BHP

Financial results for the half year ended 31 December 2019

Investor and analyst Q&A teleconference transcript – Session 2

18 February 2020

Mike Henry: Introduction

Good morning, everyone. I have Peter here with me as well. We are really happy to be here. We have a strong set of results and, of course, I am very pleased with the opportunity to lead BHP.

I will touch briefly on results. It is a great set of numbers, underpinned by strong underlying operating performance. Most importantly, we kept everyone safe; everyone made it home to family and friends at end of shift. There were no significant operational disruptions. In fact, we have had a steady 12 months now, certainly during the half, and cost control has been strong, meaning that all of the benefit of higher prices – US$1.5 billion – has flowed directly through to higher EBITDA. This in turn has supported a 46% increase in underlying earnings per share. Net debt starts with a 12, which is a great thing. There is a strong balance sheet and we have declared our second-highest ordinary dividend ever.

If I turn now to how we are seeing the near-term outlook, our operational performance means we are on track to meet cost and production guidance for the full year. Coronavirus of course presents some near-term uncertainty, but our view is that if the epidemic is contained by the end of the quarter then we expect the overall impact to be muted, with some catch-up on lost demand for most of our commodities by the financial yearend. Of course, the impact on people has been tragic.

Let me turn now to how I am seeing the company and the future. I am very fortunate to be taking up the reins from Andrew Mackenzie, with the company's foundation strong. We have a differentiated portfolio that is diversified, and exposed to different markets and different points in the economic development cycle. We have some of the world's best assets that are supporting margins and giving us high-return organic growth options. We have a strong balance sheet supporting resilience and our ability to invest counter-cyclically, all backed up by the discipline and competition stimulated through the Capital Allocation Framework. We have delivered some outstanding outcomes on social value. In the last half, we moved to full desalinisation and green energy in Chile, and we have a strong brand in our production bases. To be absolutely clear, I am wholly committed to our approach on social value, and we will achieve the commitments that we have set out.

Overall, our foundations are strong, but there is further to go. There is further to go on safety and sustainability, and further to go on performance. In a changing world we need to be fast-paced and commercial in our approach. We cannot stand still. I see immense potential in the company, and to unlock more of it there are a few things we need to strengthen. We need to become even safer, with a focus on eliminating fatalities and high-potential injuries. In the face of market uncertainty and overall slowing rates of growth in commodity demand, a greater proportion of value growth will come from an unrelenting focus on being great at what we do. We have to be lean and high-performing across all parts of BHP, and we have spoken about the five specific things that we will focus on.

In respect of portfolio, an obvious question is about the future fit. My view and our view is that we have a demonstrably strong and resilient portfolio for today and for the foreseeable future. Why? This comes back to things like the time it takes for the world to transition to a decarbonised economy, declining curves in existing commodities like petroleum, which means that globally more investment is required, and that creates opportunity for ourselves and others, a lack of substitutability of a number of our commodities' position and cost curve, and so on. We have been very thoughtful and deliberate about this portfolio that we have constructed over time.

Having said all of that, clearly the world trend is towards decarbonisation. We have been active advocates for this and we have been taking tangible action. I referenced Chile earlier; in the last half there was a move to full renewable power in Chile that is going to reduce our emissions footprint there by 60%. We are already taking tangible action. We also produce some of the products that will be essential as the world transitions to a lower carbon economy and which will continue to prosper in that world. We will, though, in my view, need to create more options in future-facing commodities so that we can be even more resilient and so that we can grow value over the long term. These options are going to come from both within our existing footprint – creating more options in the resources we have – as well as through securing more resources, with the main focus on exploration and early stage entry, all supported by this disciplined approach to capital allocation that we have put in place.

In short, I intend for BHP to be unquestionably the industry's best operator: safer, lower cost, more reliable and more productive, with our portfolio and capabilities fit for the future. Through these outcomes we will reliably grow value and returns for decades to come. With that I will open it up to questions.

Questions and answers

RICHARD HATCH, BERENBERG: Thanks, Mike and Peter. I appreciate your time for the call. The first one is just on iron ore. I appreciate FX helped you out in terms of the costs, but are you seeing any opportunities to grind those costs any lower, and can you just talk a little bit about that? Also, obviously with Rio Tinto reducing its shipping guidance yesterday, are you seeing any follow-on impacts to your own operations?

MIKE HENRY: I will address those points in reverse order. In terms of impacts on our business, yes, we have seen impacts as a result of the cyclone but I am comfortable to say that we remain on track to achieve full-year guidance on both production and cost, and that is based on seeing some of the run rates from the team coming back from the cyclone.

In reducing costs further, without a doubt there is further to go. Where is that going to come from? Let me start with the half that was. This was a half that was certainly better than the same period in the prior year, in spite of the fact that we had a fairly heavy maintenance regime during the half and, as a result of that, volumes were lowered. There will be the natural effect of not having the same burden of maintenance cost in the second half, and volumes will be higher, but it does not stop there. We have further to go in terms of cost out in the business, through labour productivity, through getting more out of the equipment that we have installed, and not all of the cost improvement that we have ahead of us is going to come through volume dilution as we creep towards the 290 that we have spoken about. I do believe that there is further to go in terms of non-volume dilution related cost out.

RICHARD HATCH: My second one is just on Olympic Dam. It transitioned into positive EBITDA this half, but it still continues to be negative in terms of return on capital employed. Can you just give us an update on what the latest is there, what you are doing and how you are trying to improve the financial return metrics of that asset, please? Thanks.

MIKE HENRY: The plan we have been pursuing at Olympic Dam has been focused on increasing operational reliability. We have been plagued by historical underinvestment and asset integrity in what is an integrated processing system, and so we need to invest in remediating asset integrity to secure more reliable operations. That will give us more throughput capacity. With that capacity we want to maximise production through higher grade. That has come through investing in opening up the southern mining area. Those two things coming together will give us higher, more stable production, a lower cost base, because of course part of that asset integrity spend is in opex. That will help lift returns to more acceptable levels, but still mid-to-high single digits. Over the longer term we will be looking at how we can expand production there through projects like BFX, but those are still in study.

RICHARD HATCH: Do you think this merits still being a BHP asset?

MIKE HENRY: Yes. If I step back and look at the fundamentals, we start with whether we like the commodity. We have been quite clear that we like copper. It is one of these commodities that is going to see strong growth ahead of it. It has good fundamentals on the supply side and this is a big resource. I am confident that, as we work our way through this plan that we have put in place, we will improve the underlying operational stability and cost base, and lift returns. Importantly, I believe we have the capabilities to operate this asset longer-term, and it has upside optionality.

JASON FAIRCLOUGH, BANK OF AMERICA: Congratulations from all of us here. You have used the word ‘decarbonisation’, and I just wonder how BHP is framing, both internally and when engaging with external stakeholders, the difference between thermal coal and met coal? Obviously met coal is a huge product for you, and you have indicated thermal coal is being deemphasised. Particularly regarding met coal, there is quite a bit of debate, at least with investors, on how this fits into things. How do you frame that internally and how do you frame it to investors?

MIKE HENRY: The safest space is always to be talking about it internally and externally in the same way. They are two very different commodities, notwithstanding the fact that they have coal on the end of their names. In the case of thermal coal there is a higher degree of substitutability, and that has been the case for a long period of time. You are familiar with the scenario analysis that we run. The bias of those scenarios is towards the downside for thermal coal over the medium to long term. We look at that, couple it with the fact that it is a tiny part of our portfolio, and the conclusion is clear: if there is an opportunity for us to exit at value, we would entertain that.

Met coal is not currently – and for the foreseeable future – substitutable in the blast furnace steelmaking route, and it is a more material part of the business, with better supply-side fundamentals. Whereas thermal coal has a relatively flat cost curve, the cost curve in met coal is steeper, so we like that commodity, we have great assets, and we have the capability to operate them, hence a different view on met coal than for thermal coal.

JASON FAIRCLOUGH: Do you feel that investors appreciate the difference?

MIKE HENRY: This is not to downplay the fact that I know investors will be under pressure from their investor base. I believe that most investors understand that these are two fundamentally different commodities. We need to get better at how we go about engaging the broader public on that point, and of course we need to back it all up with the strong action that we are taking on climate change so that people understand that we see climate change as an issue that the world needs to address. We are taking strong action on that front in terms of our own operational emissions, and we are working with our customers, including blast furnace steelmakers, to reduce their Scope 3 footprint.

MILES ALLSOP, UBS: Could you share your thoughts on Jansen? Some other diversified miners are sniffing around potash. Do you think the Sirius project is a credible threat that will impact your view of potash and the terms on Jansen? Secondly, you said there is enormous potential, which is quite bold and exciting in many ways. Could you try and explain what that is? Is that above and beyond your medium-term production and unit cost guidance? How should we contextualise enormous potential? My last question is on changes you have implemented since becoming CEO. There have been some management changes. Are you done with setting up the new management structure? What is the rationale that you are applying, in terms of the new team?

MIKE HENRY: Let me take those in order. I do not want to comment at all on the Sirius project other than to say it is a different commodity than potash, notwithstanding the fact that it has some potassium in it. How are we seeing potash? We like the commodity. It is a sufficiently sizeable industry. It has good dynamics on the longer-term supply side. We believe that demand growth is going to require more greenfield supply in due course, and we have great resources and the capability to operate them. We fundamentally like the commodity, but that needs to be coupled with a project that we like as well, and that is a decision that we will take by next February. For Peter and I to carry potash forward to the board for sanction, it is going to have to meet two hurdles. The first is that it has to compete well for capital under the capital allocation framework, which is returns, risk profile and so on. Secondly, as the new CEO, I do recognise that this is a big decision. I want to personally get across the capital assumptions and the opex assumptions to make sure that I am confident in them. Subject to it meeting both of those hurdles, then we would carry it forward for sanction. If it does not then we will not take that project forward, notwithstanding the fact that we do like the commodity.

If I then turn to the potential in the business, we have come a long way on the performance front but I believe that we have a lot further to go. In terms of the medium-term targets, keep in mind that I have been part of the system and I have helped to develop those targets. They are well beyond where we are currently. Personally I believe that we have further to go beyond that. If you look at the world's top companies they manage to eke out, year in, year out, performance improvement over time. I do not know exactly what that is going to look like, and maybe there is no end point, but the first objective here is to achieve what we have set out. To do that we need to become more reliable. Part of this is building trust in the reliability of our delivery of our results. We do want to become lower cost, more productive, and safer, as I have said. We will be taking specific actions to do that, which is a good segue into the next part of your question, which was around some of the changes that we have made.

We have made some early changes. Those have involved increasing accountability in the operating line for making this the business that it can be. We have talked about how we are transforming this business. I think to get early momentum on that meant that we did have to have that called out, and a specific team dedicated to that, but now that we have started building that momentum it is going to be even more important that the line business owners have full accountability for that.

On the technology front there are two things at play. One is restructuring technology to align it more with our operating assets to improve speed, reduce friction, and ensure that we are focused on the right opportunities. We also want to integrate that technology team together with some of our core technical disciplines, again, to ensure that we can move at pace on the technology front, and that brings me back to one of the further changes that I have spoken about today but have not yet implemented, which is a senior technical person sitting around the top table that is going to be focused on driving operational and technical excellence. Technology will sit with that group of activities.

EDWARD STERCK, BMO: I just wanted to ask a follow-up on Jansen. Over the course of the last 12 months or so the percentage of completion has gone from about 81% to 85%. Is that a deliberate go-slow on the project, and, if so, what is the logic behind that? The second one is just a more holistic view. When you look at the portfolio and the commodity mix, are there any areas where that you feel that BHP is lacking in terms of its exposure, possibly beyond the current commodity mix, and are there any areas that you are not completely confident BHP should necessarily still have exposure to over the medium to longer term?

MIKE HENRY: Regarding Jansen, it is definitely not a go-slow strategy. It is the nature of the underlying work. We are now into shaft lining, so having sunk the shafts we are now into shaft lining. By its very nature this is work that progresses slowly. It is all part of the plan. We have said in the results that there have been some delays in the shaft lining, but this is not something that impacts the overall project schedule, so we are still on track for a decision by February.

In terms where we are lacking exposure in the portfolio, the way I would put it is that we are underweight exposure to where I would like to see us longer term. It is in these commodities that will be important for the transition and will be important in a decarbonised world. In copper we have some growth ahead of us. We would like more options in copper. The same is true in nickel. We have obviously spoken about potash. Commodities beyond that are things we regularly review. Peter, any comments on that?

PETER BEAVEN, CHIEF FINANCIAL OFFICER: From a value in materials perspective we always look at those things. They grow quickly, obviously, and are certainly going to be a part of the future. As Mike has said, Nickel is obviously the fundamental in an 8-1-1 world, but cobalt is a by-product, so if you want to be in copper and you want to be in DRC then that is obviously a good play, but it is not a strategy in and of itself. Lithium, yes, it has a flat cost curve and there is lots of it around, but it is growing fast and it could be a material commodity. I think we will just keep a watching brief on that.

MIKE HENRY: The final part of the question was around the commodities that we are less confident about in the medium to long term. We spoke about this earlier in response to Jason’s question, thermal coal is one where, because it is such a small part of the portfolio and the way that we see the scenarios going forward, that is one where, if there is an opportunity to exit for value, we would.

Beyond that the other question that regularly comes up is oil and gas. I think there is value for us to create through petroleum. We have got good assets. We have more attractive, higher-returning options in petroleum, but we will continue to review that as time goes on. At this point in time I think that is an attractive business that fits with the portfolio.

DANIEL MAJOR, UBS: Firstly, with respect to your thermal coal business, I think you have indicated that you would sell it at the right price. Are there actually any active sale processes ongoing for thermal coal? Are there buyers out there that are anywhere near the right price? The second question is on potash. You are clearly moving Jansen towards potentially a decision at the board level. There are clearly some large potash assets in the market trading at inexpensive valuations. Would you look at the buy versus build option in potash or are you just focused on the organic growth through Jansen?

MIKE HENRY: On thermal coal I do not want to comment on process, and that is just a position that we generally adopt, to not comment on process. On Jansen buy versus build, we think we have a great resource here. We are obviously partway through the project, and any time that we look at assets, we want assets that meet our criteria around being high-quality assets, low on the cost curve, with upside optionality. Jansen gives us the opportunity to create that in the near term.

HUNTER HILLCOAT, INVESTEC: I hear what you are saying about petroleum in terms of having very good asset positions and being able to take advantage of supply shortfalls as the industry evolves, but how do you avoid appearing cynical in light of the other climate change initiatives you have got across the group?

MIKE HENRY: First of all, none of what we do is greenwashing or anything else. If you look at the positons that we have come up with we have been active advocates for action on climate change, and we have backed that up with effort and dollars in some instances. In the past half we had a big move to move to fully renewable power in Chile; a 60% reduction in our emissions footprint there and 15% for the Group overall. Anybody looking in at BHP will see us taking tangible action.

If we then look at the world as it evolves on this path to decarbonisation, I think it is generally accepted that there will be a period where oil, gas and coal will continue to be used by the world. Having us in there with our strong view on climate change and taking the actions that we take round our operational emissions footprint will be recognised, but obviously that is something that we need to continue to be out there telling the story around and backing it up with clear actions.

SYLVAIN BRUNET, EXANE BNP PARIBAS: Just staying with the ESG question, when we look at your targets for now there is no Scope 3 reduction targets. It is presumably a work in progress, but how close are you to disclosing that, and could you give us a bit more colour around the initiatives you could take on products to help your customers? A related question on ESG as well is the coal fired power contract: are there other Escondida-like contracts across the group that you could look at replacing by renewable contracts? Lastly, on Jansen, could you be in a position to share some of the metrics behind the contribution to portfolio diversification that Jansen would contribute? I am sure you are looking at other metrics than just IRR alone, which is not very compelling at the moment.

MIKE HENRY: I will talk to Scope 3, initiatives on products, coal fired power, and make a high-level comment on Jansen. Peter, you might want to comment on that one as well. Scope 3 will be later this calendar year, where we will come out with clear goals. I do not want to pre-empt that process, but what I will say is any time we come out with something on this – goals, commitments and so on – they are tangible. They have clear plans behind them, they move the needle, they have impact, and they will be very well thought out. You have seen that in Scope 1 and Scope 2. We will also be coming forward at the same time with updated Scope 1 and Scope 2 targets.

If I talk about initiatives on products, we have already been doing some things on Scope 3, so this is not a new thing for us. We have had investments that we have made in advancing carbon capture and storage in Canada and in China. In fact, one of my first jobs with BHP back in 2003 was getting BHP involved in a carbon capture and storage project in the US; that ultimately did not progress, but that is how long we have been focused on Scope 3. With the new set of goals that we set out we will be laying out some more activity in that space.

Your next question was whether there are more Chile-like renewable opportunities elsewhere in the Group. Absolutely; this is something that we will be looking at quite hard here in Australia as well to see whether we can replicate some of the success that we have seen in Chile. They are obviously different power markets, the dynamics are not quite the same, but I am confident that there will be some opportunities here.

On Jansen, Peter will speak to the metrics. I just want to start by saying that Jansen will never be progressed on the basis of diversification. It has to compete well for capital under the capital allocation framework.

PETER BEAVEN: We have done that analysis and I just do not have that number to hand, but there is no question that as we look through our portfolios – I think we have shown graphs on this in the past – you take a base portfolio of iron ore standalone. You get some diversification defined as lowering the volatility of cash flow, and obviously we calculate that back and forwards and make some projections based on historical volatilities and relative volatilities. Met coal does not make that much difference; that is not surprising, because it is obviously going into steelmaking. Oil makes more difference and gas makes more difference. Copper is quite diversified, and of course the biggest change of all is potash. We can dig out some numbers and show you that. When you get to London, Mike, maybe we can give that chart to show this. I think it is an important chart. But that is absolutely right. This diversification is important, but everything has to stand on its own two feet. That is absolutely right.

TYLER BRODA, RBC: I have two questions. How does Samarco fit into the portfolio, in your view? Then, more widely, you are now sitting in the CEO seat. How would you describe your philosophical approach to M&A? How do you look at things like jurisdictional risk?

MIKE HENRY: To be honest, the main focus around Samarco is coupled with Renova. The focus around Renova has been on remediating the damage to communities, the river and so on. We have been making good progress there. Subject to making sure we can do it safely and a few things falling into place, there is an intent to get one concentrator restarted at Samarco. As to whether we move beyond that in due course, we will see whether the business case stacks up. Longer term, is this an asset that we would want to hold in the portfolio? It is probably not a good fit. But that has not been the focus up to this point. The focus at this point has just been remediating the damage and getting the operation restarted.

On the broader question around how I think philosophically about M&A and jurisdiction risk, let me address the second one first. I have spoken about wanting to secure more options in commodities like copper, nickel and so on. We have a very strong preference there to do that through exploration in jurisdictions we like, but, if there is an attractive enough offer in a new jurisdiction or a harder jurisdiction, we will consider it. It is not first preference. First preference is to be where we currently are or in new jurisdictions that we are more comfortable with. You see us in Ecuador or in Mexico with Trion and so on.

If I then come back to M&A more broadly, having felt the pain of big acquisitions timed at the wrong point in the cycle, we definitely do not want to be there again. Peter and I have both been part of the team as we worked back from that over the past six years. We do not want to be there. On the other hand, we can never say never, and we do need to be open to M&A for the right assets at the right point in the cycle. Those things do not arise that often, so I am not pegging this as a high likelihood. There is going to be a much bigger focus on early-stage entry and exploration.

RICHARD HATCH: I just have one question on thermal coal. I note in the commentary you talk about taking New South Wales Energy Coal costs down to $46-50 a tonne over the medium term. What kind of timeframe are you expecting that to happen in? How much of a gradual step-down will there be? Can you just give us a bit more flavour on it?

MIKE HENRY: Generally, the way we are thinking about it, Richard, is that when we say 'medium term' that means roughly on a five-year horizon. The challenges we have had at New South Wales Energy Coal have been two or threefold. First, because of what has happened in the marketplace around switching product types, we are moving to lower volumes and higher-quality product to secure better pricing. Secondly, we are in a period of increasing strip ratios as we move through a geological structure. In doing that, we have been opening up some new pits, which will give us some lower strip-ratio material, but early on we are incurring some costs as we open those pits up. Thirdly, to be quite frank, this has not been our most productive mine in terms of our truck-shovel operations. That has been weighing on costs as well. We have seen a marked improvement in truck-shovel productivity in the past few months, and we will carry that forward.

But, again, coming back to the start of your question, the medium term is around five years. That is the period over which we expect to bring costs down.

CHRISTIAN GEORGES, SOCIÉTÉ GÉNÉRALE: Good morning. I have a quick question on your dividend. I see that consensus seems to continue to aim at your net debt, which is sitting somewhere between $9 billion and $10 billion for year end, if we take into account your guidance being at the lower end of the $12-17 billion range, am I right to assume that the board, come year end, will adjust that net debt to $12 billion based on higher levels of dividend or share buybacks to make sure the target is reached or should we assume that you will end up below that net debt target?

MIKE HENRY: Peter, you could comment on this one.

PETER BEAVEN: Yes, firstly I would not comment on what consensus has for net debt and so on. That is what it is. All I would say is I would just reiterate how we think about this. We have $12.8 billion of net debt today. That is obviously after IFRS 16, which obviously adds quite a bit of difference between this year and last year. Putting that aside, however, it is still very strong. Our new target range is $12-17 billion. We will continue to target the bottom end of that range. We do not have to be exactly at the bottom end of that range, and we will make an assessment about dividends as and when we get there. But it is fair to say we have declared another very strong dividend today. It was not a 70% pay-out ratio, as we have been paying over the last couple of goes, so we will adjust that pay-out ratio and dividend according to how we see what we have just earned and what we are likely to earn in the near term. I do not know. Hopefully that helps.

JASON FAIRCLOUGH, BANK OF AMERICA: There are just two quick questions from me. I do not know whether you have been involved in the DLC discussions over the years, but I was wondering whether you had any thoughts on the future of the DLC. Then I have maybe a more general question. Everyone is going to take some time to find their own style, but, if you had to talk about the nuances in your approach to running BHP versus Andrew's, do you have any thoughts? You do not want to define yourself by who you are not, though.

MIKE HENRY: Yes, clearly. On the DLC, we have a company of simplifiers. I am certainly in the space of more simple is better, Jason. You know the history of the DLC. It was set up in 2001 to facilitate the merger. If we were starting afresh with the portfolio we have today, it would not be what we would do, but, as with any change, the business case has to stack up. If the business case does not stack up today, we will maintain it under review.

As to me versus Andrew, probably the way I would paint it is that you have leaders for the times. Andrew had very specific objectives when he landed in the role. I think he has certainly been successful at restructuring the portfolio and establishing some strong foundations. With those foundations now in place, I want to get this business humming. In spite of us having come a long way on the performance front, we have further to go; I think we have a lot further to go. But to do that requires a different focus than the focus you have when you are putting the foundations in place in the first place.

My focus is going to be very much around how we get everybody aligned through the organisation and pulling in the same direction focused on frontline operational outcomes. We need to have the right people in place – I have spoken about increasing the proportion of people who are permanent BHP employees who we can invest in – and we also have to have the right leadership in place. If I take supervisors as an example, that means getting them upskilled, giving them the right spans of control and then, importantly, enabling them by removing some of the administrative effort that is weighing on them currently so they can spend more high-quality time in-field with their people. So we have a very operationally oriented and capability-focused approach to how we will unlock performance in this company. At the end of the day, it is not going to be about pulling the big levers. It is about getting 72,000 people to bring energy to work, to bring a passion to work and to improve, and to be willing to push the boundaries, take risks and make decisions. If we can do that, this place can be terrific.

Guys, it sounds like that is it in terms of calls. I will just close off by picking up on what I was just saying. I want this company to be unquestionably the industry's best operator: safer, lower-cost, more reliable and more productive, with a portfolio and capabilities fit for the future. Off the back of that, we will reliably grow value and returns for a long time to come. Thank you, everybody. I look forward to seeing a number of you in London in a couple of weeks' time.