BHP

Potash outlook briefing

Transcript: Session 2

17 June 2021

Jason Fairclough (Bank of America, Analyst):

Good evening, guys, and thanks so much for doing this twice. We really appreciate it here in London and probably elsewhere too. Look, just a question on marketing potash: If you decide to build Jansen solo, will you participate in Canpotex to market your product? With that, how might this answer change if you were to choose an alternative development approach?

Rag Udd:

So look, Jason, we're deeply respectful of Canpotex's capability as an established logistics and joint marketer. The organisation has stood the test of time and continues to deliver some great value for Nutrien and Mosaic. But I think it's important that we actually reflect that this isn't the norm. Most producers typically sell directly to customers via conventional regional representation offices and in regions where they do not have representation, they do it by agent.

So, based on our experience in terms of bulks and recognising the norm across the industry, we believe that the best way to maximise long-term value of the Jansen asset is to control our own production and logistics supply chain and sales. And so BHP, therefore, intends to replicate basically the marketing model we use on a whole bunch of other commodities and make use of our existing global network and sales office.

Myles Allsop (UBS, Analyst):

Great, thank you. Maybe just following up from that, why do you need a partner? Obviously from a financing perspective, six months of cash flow spot at the moment, it's not a big deal. You say you've got the expertise in mining and you're not worried about Canpotex. So would you only sell for value, a stake for value? Or why would you be thinking about bringing in a partner?

Rag Udd:

Listen, I think we need to be deeply respectful of the fact that today we haven't sold a tonne of potash, so there's a reality that we fully respect - that there's expertise out there that others may be able to bring: experience, local knowledge that would actually come into the mix.

Something I do want to emphasise here is that we're not adverse to bringing in a partner to Jansen. In point of fact, if you'd like to take a look across BHP, our modus operandi tends to be typically to have partners involved. If you take a look at our metal deposit, iron ore, the majority of our petroleum business, we do have partners involved.

That said, we don't need a partner to actually make this work. For ourselves at the moment, we're focused on getting Jansen to a position where we can take it to the Board and for that we need to lock in a port solution. But look, happy to consider a partner, at this point we don't need one to proceed though.

Liam Fitzpatrick (Deutsche Bank, Analyst):

Thank you. First question is probably somewhat of a technical one, just on excess capacity and just for full disclosure, I'm far from an expert on the market. But if you look at some of the capacity numbers out there, there are different ways of quoting it and measuring it. There's effective utilisation and then there's nameplate utilisation, which is a lot higher than what you're showing in the presentation cap. Can you just discuss the differences there and why you don't use or refer to the much higher nameplate utilisation number?

Paul Burnside:

So the reason we had that slide, that we've got back up again here to take you through, on how we consider capacity, is exactly because of the shortcomings, I think, from some of the series that you might have seen. Either you have nameplate, which I don't think in a lot of cases is reflective of how much a site is able to actually produce, or you might have effective, which might be a guide of what they can produce this year, but not necessarily what they can produce in the medium term if they're being fully utilised.

So we've developed our own in-house model on this to understand capacity, where we look asset by asset over the last 20 years, trying to estimate what their limitations on output are. So we put those limitations in place and then when you have years like 2020, where you know that demand was so strong that available capacity was being run very hard, that helps you to validate whether your assumptions on the limitations are accurate.

And it's done exactly that for us, so that's why we refer to this rather than some of the external series, because we think it gives us a very good indication of what sites are available now, sorry: what sites are able to produce now. And also, we can get a good handle on what they're going to be able to produce, if any offline or understaffed capacity is brought back in the future.

Dominic O'Kane (JP Morgan, Analyst):

Morning, my question relates to the port options. So could you maybe just give us some insight into what the different options are for ports, the pros and the cons? And then in addition, what you're expecting in terms of domestic transportation costs

Rag Udd:

Sorry, remind me of the first part of that question, I missed that, I'm afraid.

Dominic O'Kane (JP Morgan, Analyst):

So you're looking at two different port options. If you could just maybe give us some insight into pros and the cons.

Rag Udd:

Not a problem at all. So look, both port options that we're taking a look at are located in Vancouver, Canada. We have one facility that we're considering that is a commercial operation that's an already existing facility and then another one that's a greenfield operation. Both have relative pros and cons that are quite attractive and Giles as our leader up in Canada running the project, and the team are exploring and hopefully finalising it up in the near term in terms of the options around that.

In terms of the logistics costs on that, prefer not to talk about that in this call today. I think we've given a broad indication though in terms of the FOB costs that we're broadly expecting with the project. If, and when, the project does get sanctioned at a later date, we'll be more than willing to actually talk and give you a bit more detail at that point.

Sylvain Brunet (Exane BNP Paribas, Analyst):

Good afternoon, gentlemen, thank you for the second presentation. My question is on the weaker displacement of MOP demands by cheaper, newer speciality fertilisers supply, like SOP or polyhalite. We're not specialists in this, but clearly it would help if you could give us a sense of how real you think the risk is, if we're talking slightly different markets, which would find their own customers, and how much of that is embedded in your 1% to 3% demand CAGR you're presenting into the next decade. Thanks.

Paul Burnside:

As I said, you've got different kinds of potash. When I said primary potash, that's stuff that's directly extracted from natural resources and then you can also have derivative products that are converted from primary potash. So, MOP is the most abundant and most economic source of primary potash to extract, and that's why it dominates the market:, because most people buy potash fertiliser because they want the potassium content. That's its job and that's what MOP is doing.

Most of these other products, like potassium sulphate or polyhalite or potassium nitrate, things like this, they've all got additional characteristics, which, in certain niche applications, make them more desirable and they usually trade at a premium per unit of potassium as a result. But they do stay then a niche part of the market, because people need to be willing to pay that premium for those products.

In terms of how we forecast, we forecast the requirement from agriculture for potassium, and then we look at potential non-MOP sources for that. None of those other products are new, by the way. They've all been known of for a long time. Polyhalite is the one that's most recently come to commercial production, but it's long been known as a potash mineral.

So at the moment, those are remaining niche, and we would expect them to do so. We do, as we do with everything, we range things in our forecast, and we range the amount of some other primary sources of potash to come on, but basically our expectation is that MOP continues to be by far the largest source of potash fertiliser.

Carsten Riek (Credit Suisse, Analyst):

Thank you very much and good afternoon. I think we can all discuss for hours where the demand will actually go, whether the population growth will be positive or slightly negative, looking at how the risks are forming up in Asia. But one thing is actually more tangible, which is the new capacity coming, especially from Russia, CIS.

I was just listening to your assumptions, you're saying the lowest cost operations are at about US$100 per tonne. I think most of the capacity we see from Russia CIS is pretty much in that bracket or even slightly below. Could that not lead to the flattening of the cost curve quite a bit, and also push out rather high-cost producers - ending up with a reasonably lower potash price for a rather extended period of time?

And if that happens, is there a point of no return, when you actually go with Jansen, when if the decision is done, there's no kind of way that actually can turn from that project, and we have to live with the potash prices?

Paul Burnside:

In terms of projects coming on, I think pretty much all projects that are out there, they have Opex that is below today's short run marginal costs in the cost curve. So, in other words, on an Opex basis, they would come in somewhere in the middle of the cost curve. Some of them might even be Q1 on the cost curve, so that's true, so they're certainly not going to be pushing up the short run margin cost.

But you'd have to take what I would say would be an extremely bearish view on future demand: if you think that the capacity that's currently under construction is actually going to push out the fourth quartile volume that's currently setting the marginal cost in the industry at the moment. Or you think that there's a lot more capacity to come, beyond what is currently being built, which in the case of the CIS, I certainly don't think it's the case. The deposit in the Urals, where Uralkali is, is almost entirely staked out. There's only really three future greenfield permits there, all in the hands of Uralkali, and two of those are earmarked for replacement of depleting resources.

Belarus, as well, I think there's going to be construction in the future, just to replace depleting resources. So, given our demand expectations, I don't see a point where you have so much very low-cost capacity coming in that it depresses the short run marginal cost from where it is today.

Oliver Grewcock (Berenberg, Analyst):

Thank you. On Jansen, do you have any concerns over cost inflation, mining methods, or your understanding of the resource?

Rag Udd:

It would be fair to say that as we're coming out of COVID-19 in particular, there's no doubt about we're starting to see some inflationary pressures across most commodities, whether it's diesel, or some of the other consumables, that sit out there. What I think the potash team have done a fantastic job on, over the last couple of years, has been really about focusing on optimising the project to find even more efficiencies in terms of how we take this project and actually hold costs, or even in some cases, get them to slightly decline.

Now, important to understand that when this is a BHP project and the work we're doing here, we actually have a very robust system that we built off of a lot of history in terms of projects across iron ore. In point of fact, we've just completed our South Flank project, on time, on budget. Our Spence Growth Option project in Chile, on time, on budget, and so using that same project methodology, we're actually quite confident in terms of the cost estimates we've put in place, the escalation and the elements that sit behind that.

But, Giles, I might hand over to you, if there's anything further you'd like to add to that.

Giles Hellyer:

Good morning. Giles Hellyer from Canada. I think it's fair to say that the positioning of Jansen in Saskatchewan and being close to Alberta would see us having less inflationary pressure on labour in the short term, so we're getting all indications that we won't see anything more than CPI going forward.

I think as Rag said, there's been a lot of attention to detail around looking at the estimates - I know we've had questions around the increase in our steel pricing risk have gone up, but our exposure is quite low. In that particular commodity, we're into roughly all of the supplied and fabricated steel that's around about, say, for argument's sake, US$350 million, and our exposure on that in, say, total steel, is probably around about 30% of that.

So the exposure levels on some of those key commodities is relatively low, and of course, as Rag has said, we've done a lot to do this in the project already, and we put quite a bit of infrastructure into the ground with wood shafts. And I think a lot of optimisation has definitely taken place.

I would also just clarify, on understanding resource, which was the second part of the question, such an extensive commitment around three-dimensional seismic across the entire property. Supported by BHP petroleum knowledge of underground structures, we have a very, very good idea of what we're dealing with resource wise, and we've built a mine plan that is capable of going out to the entire life of mine, from day one. So very well positioned in terms of starting, like nobody else would possibly have had in the last series of constructions, which were 50 years ago.

Jason Fairclough (Bank of America, Analyst):

Thanks, guys. Just a follow up, so really interesting, your comments on the long run marginal project being the Canadian solution mines. I'm just wondering, how should we think about the timeline for capital allocation to these mines. For you, is it after Jansen's producing at 16 million tonnes a year?

Paul Burnside:

Well, the easy answer is we don't know, because we don't know when Jansen's going to be producing at 16 million tonnes a year. The Stage 1 decision on Jansen is completely distinct from subsequent decisions to expand, which will be made based on how the market evolves. But in terms of timing, so what we showed there were the projects that are currently under ramp-up or under construction. I think beyond that, there's a certain amount of brownfield that we factor in and some particularly low-cost greenfield projects that might come in.

But there's not a huge amount of volume in those two buckets, and then it's after that we see this big resource in Saskatchewan becoming not the only source of long-term supply but the one that's really got the big-scale resource to keep adding to or keep meeting incremental demand volumes decade after decade. Yes, there is certainly potential for Jansen to expand alongside other projects in Canada coming in.

Rag Udd:

Paul, I wouldn't mind just building on that, because I think it's a really important point here for folks taking a look at the decision that BHP will be taking on - we're talking about just over 4 million tonnes of potash coming in around 2027 and obviously ramping up through that period. So that's into this market of 70 million, 80 million tonnes, so that's the sort of scale we're talking about here.

Yes, Jansen has got some fantastic optionality to it in terms of the size of the shafts that we've built, they actually enable stages 2, 3 and 4, but please understand, as an organisation, we will take decisions on stages 2, 3 and 4 at an appropriate time, when the demand basically calls out for it, and we're prepared to sanction it. It competes for capital like any other project in BHP.

Myles Allsop (UBS, Analyst):

Yes, maybe again just following slightly on Jason's question, first, and then there's another question. But what would the incentive price be for stage 2, 3 and 4 for Jansen. I presume that would be back in the US$200s.

Then, secondly, just in terms of the potash content in soil, do you think - are we at levels now which are below what is the long-term sustainable level? So do you think there is a deficit as we look at soil quality around the world today, or do you still think that there is an excess versus that sustainable level?

Huw McKay:

I'll take the one about soil quality. On the chart where we talk about demand expectations for the 2020s, one of the metrics you'll see on that slide for each of the major regions is the FAO's latest assessment of the degree of nutrient imbalance in those major regions, and you will see that the positioning is not good. The word poor appears essentially everywhere, and some of them have a comma and then the word ‘deteriorating’, so we're well below where we could comfortably be in those major regions.

But this is the uncertainty; we know that it's a problem. We know we're sleepwalking towards something, but we just can't really time it, and that’s why we range a lot of different scenarios, where sometimes things are just steadily and smoothly, and sometimes, the disruption is stark, and we have to look at all of those things within our ranges. That's one of the ways we think about the skew of risks around our central case.

Tristan Lovegrove:

Right, so, Myles, I think that the first part of your question, unless Rag has anything to add, I think we'll probably pass on that one, so probably hand over to the next question.

Rag Udd: Look, let's be a bit more overt on that one, Tristan. The reality is, is that any decision in terms of those next couple of stages is at least five-plus years out, and so what we're talking about today really is Jansen Stage 1, so let's stay focused on that if we could.

Sylvain Brunet (Exane BNP Paribas, Analyst):

Thank you. So my question is a back-casting question casting back, if I may. Last time BHP took a public view on potash was August 2010, on the time of the bid on PotashCorp. I'm curious to know what the surprises, positive and negative, have been to your forecast back then - over the past decade. Thanks.

Huw McKay:

Okay, so there's quite an echo there. I think it's been tamed. So in terms of what we were saying 10 years ago, I can speak with more force to what's happened over the last five years, because I've been on the inside of the process: our forecasts have been quite stable over that period. We've been very, very clear about identifying that one particular bench that we've been discussing at length today, that solution mining bench, which is really the best candidate to be the consistent source of greenfield at scale once we get to structural market balance.

If you think about the short term, I think we've also been very consistent, saying, ‘well, this market's probably going to get worse before it gets better’. Because if you think about where we were in the middle of the 2010s, this is where the supply catch-up to the huge price signal around the time of the super cycle was starting to come through, at a time when demand was having one of its off years, and we really did get slammed down very, very hard through short-run marginal costs through that period.

So, it was a tough period for the industry in the second half of the 2020s. Over that period of time, we didn't lose sight of the deep fundamental drivers in this market, and we didn't lose sight of identifying that long-run bench. Those two points have been very, very consistent throughout my experience of BHP thinking about this market.

Carsten Riek (Credit Suisse, Analyst):

Thank you very much. Just on the crop yield differences, especially India versus US because you mentioned it, do you know how much of that is technology driven rather than a function of soil quality? It means availability of machinery such as combines to harvest the crops more effectively.

Paul Burnside:

Quantifying exactly how much each factory is contributing to yields in different countries is extremely difficult, because there's so many contributing factors, and they change - never mind country to country or state to state, but field to field and from crop to crop. There's certainly obviously a huge scope for increasing the amount of technology used in agriculture in India. As we've said, we think that that's actually a positive, because one of the things we think about India, and it's partly driven by the subsidy system that skews retail prices - so higher retail prices for phosphate and potash, low retail prices for nitrogen, very high nitrogen-to-potash use ratios in India.

Technology doesn't just buy you free yield, but it's about what can it do for your yield. One of the things it can do is help you identify where you need potassium, where potassium is underapplied, and work toward more of a nutrient budget approach, rather than just - applying something, whether you get your yields or not.

But certainly over the last decade, it was 10 years ago India overhauled its subsidy system. Potash retail prices trebled overnight, as did phosphate retail prices. If you look at yield growth of different crops in India over the last decade, it hasn't fallen off a cliff, but it was already at a low base. The rate at which it's been growing hasn't fallen off a cliff, but it was already at a low base and the rate at which it's been growing seems to have slowed down. So I definitely think that the setback in consumption of phosphate and potash fertilisers has played a role in that.

Tristan Lovegrove:

Well, thank you. Thanks, Paul, and thanks, everyone else, for joining us for the Q&A. Before we finish, we thought that some closing remarks from Rag on Jansen would be warranted. So over to you, Rag.

Rag Udd:

Thanks, Tristan, and a big thank you for joining us today and for your questions. As Tristan said earlier, we've got a really big decision ahead of us on Jansen. That said, a number of investors has asked us for a deep dive into our views on potash, ahead of any decision, and that is really the primary purpose of today's briefing. But our decision at Jansen depends on more than the fundamentals for potash. We're still working through the final steps to get a decision, as I mentioned earlier, particularly finalising the port. Before we close though, I'd like to give you some of my personal reflections on the project.

As you'd expect, the starting point for any portfolio decision is its fit with our strategy to create long term value and returns. That's built on three aspects. Firstly, growing our exposure to highly attractive commodities, with world-class assets and via operational excellence. Now if I was to touch briefly on each of those three components. First on commodity. I don’t know that we could do more to impress on you just how evident from Huw and Paul the depth of our understanding of the potash market. In case you missed it, we actually think that the potash market has some very, very attractive fundamentals.

Second, we see world-class assets, large, long-life, upstream, high margin and expandable as a key focus for us. Jansen has this potential through a great resource. It also provides us with attractive diversification as a commodity, by products, it's a huge diversification by customers and also by operational location.

Finally, in terms of operational excellence I really believe that we have the capabilities to operate an expand Jansen in a way that would confer a number of significant competitive advantages. We accept that potash mining is new to BHP, but we do have world-class capabilities in bulk mining and have a long history of marketing high quality commodities in global markets.

We would apply the latest technologies, be that in 3D seismic, advanced material handling capability or automation. We would also bring the BHP culture of safety, simplicity and operational excellence. This includes, and really importantly includes, our approach to social value on key topics such as cultural heritage, water stewardship and emissions.

Now, if I was to reflect back on Jansen and the last decade, we've been very open that we're not happy with the amount of capital that we've already sunk here and if we were to have our time again, we would have gone about doing things differently. With that said, we are where we are, and our decision needs to be about how best to apply the next shareholder dollar. All investments in BHP need to compete for capital against the other options in our portfolio and against cash returns to shareholders.

So in making our assessment we are always going to take into account a number of metrics, not just IRR. We will also consider NPV, payback, margin and various risk metrics. Now in addition to that you'll also be familiar within BHP we don't tend to make assessments on solely single point outcomes; we tend to work in ranges.

Lastly, we are finalising the assessment currently with locking in our port option and we'll then sit with our Board to determine whether to now pull the trigger on the first phase of Jansen. We continue to expect that this will occur in the next few months.

Thanks so much for joining us this evening, or this morning, depending where you are in the world. That represents the end of our briefing.