BHP

Financial results for the year ended 30 June 2017

Investor and analyst briefing speech

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ANDREW MACKENZIE, BHP

Welcome everyone to our results for the 2017 financial year. I am presenting from Melbourne, and Peter Beaven, our Chief Financial Officer, joins us from London.

Before I begin, please note the disclaimer and its importance to this presentation.

At BHP, our purpose is to create value for shareholders. This is at the centre of everything we do. Over the last five years, we have laid strong foundations that will support shareholder value for years to come.

We have reshaped our portfolio; created a connected culture; enhanced our capital allocation framework; reinforced the balance sheet; and unwound almost a decade of cost inflation.

The benefits of these foundations are clear in our 2017 financial year results. And, with our continuing and relentless focus on cash flow, capital discipline, and shareholder value and returns, we will carry this momentum forward into 2018 and beyond.

We will further reduce costs and, over the next two years, embed additional productivity gains of US$2 billion.

We will continue to strengthen our balance sheet, with a net debt range of US$10 billion to US$15 billion in the medium term.

We will maintain capital discipline, with capital and exploration expenditure over the next few years of less than US$8 billion per annum.

Lastly, we have classified Onshore US as non-core. However, with value as our guide, we will be patient as we pursue options to exit our position.

But first, our results.

Over the 2017 financial year our performance was strong. Through our productivity agenda and further cost reductions, we have offset lower volumes. Combined with better prices, we achieved a substantial increase in Underlying EBITDA to over US$20 billion at a margin of 55 per cent.

Improved operational efficiency and capital discipline delivered free cash flow of US$12.6 billion, our second highest on record.

We reduced net debt by US$10 billion. We invested for the future. And, the Board determined dividends of US$4.4 billion, which includes an amount over the minimum payout ratio of US$1.1 billion.

Before I hand over to Peter to go through our financial performance in detail, let me start with safety and Samarco.

Tragically, one of our colleagues, Rudy Ortiz Martinez, died at Escondida during the year. And, just two weeks ago, another colleague, Daniel Springer, was fatally injured at Goonyella Riverside.

These deaths are heart-breaking reminders that health and safety must come first in everything we do. We work tirelessly to make our workplaces safer. And, to this end, our Safety Field Leadership Program is currently being rolled out across the business.

When combined with technology initiatives, this will drive higher levels of safety across all assets. The health and safety of our workforce is our top priority. We hold that a workplace can be free from fatality and serious injury. And, we will not rest until this is a reality.

At Samarco, BHP remains committed to the recovery of the communities and ecosystems affected by the dam failure. With the support of both BHP and Vale, the Renova Foundation continues to deliver the social and environmental remediation programs outlined in the Framework Agreement, and substantial progress has been made. Samarco, Vale and BHP are in constructive negotiations with the Federal Prosecutors' Office to settle the major outstanding civil claims. And, restart remains a focus for Samarco and its owners, and is extremely important to the community. However, we will be patient as we work to find the right long term solutions.

With that, I will now hand over to Peter.

Welcome Peter.

PETER BEAVEN, BHP

Thank you, Andrew.

This is a strong set of financial results.

Our ongoing focus on productivity and portfolio simplification means that we fully captured the benefit of higher prices.

In the 2017 financial year, we generated EBITDA of US$20.3 billion, up 64 per cent. We achieved a margin of 55 per cent, our highest since 2008. And, our Underlying attributable profit was US$6.7 billion, more than five times last year.

As previously announced, we recorded four exceptional items, related to:

- withholding tax on Chilean dividends;
- the industrial action at Escondida;
- ongoing funding for Samarco; and
- proceeds from the cancellation of the Caroona Coal licence.

Including these, our attributable profit was US$5.9 billion.

The EBITDA waterfall chart, which I present each period, clearly shows the significant contribution that higher realised prices made to our results. Through our actions, we converted all of this upside to our bottom line.

This period, we reduced unit costs by a further four per cent (on a copper equivalent basis), which supported a US$1 billion reduction in controllable cash costs.

When combined with the ongoing release of latent capacity, we delivered US$1.3 billion of productivity gains this year, taking the total over the past five years to more than US$12 billion.

All major commodities in our portfolio again made a meaningful contribution to these strong results.

Our Iron Ore business generated high margins on record volumes, resulting in EBITDA of US$9.1 billion.

EBITDA from Petroleum was up 11 per cent to over US$4 billion, despite a 13 per cent decline in volumes. We look forward to reversing the production decline. And encouragingly, Petroleum delivered reserve replacement of over 200 per cent over the past 12 months. This doesn’t include our recent drilling successes or the Trion resource in Mexico.

The productivity push in our Coal business positioned us to convert higher prices into cash. Even including the impact of Cyclone Debbie, Coal created EBITDA of US$3.8 billion.

And lastly, in Copper, despite the strike at Escondida and extended power outage at Olympic Dam, we delivered over US$3 billion in EBITDA.

These strong performances have led to outstanding cash generation. Net operating cash flow over the period was US$16.8 billion, up 58 per cent. And, as the chart on the right illustrates, free cash flow of US$12.6 billion was the second highest ever – well above most years of the mining boom and its high price environment.

This is a remarkable result. And yet, as I will discuss in a moment, we have many opportunities for further improvement. But before I do, let me explain how we have applied our capital allocation framework over the last 12 months.

We have a very clear framework. And, it is embedded in every investment choice we make. But any framework is only as good as the outcomes it produces.

Here, we have again shown how we have allocated capital in line with our stated priorities:

- we invested US$1.2 billion to maintain safe and reliable operations;
- we preserved our balance sheet strength; and
- under the 50 per cent dividend payout ratio, we paid out US$2 billion.

With the remaining US$13 billion, we:

- invested US$4 billion in high-returning organic development;
- returned an additional US$900 million to our shareholders; and
- consistent with our bias to debt reduction, we allocated the majority to further strengthening the balance sheet.

Over the period, we reduced net debt by almost US$10 billion, to US$16.3 billion. Gearing decreased to 20.6 per cent. And, following our bond repurchase, our average debt maturity has been extended to over nine years.

We have also launched a further bond repurchase for up to US$2.5 billion. We are targeting short-dated Euro, Sterling and US dollar notes in order to generate higher returns on some of our surplus cash, and further extend the maturity profile of our debt.

Our balance sheet strategy has not changed, we seek to maintain a strong balance sheet through the cycle. Over the medium term, we expect this to translate to net debt levels of between US$10 billion and US$15 billion.

We have a broad suite of high-quality projects which will grow shareholder value and provide excellent returns. But, our capital allocation framework means that we only invest in the best of these. Combined with our ongoing focus on capital efficiency, we expect annual capital and exploration expenditure to remain below US$8 billion in both the 2019 and 2020 financial years.

We have learned to thrive on lower levels of capex. In 2017, including both organic development and maintenance spend, we invested just over US$5 billion. This was marginally below our guidance, primarily due to strike-related interruptions at Escondida.

For the 2018 financial year, we now expect to invest US$6.9 billion, slightly above prior guidance due to:

- the roll-over of last year's underspend at Escondida; and
- an increase in Onshore US development based on the competitive economics of the wells we are drilling.

This spend will be balanced between maintenance, improvement and investment for the future.

Maintenance capital is expected to increase to US$2 billion, due to a US$300 million increase in deferred stripping at Escondida and the smelter re-build at Olympic Dam. And, higher spend on major projects reflects the recent approvals of Mad Dog Phase 2 and the Spence Growth Option.

We are also spending around US$300 million on Jansen as we look to complete both shafts. Let me discuss Jansen further.

We are always focused on cash flow and capital discipline and we must build both short and long term, shareholder value. So, we are very happy that we have multiple value-creating options, which span both commodities and time frames.

The Jansen project is one of those options. Demand for potash is growing. It can provide excellent margins for well-placed assets. And, we have a large resource, which has the potential to provide a low-cost, long life, expandable mine. While timing is uncertain, we have no doubt that the world will need new potash supply. And, when it does, we believe Jansen is best placed.

But, Jansen will not proceed unless it passes our strict capital allocation tests. And, as we complete the shafts, we continue to thoroughly investigate all opportunities to further improve its economics. We have done this, successfully, with multiple options over the past four years.

We could:

- delay sanction, to better time first production;
- bring in a partner, to add expertise, secure off take, or share risk;
- divest, to crystallise value; and
- optimise the design, to further improve the investment case.

So, while Jansen is an important option in our portfolio, there is no rush. And, as with every other project, Jansen will be assessed in accordance with our capital allocation framework. There are no exceptions.

As we continue to work on improving the risk return metrics of the project, we will not be seeking Board approval in the 2018 calendar year.

So now to my favourite chart.

I think this chart is extremely important. Higher return on capital is a critical metric, and is presented here by asset.

Over the past 12 months, our return on capital employed improved to 10 per cent. This is a sharp increase from the prior year, but there is still much more to be done. This is where we are focusing our efforts, every day. And why we are confident about the future.

BHP has assets that provide outstanding returns today – but they can get even better:

- Western Australia Iron Ore generated over 25 per cent returns last year. It is a great asset, but can improve further. We can reduce unit costs to less than US$13 per tonne.
- At Queensland Coal, lower costs and the further release of latent capacity (by increasing truck utilisation and unlocking the full potential of Caval Ridge) will see an improvement in returns.
- And, our Conventional Petroleum assets continue to deliver strong returns, despite low oil prices. Our pipeline of high-return, low-risk brownfield projects will offset natural field decline, and ensure that Conventional continues to make a significant contribution.

These assets account for half our capital employed. The improvements we expect are embedded in operational plans, and our track record in delivering these should give you confidence.

Across our Copper assets, Spence is performing well following completion of the Recovery Optimisation project. But, Escondida and Olympic Dam are currently generating returns below the Company average.

- At Escondida, after a period of significant investment to address grade decline, the new desalination plant is now commissioned, and the Los Colorados concentrator is ramping up and bringing incremental capacity of 200 thousand tonnes. Supported by improved productivity, we can now harvest cash flows from Escondida over the next decade. At spot prices, we would expect Escondida’s return on capital to grow from the six per cent on this chart, to over 14 per cent in 2018.
- Olympic Dam is largely a fixed cost operation. So, the secret to improving returns is to increase volumes from the existing footprint. To achieve this, we are today accessing higher grade ore in the Southern Mining Area and progressing options to debottleneck the current operation. Combined, this can increase copper production to 280 thousand tonnes with potential upside to 330 thousand tonnes, which would drive considerable improvement in returns. But first, we must secure asset integrity, and to this end, have a significant maintenance programme this year.

Together, these plans will substantially lift returns in the near to medium term in Copper.

To the right of this chart, there are three assets, or projects, with negative returns. These represent a quarter of our capital.

I have already talked about the importance of creating high-quality options to grow shareholder value in the future. And, Jansen and Exploration both sit in this category.

- At Jansen, as I just mentioned, we are considering multiple ways to maximise the value of the project, from improvements in capital efficiency, to better timing first production. Through these actions, we will both reduce risk and improve returns. But, the project will only proceed if it passes our capital allocation framework.
- In exploration, our recent successes have de-risked future wells, giving us confidence to continue our counter-cyclical investment. With our exploration program targeting prospects that would work economically at less than US$50 per barrel, we are confident of this investment delivering attractive returns.

Our Onshore US assets require a different solution. Andrew will elaborate on this shortly. Suffice to say, current returns on this capital are clearly not acceptable.

As you can see, we are making strong progress on returns. But, as always there is room for improvement.

Individual asset plans and disciplined capital allocation give us confidence that we can maximise cash flow and significantly increase our return on capital.

Back to you, Andrew.

ANDREW MACKENZIE, BHP

Thank you, Peter.

As you've just heard, Peter – along with the rest of the organisation – is incredibly focused on squeezing the most out of each dollar of existing and future capital. To this end, we have fundamentally changed the way we think about capital allocation and the process that supports this to make sure this discipline remains entrenched throughout the cycle. On this note, let me now turn to our views on markets.

Our economic and commodity outlooks remain largely unchanged. The Prospects blog released today and up on our website provides detailed insights. We increasingly aim to communicate with investors via digital and social media. BHP is a company of the future. Our economists are ready and waiting to dialogue with you all through that medium, but let me make a few quick comments before I discuss our strategy.

We believe that population growth, continued urbanisation and better living standards will increase demand for our commodities over the long term.

We remain especially positive on the outlook for oil and copper, where field and grade declines will result in a sharp reduction in base supply.

The near term, however, remains uncertain.

Some of our commodities are trading above industry marginal costs, which cannot continue indefinitely. Nonetheless, we expect a number of our commodities to perform well over the coming year. Where prices do come down in the medium term, we expect they will settle comfortably above their recent lows.

We are well placed for these conditions.

As I mentioned at the outset, we have laid strong foundations to grow value and support shareholder returns for decades to come. We're simpler, with half the assets we had before and a portfolio now focused on truly tier-one assets with common characteristics.

We're more connected, with an operating model that allows us to fully leverage our expertise and creates a workforce which acts as a global community. We now have multifunctional teams that connect across the organisation to share best practice, make us safer and solve problems together, every day.

We're more efficient, with unit costs down more than 40 per cent, which has kept margins strong.

And, we’re leveraging technology. The scale of our orebodies allows us to maximise returns from technology breakthroughs. We intend to be an industry leader in this area and are investing sensibly to capitalise on this opportunity.

It is distinctive enablers such as these that allow us to maximise value and returns from our assets.

Let me share an example. Our team at Jimblebar, in Western Australia, identified that Cerro Colorado, in Chile, had reduced explosive use in blasts with minimal impact on fragmentation. The technique was replicated at Jimblebar, saving almost US$4 million per annum.

Examples such as this would not be identified, and acted upon, without an engaged and connected workforce.

Earlier this year in Barcelona, I outlined how BHP would put our strategy into action. And in 2017 we continued to make great progress against those plans.

Firstly, cost efficiency. Our productivity momentum remains strong. A further US$1.3 billion this year takes annualised gains over the last five years to more than US$12 billion.

Secondly, latent capacity. We’ve made small, high-return, low-risk investments in our existing assets to fully utilise installed infrastructure and to make the most of what we have.

Thirdly, major projects. We completed two development projects over the year and approved the execution of two more (after significant reductions in capital). Mad Dog Phase 2 and, just last week, the Spence Growth Option both represent capital-efficient, counter-cyclical investments in attractive commodities.

Fourth, exploration. We have had positive drilling results in the Caribbean and the Gulf of Mexico, while the successful bid for Trion provides further opportunity. This month, at Wildling, we encountered oil in multiple horizons, which appear to be in communication with our neighbouring discoveries at Shenzi North and Caicos. While it remains early days and appraisal is still underway, there are encouraging indicators of this being a significant commercial discovery. Taken together, these successes have the potential to add valuable reserves to support our Conventional Petroleum business in the years to come.

Next, Technology. Our global Technology function has rapidly deployed high-value, capital-efficient programs to unlock resource and lower costs even further.

And finally, Onshore US. This business was free cash flow positive over the year.

We are proud of these achievements. But, as Peter has mentioned, some of our assets and projects have not delivered the return we, or our shareholders, expect. Peter has touched on the detailed plans for many of our assets. Let me now take a moment to discuss Onshore US.

As I have said previously, the shale acquisitions were poorly timed, we paid too much and the rapid pace of early development was not optimal. When we entered the industry our objective was to leverage our systems and scale, become an industry leader, and then replicate the opportunity around the world. However, following a global endowment study, it became apparent that opportunities to replicate US shale oil elsewhere did not exist.

So, since then, we quickly improved our capability and significantly lowered investment levels. We also reduced our footprint through divestments and optimised our remaining position through a number of acreage trades and swaps.

This sharpened focus informed our regular portfolio review and we have now concluded that these assets are non-core.

With extensive input from independent advisers, we are pursuing options (several of which are outlined on this slide) to exit our quality acreage. However, all options will take time.

We will be disciplined and use this time productively to maximise the value of this acreage, through:

- larger completions;
- acreage consolidation;
- a midstream solution in the Permian;

- gas hedging in the Haynesville; and
- further well tests to assess prospective resource across all fields.

We will be guided by value. We know what the acreage is worth in our hands and are prepared to be patient.

So, to conclude.

Our investment case is built on:

- cash generation;
- capital discipline; and
- value and returns.

In the 2017 financial year, we made great progress.

We delivered:

- free cash flow of US$12.6 billion – our second highest on record;
- a US$10 billion reduction in net debt;
- cash returns to shareholders of US$4.4 billion; and
- increased return on capital employed to 10 per cent.

While we are heading in the right direction, our plans for the future will deliver much more.

In 2018, we expect further strong free cash flow, average returns from development spend of 20 per cent, and (at 2017 financial year prices) another step up in our return on capital.

Beyond this:

- we will continue to maximise cash flow – with further cost reductions;
- we will always maintain discipline – with a focus on highly capital efficient investments; and
- value and returns will remain at the heart of what we do every day.

We have delivered a strong result today, which reflects the consistent and disciplined execution of our strategy. And, we have everything in place to build significant value well into the future.

Thank you.