engaged with unions and got a sense of the kind of requests that are being made? In a higher-price environment, people tend to be a little bit more demanding sometimes.

Vandita Pant

Sylvain, you know the industrial relations landscape. These are cycles which come, and we are not an exception by any means. There are a few of those this year for us and for the rest of the industry. There have been no specific things or engagements yet, but, as you know, this is something that is part and parcel of the landscape there. Engagements will happen at the right time.

Interviewer

If we could talk a little bit about energy transition, which is a theme that applies very well to BHP's portfolio, I want to ask you a question in a slightly provocative way. Do you believe that one day oil will be replaced by metals?

Vandita Pant

If you ask me whether the pivot to metals is something that we believe in, the answer is yes, absolutely. Copper and nickel being in our portfolio is something we think of as our leverage on decarbonisation. There is a strong secular trend. That is why we think of these two commodities as attractive and something we want more of.

From a petroleum perspective, over the long term, we are quite clear-eyed about where that commodity set goes in the mix of the energy transition, as you said, Sylvain. Equally, from the perspective of the next decade or so or the next decade and a half, if you look at commodities, the post-COVID recovery will happen over the next year or two. From then onwards you do not even have to believe in the increase in demand as a factor at all, given a field decline of 3%, 4% or 5%. You can pick a number depending on what you believe in. That means that new supply needs to be induced to keep even flat demand satisfied. Hence, from our perspective, though the investments have actually gone down dramatically in that commodity set, over the next decade or decade and a half the attractiveness of the commodity is there. That is how you have seen us starting to look at some of the things that reshape the portfolio. Of course, we had some mature assets that we are divesting, like in the Bass Strait, but equally we are taking advantage of last year's very interesting and depressed landscape to acquire Shenzi, an asset that we know very well because we were already part of it. We took the view that this acquisition was countercyclical and that it was an asset that started to deliver from day one. Because of that our production profile, rather than declining, starts to become flat over the next five years. You have seen us reshape the portfolio for value with that view in mind.

Interviewer

On nickel, I wanted to get a sense of BHP's ambitions in nickel and the outlook. Is there a risk that HPAL development in Indonesia could potentially address the class 1 market for batteries in spite of their high carbon footprint?

Vandita Pant

That is right. Nickel plays very well, Sylvain, in terms of the electrification of transport and the battery story, if you will. As you would think, Nickel West is a small asset, but it is the second-largest sulphide reserve that we have in Western Australia. We play very much to the class 1 nickel, the higher-quality nickel, which has pivoted towards battery usage.

In fact, yes, there are alternate technologies, such as HPAL in Indonesia and laterites. As those projects come in, as you know, from that perspective, there are issues to be tackled around the cost curve, the cost of operations, the capital costs and the environmental issues with the tailings in the sea etc. From the nickel perspective, our view is that, for us, this is a real pivot towards the battery market, the higher-quality market. In fact, it may surprise you that, although the full demand has not pivoted towards batteries, Nickel West sales have already pivoted to it. My team sells 80% of the nickel we produce for battery end use rather than the traditional steel-mill end use. We are looking at that. It is an option. The change of heart happened when the new usage of nickel in the decarbonisation story started to become very apparent four or five years back. It is a great option for us and something we would like to build on.

Interviewer

On potash, I am interested to get your sense, in this case purely from a marketing standpoint, of what dynamics you find interesting in that market. If BHP were to go ahead with Jansen and if you were to partner with somebody, would you still think that keeping the marketing right on the BHP side would be important?

Vandita Pant

I would look at your question, if I may, on three levels. The first is the commodity set, because the project follows that, and then the access to market follows the project. The first part is around demand and potash's attractiveness as a commodity. It is very attractive. I do not think we need to go into the weeds to figure out why potash is attractive, but potash is about megatrends. It is about the secular megatrend of population increase and the secular trend of increasing standards of living, which result in higher caloric value and hence a requirement for the yield of crops to be increased. These are real secular megatrends.

The third megatrend that potash also benefits from is around decarbonisation. As the world thinks of its solutions for decarbonisation, the pressure and competition for arable land goes up, whether it is because of afforestation or nature-based solutions, which everyone will look to implement in decarbonisation. That means that the crop yield as a metric for farmland becomes really, really critical. Hence potash now starts to play very positively in the decarbonisation part of the story as well. Those are the demand aspects of the commodity. Right now, there is oversupply, but over a period of time, by the end of this decade or early next decade, everything that is latent, greenfields which have been put in – come into play, and then the deficit is in the market.

If that is the case, it is attractive, then you come to the project. Project Jansen plays into it from a timing perspective. If Jansen was coming in today, that would be different. That is the positive dynamic. The attractiveness of the project needs to stand up before we take it to the board for making a decision by the middle of this year. The third issue is about marketing, which is a dilemma: putting the horse before the cart or the cart before the horse. I would say that the important issue for potash at the time is having the deficit in the marketplace at the right time. You are not trying to take market share from someone else; you are going into the market that requires those extra tonnes. That is the way I would think about the dynamics of the project and how you bring it to market at the right time.

Interviewer

On lithium, is there any sense that maybe one day BHP could get involved? If I can ask you the other way, is there any reason why BHP would not look at getting involved in marketing or production conceptually?

Vandita Pant

Lithium is not really attractive from our perspective. When we look at its commodity attractiveness, it is highly concentrated. When one project comes in, it completely shifts the scale of the market. It is abundant in nature. Then you are in the position where you have probably a big issue. We are not attracted to the brine process and then you are into hard rock. If I were to put it in a nutshell, lithium is not really attractive.

Interviewer

It is fair to say that copper and nickel are probably the two areas where you have a large footprint already, where we would expect BHP to deploy some growth capital if and when opportunities rise. Is that right?

Vandita Pant

Yes, absolutely.

Interviewer

Could I move on to ESG, to get a recap of how BHP would define 'sustainable mining'? Year after year, we see new topics being added. Of course, energy efficiency was one. The licence to operate is clearly a concept who has only emerged in mining lately, but it is now a rich one. More recently, we have heritage. How would BHP define the best way of operating within those criteria? Could we see some geographies or commodities having their place in the portfolio challenged in the future?

Vandita Pant

The ESG issue, as you mention, is not separate to the business of running the business of mining, in my mind. It is inherent and intrinsic to the kinds of decisions we need to take. As you mention, Sylvain, the viewpoint around the licence to operate has been there in mining, but it is more than a licence to operate; it is social value. You have to think about this locally and think about the social value that we can bring to the ecosystem around a mine. That is something that is not new for us.

I would say that we have taken decisions repeatedly through that lens as we have thought about new projects and our operational footprint. We have an investment of $4 billion in the Escondida desalination plant years back when not everyone could say why that was needed. It was exactly the right thing to do, because having a copper mine in the Atacama Desert does mean we need a desalination plant. The ability to accelerate stopping our usage of fresh water and aquifers is exactly what was needed. This is not just about the licence to operate but about social value, because this becomes a distinctive competitive advantage. That is exactly where we are in Escondida. With Spence we did exactly that. There is another desalination plant coming along with the SGO project. We are on stream to be able to use desalinated water there.

On heritage, it has been a very long relationship, for example, in the Pilbara with the Banjima people. Our heritage teams and our operational teams literally sit on the same floor in the same place to ensure that, when decisions get made, they get made with them. Of course, we continue to need to work on and focus on that. That is something you will see us do through the advisory council set up with the traditional owners. Again, that is a really important part of the way to look at it.

From the perspective of emissions, as you said, we are looking at net zero. We also have mid-term targets for our operational footprint on Scope 1 and Scope 2, but we are also looking at the goals on Scope 3 with our customers: a 30% reduction through the technologies we can develop together by 2030 which can be scaled up. Those are all in a package, I would say, as part of sustainable value. This is really critical. It is not about our licence to operate; these are not some ESG issues on the side. It is intrinsic to sustainable value for the business and for having the right model around it. That is how I would think about it.

Interviewer

I have one question from the audience on Scope 3. You have set targets within BHP on what would be more controllable, Scope 1 and Scope 2, with a reduction of 30%. What about Scope 3? What could be the quick wins? How quickly could the company demonstrate that it can deliver on these changes, which are largely a function of how quickly the steel industry in particular can transform itself?

Vandita Pant

The goal we have put in place around Scope 3 is to partner with our customers and counterparties (in steelmaking) so we can enable the technological pathways, if you will, that can enable a 30% reduction in emissions by 2030, and then they will be operationalised and scaled up. In that, I would spend one minute on the decarbonisation of the steel industry. It is really important to note that different places and different regions are at different starting points of that journey. If you look at a place like Europe, where process optimisation has taken place, you can be quite sophisticated around getting into the endgame of decarbonising steel. That is 8% of steel production in the world. That requires a shift around renewables and other technologies.

If you go to the other extreme and go to South East Asia or India, which are very big growing steel markets in production, you are at the starting point of process optimisation. Hence, higher-quality products – be it met coal or iron ore – and optimisation through process optimisation are the phases that you need to go through. There is a long way to go there. Given the young blast furnaces in those markets, you will need a big transition time. In China, the blast furnaces are 12 or 13 years old. With the life of the blast furnaces being as long as it usually is, which is decades, you will see that decarbonisation and transitional technology is needed for low-carbon emissions before you get to a 2050 or 2060 DRI green-hydrogen kind of view.

Hence our partnership with our customers is very targeted and very action-orientated to explore, in a technology-agnostic way from BHP's perspective, different low-carbon technologies that can look at decarbonisation. Our three partners across China and Japan, which I mentioned, are targeted exactly at that. The technologies have different scopes, and we can share those findings and insights broadly in the market. As I mentioned, LNG vessels will be another big part of Scope 3. We have a really action-orientated way of looking at the momentum. This has all happened in the last six months. When I look at what we have done with our customers in six months, it has been fantastic.

Interviewer

On that point, Vandita, do you think the narrative with customers and also with investors is changing in terms of the perception of the role the mining industry plays and should play in the energy transition?

Vandita Pant

Yes, absolutely. I just mentioned some of this, but the way the value chain has to come together in partnership, pulled from each end, is exactly the way we solve these things. That is something we are demonstrating with our customers. These are the largest steel mills in the world. It is not as though I have to go knocking and say, 'Please let us do this together'. It is not. It is a matter of sitting there and saying, 'Of course we are going to do this. Let us really scope out action-oriented stuff'. There is pull from every part of the value chain, which is fantastic. BHP is playing into that strongly.

Secondly on narrative, Sylvain, it is so clear. Our commodities have always been the building blocks of our way of life. That is irrefutable, and we know it. In fact, we now look at this in terms of enabling the world to transition to decarbonisation. The things that are needed to make that work are what mining companies like ours have in our portfolios: steel, copper and nickel. If you look at the Paris-aligned 1.5-degree world, the scenario analysis we have done on our portfolio can sound counterintuitive, but that is the narrative. If we look at the demand dynamics in a 1.5-degree world, demand for copper in the next 30 years has to be around double what it was in the last 30. For nickel, demand in the next 30 years has to be four times what it was in the last 30. Perhaps a little counterintuitively, in the 1.5-degree world even steel goes up 1.8 times in the next 30 years compared to the last 30. The decarbonisation infrastructure – such as the pipelines, the windmills and everything else we need to do – is also demand-intensive. In fact, I would argue that the centrality of BHP and what we produce to decarbonisation is going to be irrefutable as well.

Interviewer

On this note, thanks very much, Vandita. We have come to the end of this interview. It was a pleasure to speak to you. Thanks very much for your time. Keep well.

Vandita Pant

Thanks a lot, Sylvain.