

EQUITY INSIGHTS

BHP Group: Stronger Business, Reflected In The Price

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3-YEAR TOTAL RETURN OF 134%

After a punishing period of value destruction in 2014 and 2015, brought about by over-investment, poor capital allocation and a commodity price slump, BHP's market cap was \$72bn at the start of the 2017 financial year. During 2017 and 2018, the business produced free cash flows of \$26bn and sold the loss-making US onshore business for \$10.8bn. Dividends and buybacks worth \$21bn have been returned to shareholders, and the balance sheet de-gearred. The market cap has now risen to \$123bn.

NEW MANAGEMENT ARE DISCIPLINED CAPITAL ALLOCATORS

Years of favourable commodity markets driven by the Chinese economic boom fostered a culture of aggressive expansion under past management. The group reinvested \$113bn of the \$153bn cash flow generated between 2008 and 2014, and expanded the business into areas outside management's circle of competence such as US shale assets. Despite an intention to acquire best in class assets, \$27bn was ultimately impaired and cash flow return on assets declined from 25% to 15%. Net Operating Assets grew to \$110bn in 2014, without similar improvements in revenue and cash flow. This caused a sharp reduction in asset turnover, burdened the business with substantial depreciation and capex requirements and left little protection against a fall in commodity prices. As supply exceeded demand, commodity prices fell between 2014 and 2015, and the business suffered a 60% fall in free cash flow and a loss in 2016.

Andrew Mackenzie was appointed CEO in 2014. He introduced capital allocation discipline, cut capex, sold and spun-off low-return assets and returned excess capital to shareholders. As a result of these efforts, and assisted by improved commodity price conditions, cash flow generation has recovered. Most telling, conversion to free cash flow after capex spending increased from 37% to 80% to deliver an outstanding 29% FCF return on net tangible equity over the last two years.

BHP GROUP IS A BETTER BUSINESS TODAY

Today, BHP Group's portfolio of net operating assets is leaner at \$68 billion and consists of highly cash generative copper, iron ore, petroleum and coal resources. Returns are strong and free cash flow conversion is superior to the past. De-gearing is complete at a net debt of \$10bn, down from \$27bn, enabling future free cash flows to be returned to shareholders or used for acquisitive growth. Investments must exceed the internal hurdle rate of 20% return on capital employed.

FREE CASH FLOWS FORECAST TO REDUCE

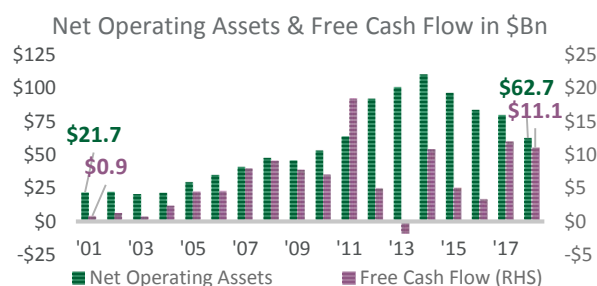
- Free cash flows are at a high base at 13.6% on net tangible assets.
- Increasing capex to develop and replace resources from a low base.
- Productivity gains are becoming more difficult to achieve.
- Cost of production to rise in 2019 and beyond, driven by iron ore.
- 3-Yr prices expected to weaken in coal and iron ore and gain in copper.

CONCLUSION – REDUCE AMIDST LOW MARGIN OF SAFETY

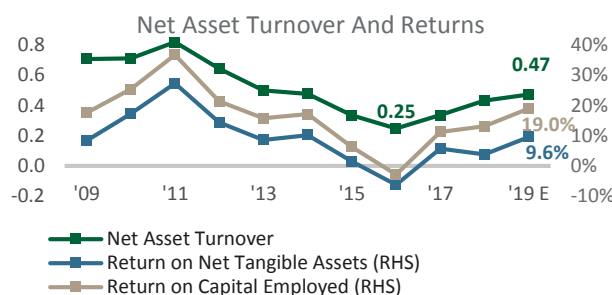
Unusually high shareholder windfalls from the improved cash flows and US onshore sale are now past. We expect lower future cash flows and the Samarco dam disaster contingent liability presents a risk. The investment case is therefore less compelling at the current price. The group remains a core holding at a lower weighting given sector leading expected returns.

	BHP Group
Market Cap	R 1707bn
Current Share Price	R 337.25
52w High-Low Range	R 225.77 - R 337.43
Forward PCF	7.1x
Forward DY	6.5%
Financial Year End	30 June 2018

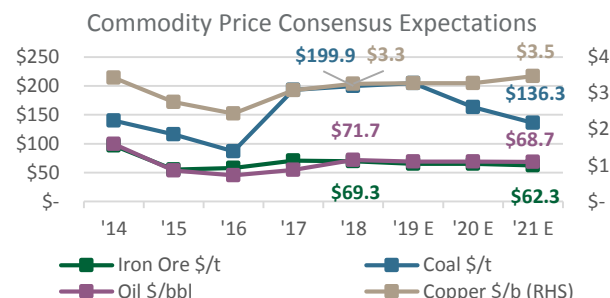
Sources: FactSet, March 2019



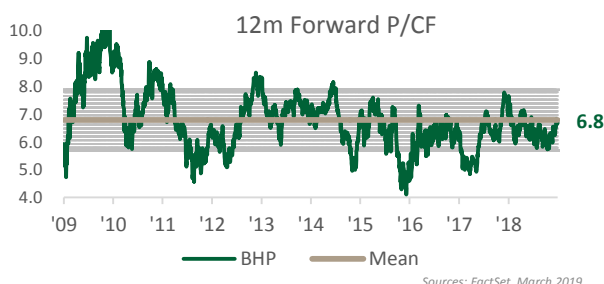
Sources: Company Filings & FactSet, March 2019



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FOR MORE INFORMATION PLEASE CONTACT:



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