

BHP Billiton

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Another WAIO record on an improved year

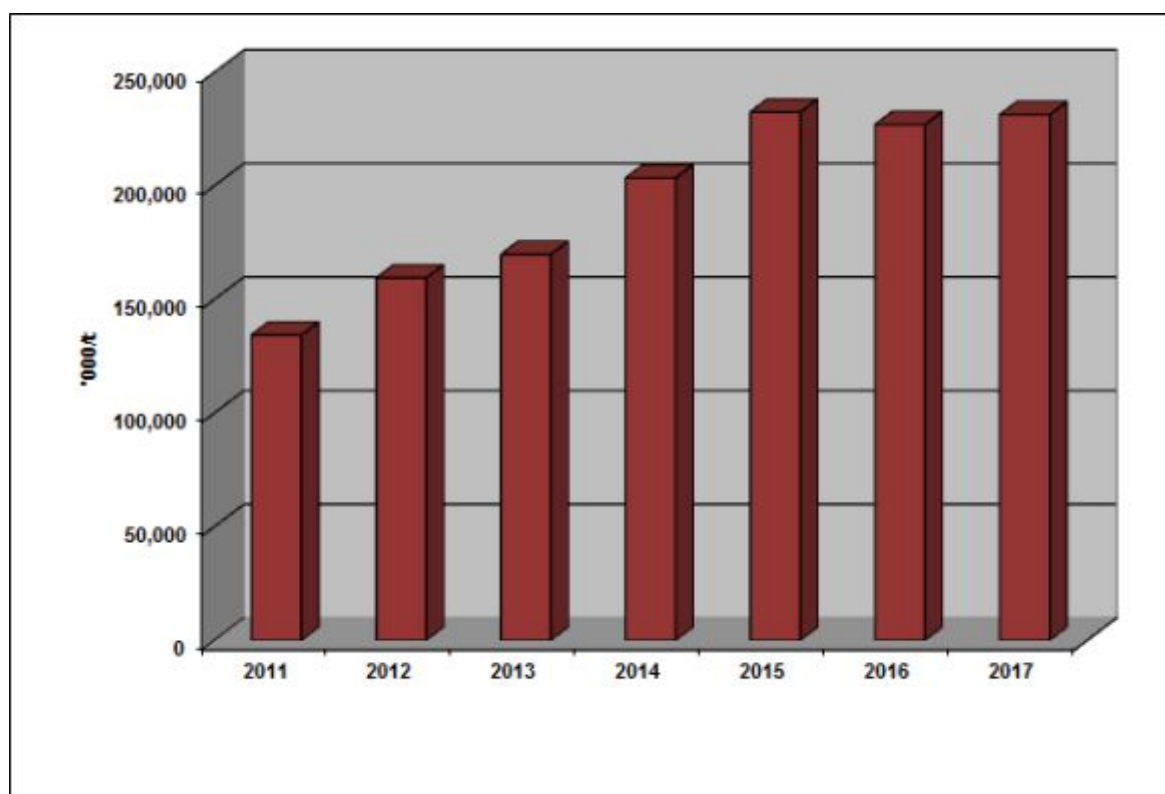
BHP Billiton has released its operational results for the full year to 30 June 2017, and in doing so has revealed another Western Australian Iron Ore (WAIO) record, even in the backdrop of another tough year. The company's other key commodity exposures found the going difficult with the reporting of softer operational numbers for the year. Production guidance for 2017 was met across three of the company's key operations with only copper being the exception. Moreover, some of the lesser operations produced solid cameo performances for the year. The following table shows a synopsis of the company's 2017 production results (NGL – natural gas liquids):

Principal commodities		FY17	FY16	Change on FY16
Petroleum				
Crude oil, condensate & NGL	(Mboe)	97,079	116,039	-16.3%
Natural gas	(bcf)	667.8	744.7	-10.3%
Total petroleum products	(MMboe)	208.4	240.1	-13.2%
Copper				
Copper	('000 t)	1,326.0	1,579.8	-16.1%
Lead	(tonnes)	5,473	3,719	47.2%
zinc	(tonnes)	87,502	55,438	57.8%
Gold	(ounces)	215,004	226,682	-5.2%
Silver	('000 oz)	10,877	13,189	-17.5%
Uranium	(tonnes)	3,661	4,363	-16.1%
Molybdenum	('000 t)	1,144	1,113	2.8%
Iron Ore				
Iron ore	('000 t)	231,352	226,958	1.9%
Coal				
Metallurgical Coal	('000 t)	39,899	42,840	-6.9%
Energy Coal	('000 t)	29,586	34,247	-13.6%
Other				
Nickel	('000 t)	85.1	80.7	5.5%

Source: BHP Billiton

Turbulent trading conditions and weather events in 2017 buffeted the company's operations, with three key pillars of petroleum, copper and coal all feeling the headwind effects. The fourth pillar in the company's arsenal in iron ore was the only standout, delivering a record. **Overall, we are of the view that the operational results for 2017 looked a little ordinary and will have a negative impact on the company's 2017 full year financial result.**

Iron ore reported a modest 1.9% rise in 2017 production compared to the year ago result, to 231.4 million tonnes. **Iron ore production came in at the bottom end of guidance for 2017 which was in the range of 231 million to 234 million tonnes.** The following chart shows annual production numbers for iron ore:



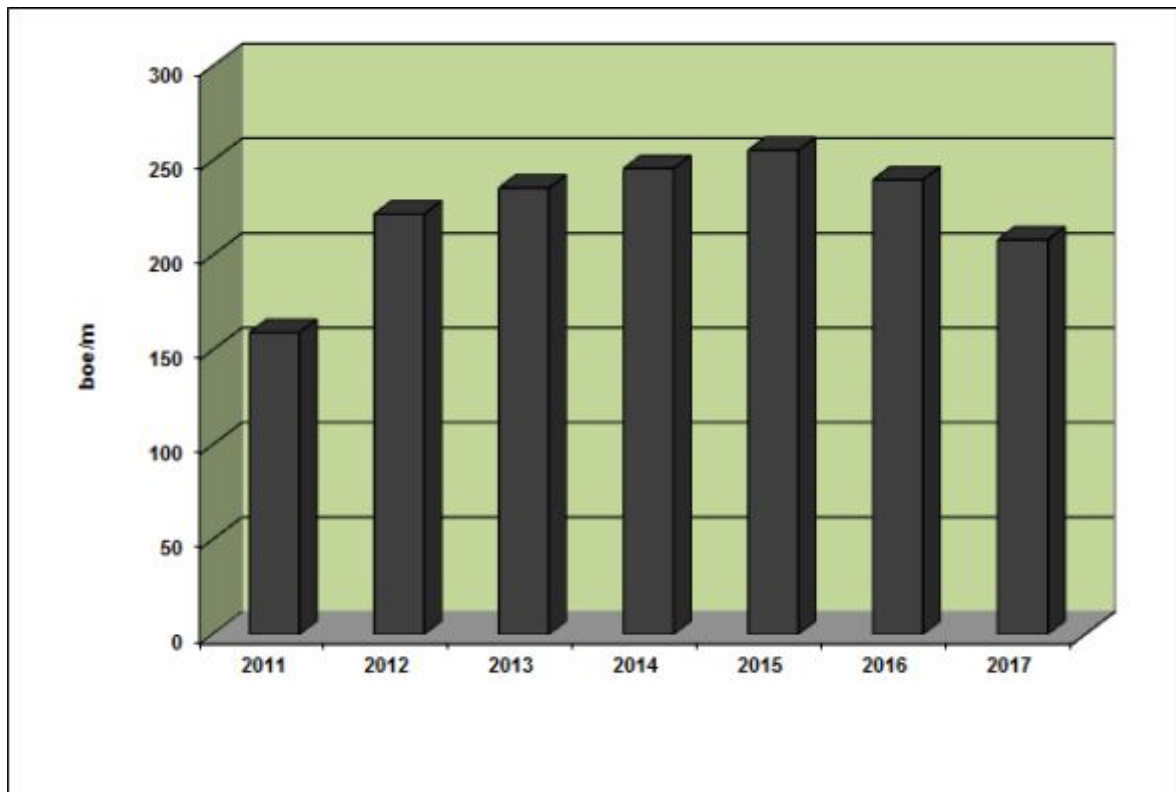
Source: BHP Billiton

Despite the lower overall performance by the iron ore operations in 2017, a key contributor within operations was WAIO which produced a record 226,958 tonnes of iron ore. The figure represents a rise of 1.9% on the 2016 result. Improved productivity gains and efficiencies were the primary drivers of the record performance by WAIO.

Dragging on the 2017 iron ore result was the company's Samarco (BHP's interest 50%) operation in Brazil. As a result of the 2015 dam incident, iron ore production fell to zero compared to 5.4 million tonnes produced in 2016. Operations at the Samarco mine are suspended, and could remain that way well into the foreseeable future.

Guidance for iron ore production in 2018 is forecast to be in the range of 239 million to 243 million tonnes. On a 100% basis WAIO is forecast to be in the range of 275 million to 280 million tonnes. The step-up in production in 2018 will see WAIO set new records and will again be a positive contributor to the financials of the company.

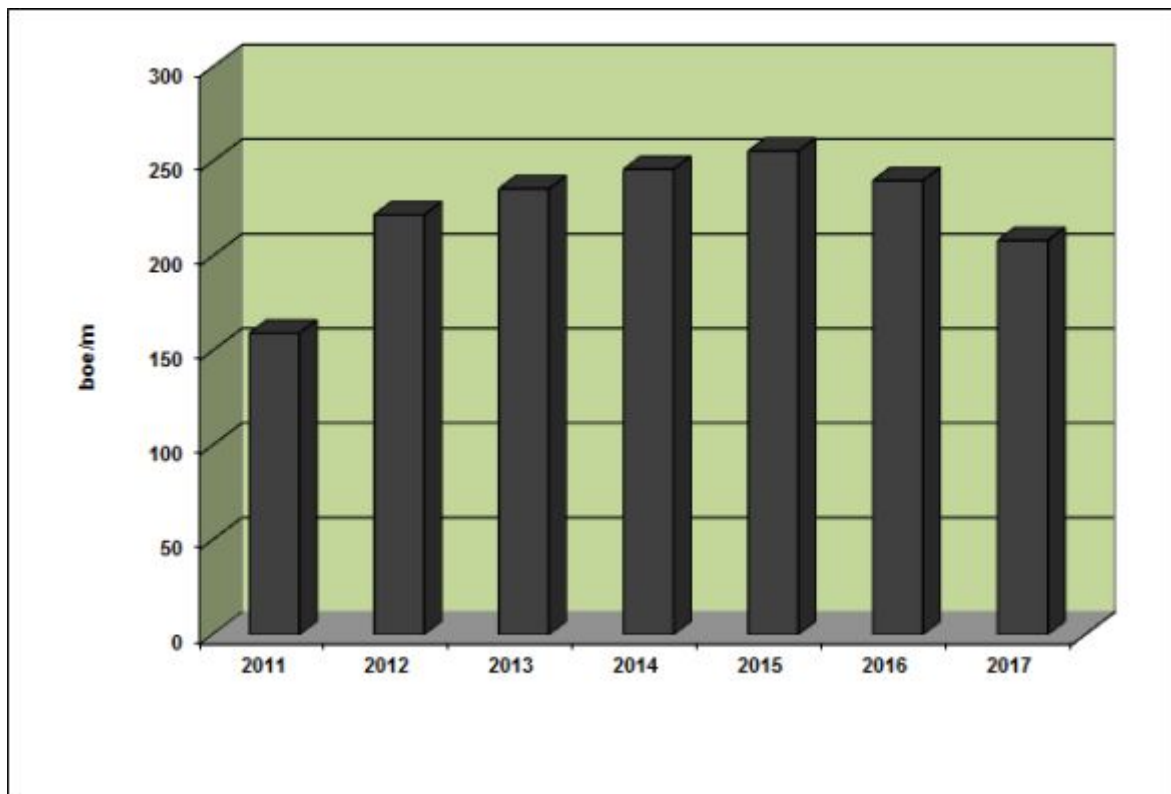
Petroleum operations reported a soft 2017, and also fell short of 2017 guidance. Guidance for 2017 was in the range of 200 million to 210 million barrels of oil equivalent (boe), with petroleum production coming in at 208.4 million boe; compared to 2016 production declined by 13.2%. The following chart shows annual boe production:



Source: BHP Billiton

Of the constituents under the petroleum banner, both crude and natural gas production contributed to the overall softer outcome in 2017. **The company was reacting to poor pricing in the energy complex, by leaving oil and gas in the ground.** We are not concerned with this approach given the long life of the company's energy assets. **The company has the financial strength to withstand the ramifications (asset valuation write-downs in the balance sheet) in following such a production approach in its profit numbers.**

For 2017, production of crude and condensate fell 16.3% on 2016, to 97.1 million boe. The following chart shows annual crude oil production:



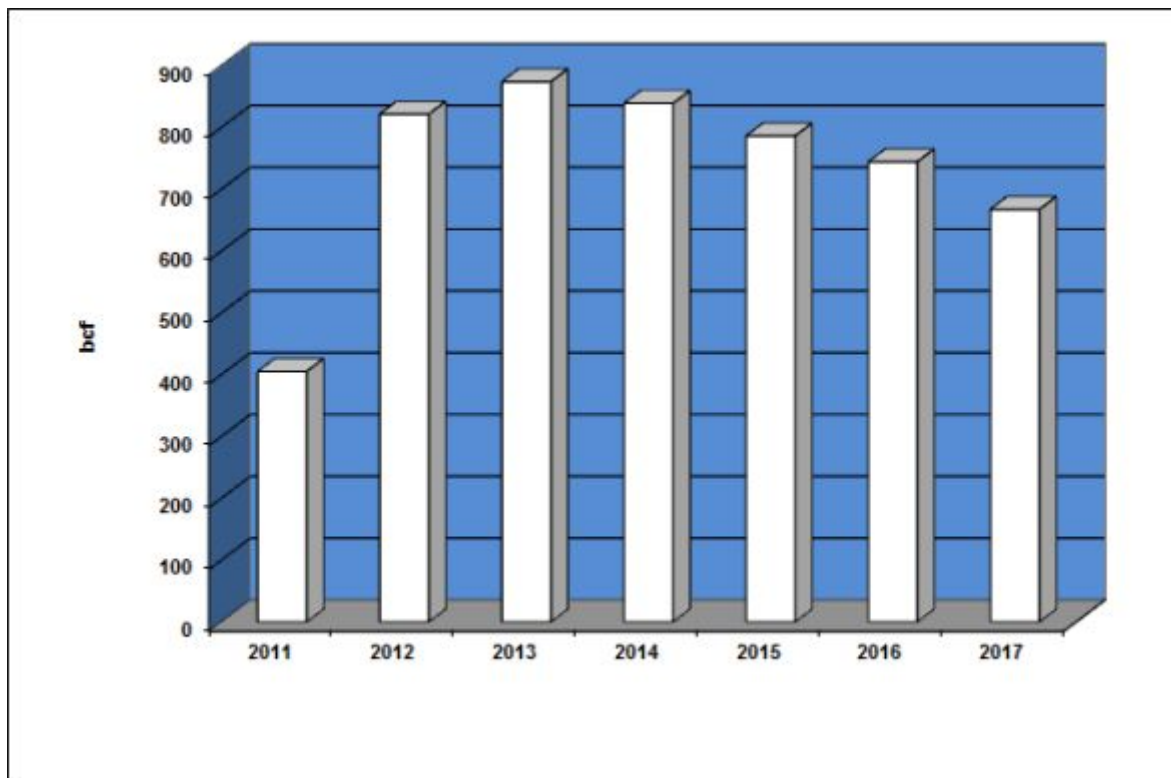
Source: BHP Billiton

The two operating components within petroleum in onshore US and conventional, both contributed to the overall softer production outcome in 2017. Onshore US (shale assets primarily) reported a fall of 26% on 2016, to 80 million boe. A more modest 2% fall on 2016 was reported by conventional, to 128 million boe.

Production across the company's onshore US shale fields was deliberately curtailed on value grounds. Field maintenance and natural field declines drove the conventional performance.

Production guidance for 2018 has been provided by the company for its onshore US and conventional oil fields, with production expected to be in the range of 61 million to 67 million boe and 119 million to 123 million boe respectively. The expected step-down in production for both operations in 2018 is disappointing. Leaving the oil in the ground for a "better day" however, does make longer term commercial sense.

Production of natural gas was also throttled back in 2017, which was reflected in the softer production number. Natural gas production fell by 10.3% on 2016, to 668 billion cubic feet (bcf). The following chart shows annual natural gas production:

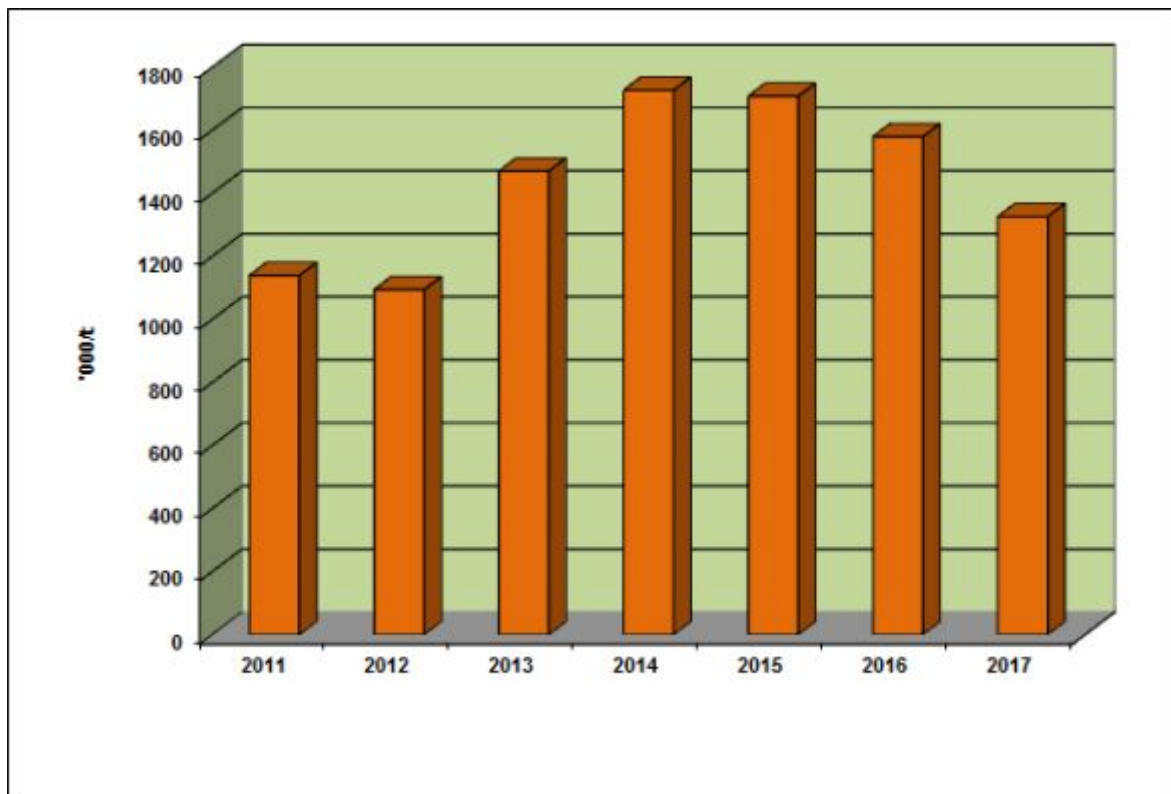


Source: BHP Billiton

Onshore US natural gas production fell by 25% on 2016, to 275 bcf, while the company's conventional natural gas operations printed a rise of 3.3% on 2016, to 392.8 bcf. Conventional natural gas benefitted from higher third party demand, especially in Australia. Onshore US gas production suffered from the curtailment of operations. Pleasingly, the production of North West Shelf (NWS) natural gas partially offset the loss of US natural gas production. NWS lifted the production by 7.8% on 2016, to 140.3 bcf. Better third party demand in the export liquid natural gas sector drove the higher result on improved infrastructure availability and efficiencies. The company does not provide guidance on natural gas production.

Guidance for 2018 petroleum production is in the range of 180 million to 190 million boe.

Copper is one of the company's four pillars structure, and like petroleum production fell by 16% on 2016, to 1.3 million tonnes. **Copper production fell short of 2017 guidance which was in the range of 1.33 million to 1.36 million tonnes.** The following chart shows annual copper production:



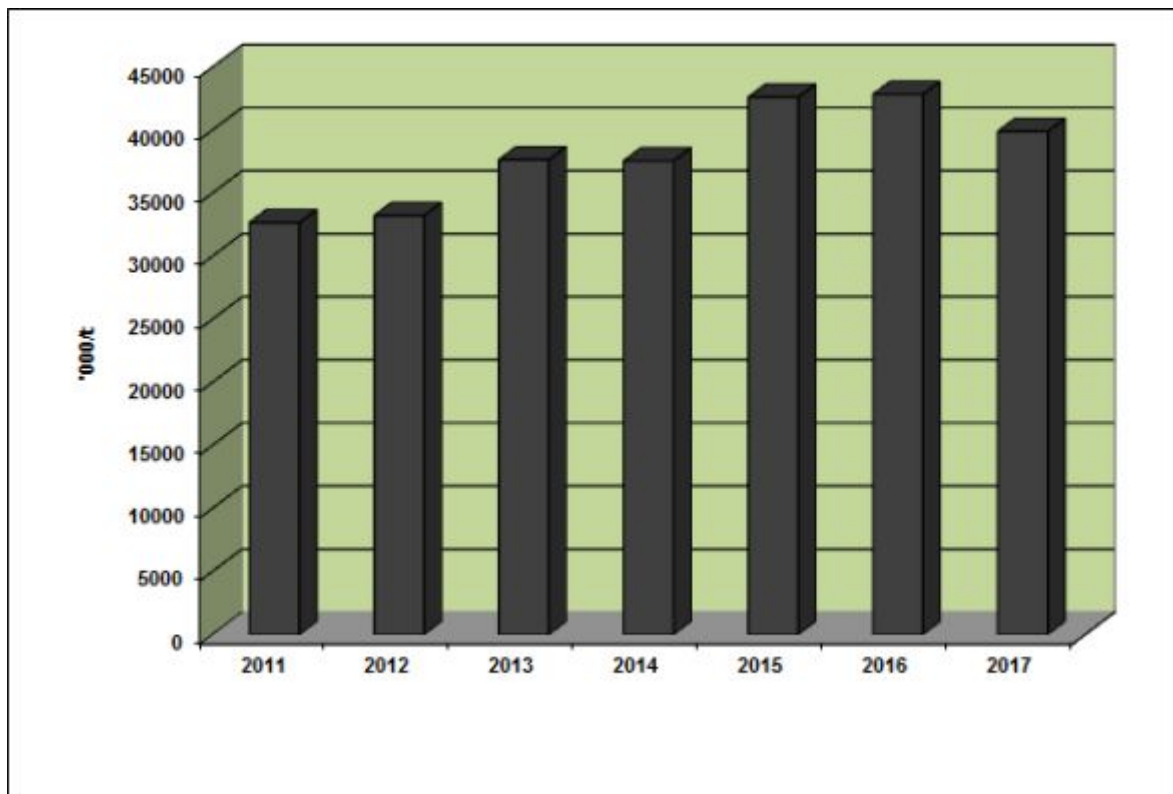
Source: BHP Billiton

The company's Escondida (BHP's interest 57.5%) mine in Chile reported lower copper production with the printing of a 21% fall on 2016, to 772,000 tonnes of cathode and concentrate. Operational issues, weather and a prolonged strike drove the poor result. All the matters controlled by the company have been settled. Olympic Dam also contributed to the softer production outcome, following the printing of an 18% fall on 2016, to 166,300 tonnes of copper cathode. Power outages (South Australia wide) and operational issues drove the weaker result. **Escondida is forecast to contribute in the range of 1.1 million to 1.23 million tonnes of copper in 2018.**

The performance of the company's Pampa Notre operations partially offset coppers' overall lower performance. Pampa Notre's Spence operation printed a rise of 8.9% on 2016, to a record 189,600 tonnes of copper cathode. Driving the Spencer result was better infrastructure efficiencies delivered by the Recovery Optimisation project.

Production guidance for copper in 2018 is expected to be in the range of 1.655 million to 1.79 million tonnes. The step-up in production in 2018 will be very welcome; after what has been a troubling few years for copper.

The company separates its coal operations between the two main coal types in metallurgical (met) and energy coals. Production of met coal fell by 6.9% on 2016, to 39.9 million tonnes. **Met coal production came in at the bottom of 2017 guidance which was in the range of 39 million to 41 million tonnes.** The following chart shows annual met coal production:

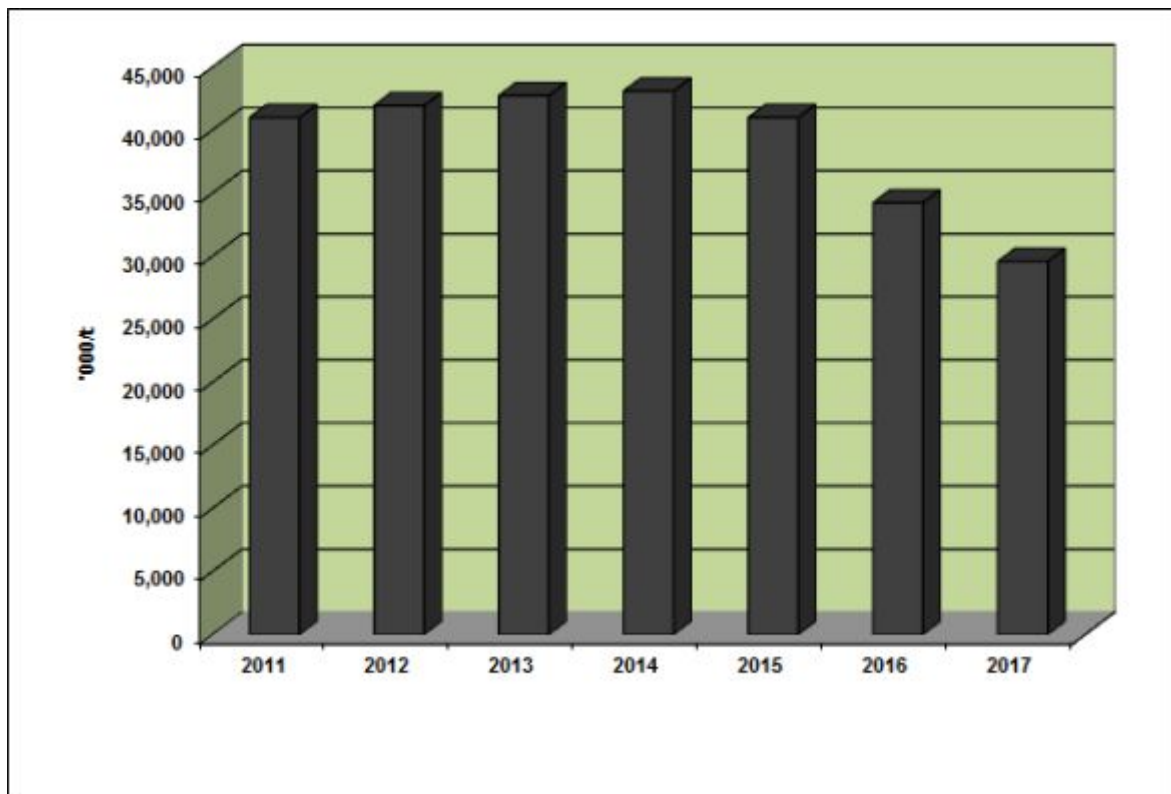


Source: BHP Billiton

The company's BMA Queensland (BHP's interest 50%) met coal operations were impacted by weather events which resulted in a 5.9% fall in production on 2016, to 31.5 million tonnes. The inclusion, in 2016 and not in 2017, of 1.3 million tonnes from the Gregory joint venture as a result of operations ceasing in 2015, also had a negative role. Tucked inside the BMA numbers was a good performance by the Saraji pit with a record 4.7 million tonnes, which represented a rise of 13% on 2016. The Peak Downs pit also hit a record 6.1 million tonnes on a rise of 20% over 2016. Improved infrastructure efficiencies drove the results for both pits.

Production guidance for met coal in 2018 is forecast to be in the range of 44 million to 46 million tonnes. The step-up in production in 2018 is very pleasing and reflects the likely strength in the global steel sector.

Energy coal production for 2017 fell by 13.6% on 2016, to 29.6 million tonnes, which was a tad below the years' guidance of 30 million tonnes. The following chart shows annual production numbers for energy coal:



Source: BHP Billiton

The sale of the company's US operations withdrew 7.1 million tonnes of energy coal production that was included in 2016. The Australian operations reported an increase of 1.0% on 2016, to 17.9 million tonnes. Improved third party demand drove higher efficiency rates across the company's sites

Guidance for energy coal production in 2018 is forecast to be in the range of 29 million to 30 million tonnes.



Turning to the daily chart, prices have cleared both the 50 (red line) and 200 (green line) day moving averages, which is suggestive of momentum to have swung north. In order for the short-term technical outlook to resolve to the upside, a decisive break above the current resistance band sighted between \$25.70 and \$25.79 is required. This consist of the 61.8% Fibonacci retracement and the April high (horizontal solid-red line) respectively. Should this favourable scenario unfold, then above, the next focal point is aimed at the 78.6% Fibonacci retracement of \$26.69.

We believe the company's full year operational result has, for the second time, been biased to the softer side, and in doing so will have a negative impact on its financial result for the year.

The company provides data on realised commodity prices for 2017, which broadly speaking showed a positive trend in 2017 and are shown below:

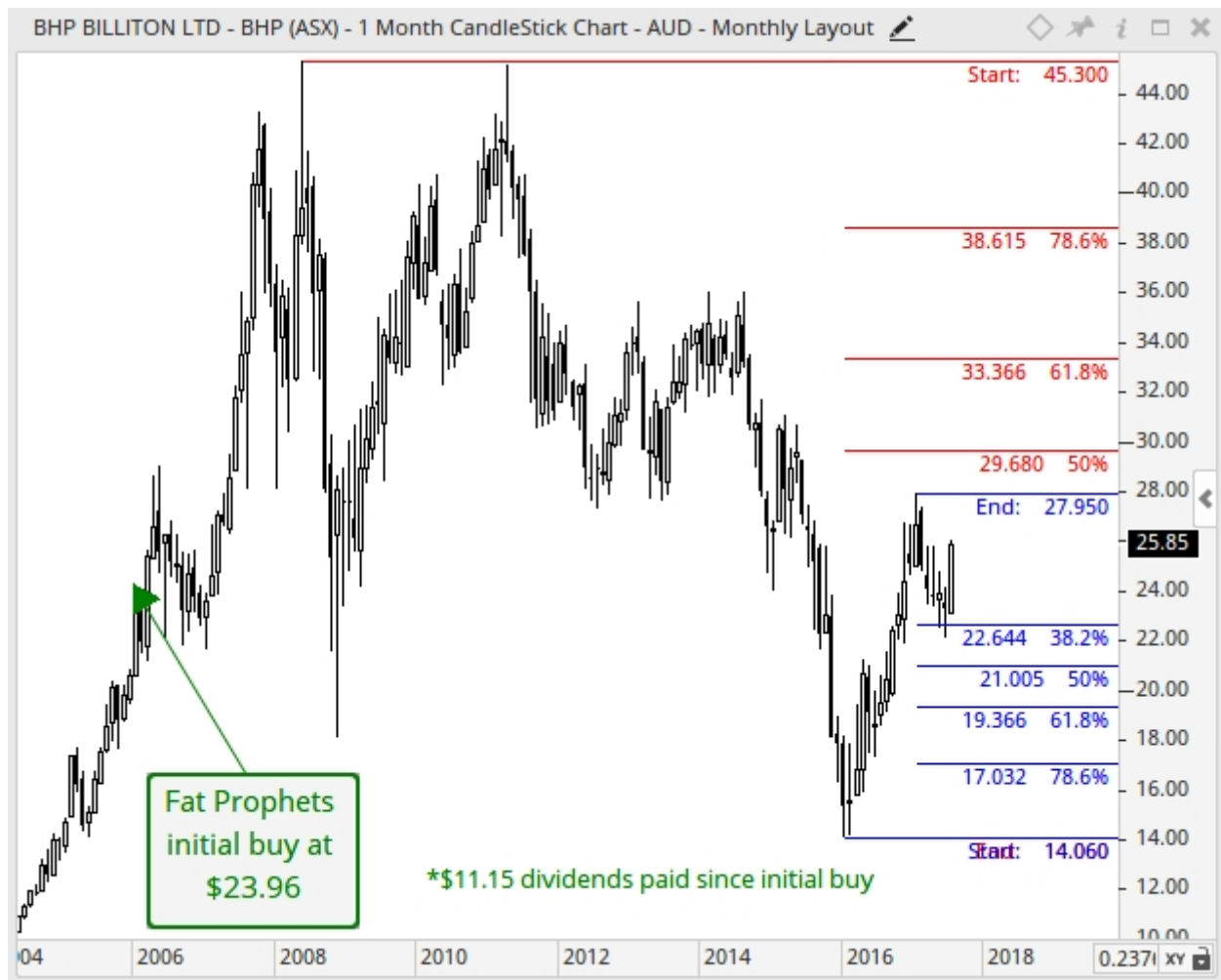
Average realised prices	Jun H17	Dec H16	FY17	FY16	FY17 vs FY16
Oil (crude and condensate) (US\$/bbl)	50	45	48	39	23%
Natural gas (US\$/Mscf) ⁽¹⁾	3.48	3.21	3.34	2.83	18%
US natural gas (US\$/Mscf)	2.98	2.79	2.88	2.16	33%
LNG (US\$/Mscf)	7.37	6.35	6.84	7.71	(11%)
Copper (US\$/lb)	2.70	2.41	2.54	2.14	19%
Iron ore (US\$/wmt, FOB)	62	55	58	44	32%
Hard coking coal (US\$/t)	180	176	180	83	117%
Weak coking coal (US\$/t)	121	122	121	69	75%
Thermal coal (US\$/t) ⁽²⁾	75	74	75	48	56%
Nickel metal (US\$/t)	9,799	10,581	10,184	9,264	10%

Source: BHP Billiton

This commodity price strength will be a major feature in the company's 2017 financial result, and fortunately it will be very positive. **The positive commodity pricing impact will more than offset any negative impact caused by the softer operational performance.** We expect commodity prices may continue to rise over the course of 2018, and certainly going into the second half of calendar 2017.

Taking account of the company's full year operational result, with an emphasis on positive commodity prices, we BHP to report an underlying profit in 2017. The company will report its 2017 profit result on 22 August 2017, when it will provide greater clarity on its financial position.

On the exploration front, the company continues to constrain spending, with just US\$163 million spent on mineral exploration in 2017. The company reduced spending by 6.9% in 2017 compared to 2016. **The long-life tier 1 assets provide the company with upside growth through brownfield development opportunities, rather than greenfield exploration. We are not concerned with the near-term rationing of capital in this activity.**



With reference to the monthly chart, after printing a low of \$14.06 in January 2016, prices have spent the remainder of 2016 until January 2017 in a bullish-rotational mode. A short-term correction then ensued until June, in which, we now believe to have terminated, as support was respected at the 38.2% Fibonacci retracement of \$22.64 (blue set of retracements). Moving forward, and over the broader term, we would expect prices to gravitate towards a band of resistance situated between \$27.95 and \$29.68. This is made up of the January high and the 50% Fibonacci retracement (red set of retracements) respectively. A definitive clearance of this price range would further strengthen the long-term technical landscape.

Investing capital to develop long-term tier 1 projects from within its own portfolio remains a priority for the company. It has been this ability to draw on the advantages of developing such assets that has allowed the company to expand during a prolonged negative commodity pricing cycle.

BHP Billiton, we believe, has the financial and management capability to deliver shareholder value across commodity cycles. The 2017 operational result, albeit a little soft, has nothing untoward in it to concern over for when BHP Billiton reports its 2017 results. The operational result does not sway us away from a firm belief in the quality of the company's asset base.

Consequently, our recommendation on BHP Billiton as a high conviction buy for Members with no exposure to the stock remains unchanged.

Disclosure: BHP Billiton is held within the Fat Prophets Mining and Resources, Concentrated Australian Share, Concentrated UK Share portfolios and the Fat Prophets Contrarian Fund.

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Snapshot BHP

BHP Billiton

BHP Billiton ranks as the world's biggest diversified resources company. The company has a dual-listed structure, with its primary listings being on the Australian Stock Exchange and the London Stock Exchange. The group was formed following a merger between BHP and Billiton. The company's principal business lines are mineral exploration and production, including coal, iron ore, gold, titanium, ferroalloys, nickel and copper concentrate, as well as petroleum exploration, production, and refining. The company is the world's third-largest supplier of iron ore, copper and nickel, the world's largest international supplier of coking coal and the sixth-largest producer of aluminium, and one of the world's largest thermal coal suppliers.

Market Capitalisation:\$139.0B

	FY1	FY2
Price to Earnings	16.1	17.5
Dividend Yield (%)	4.30	3.30
Price to Book	1.92	1.94
Return on Equity (%)	12.50	11.00
EV/EBITDA	9.9	10.2

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