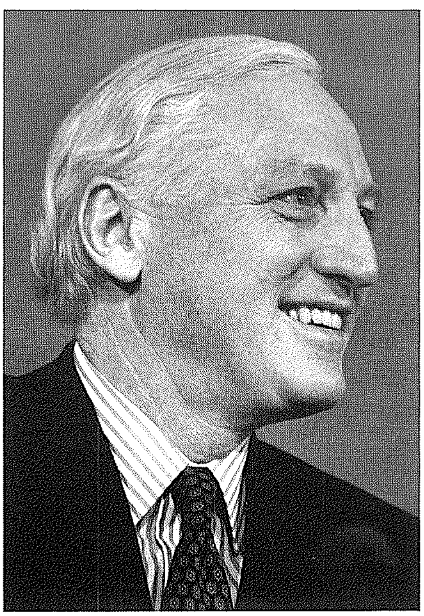
FIVE YEARS ON – THE BHP VISION

IT'S A 'DO' MODE FOR THE BIG AUSTRALIAN



by BRIAN LOTON

Australia's biggest company is constantly searching for new opportunities for growth. What will be the shape of BHP in the 1990s?

I was reminded during a visit to the US, during which I talked to the New York Society of Security Analysts and various investors, that it is fairly standard in that environment to ask about the shape of the company five years out. I suppose that security analysts need reassuring from time to time that large corporations do have a planning process to guide them. Each of our major businesses presents to the board annually its future business plans. Indeed, part of the process of managing a large, diversified corporation is to translate these plans into a contract for action by the business unit.

Our planning process has an emphasis on strategies to enhance shareholder value. We seek to deliver superior returns to our shareholders by concentrating on profitable growth opportunities and building long-term advantage in attractive industry segments.

However, one cannot let major opportunities for creating shareholder wealth slip by because that opportunity is not allowed for in the plan. Rather, the planning process should be one that enables the board and management to know the capacity that is available to undertake unplanned activities that represent significant opportunities.

The restructuring that BHP undertook this year was such an opportunity. Having full knowledge of where our business units were heading, having faith in the estimates of cash flows we expect to generate in the next few years from those businesses, and seeing the opportunity to buy real value, we were able to undertake a series of investments that will deliver superior returns to our shareholders as our earnings-per-share and share price increase.

No planning process could have delivered such an outcome. That, of course, is not a reason to deprecate the planning process but rather enforces the need to know the company's ability to undertake a major transaction and stay on course with the plans developed through a very rigorous planning process.

The other factor that you need to recognise in a resources company such as BHP is that a new discovery could be just around the corner that could lead the company in a new direction. BHP is the largest explorer in what is a relatively under-explored continent, Australia. In addition, we have exploration activities for oil and minerals in all of the inhabited continents.

Much of the success and profits of BHP have come from exploration successes or acquisitions in the pre-development phase of major mineral finds. The Bass Strait story is well known to all of you. That discovery and the rewards that flowed from its development provided the financial base for much of BHP's later developments and will do so for some years yet. It led us ultimately to the Timor Sea, which may well become

Brian Loton is Chief Executive Officer of The Broken Hill Proprietary Company Limited. This is an edited version of his address in August to the Victorian Division of the Securities Institute of Australia.

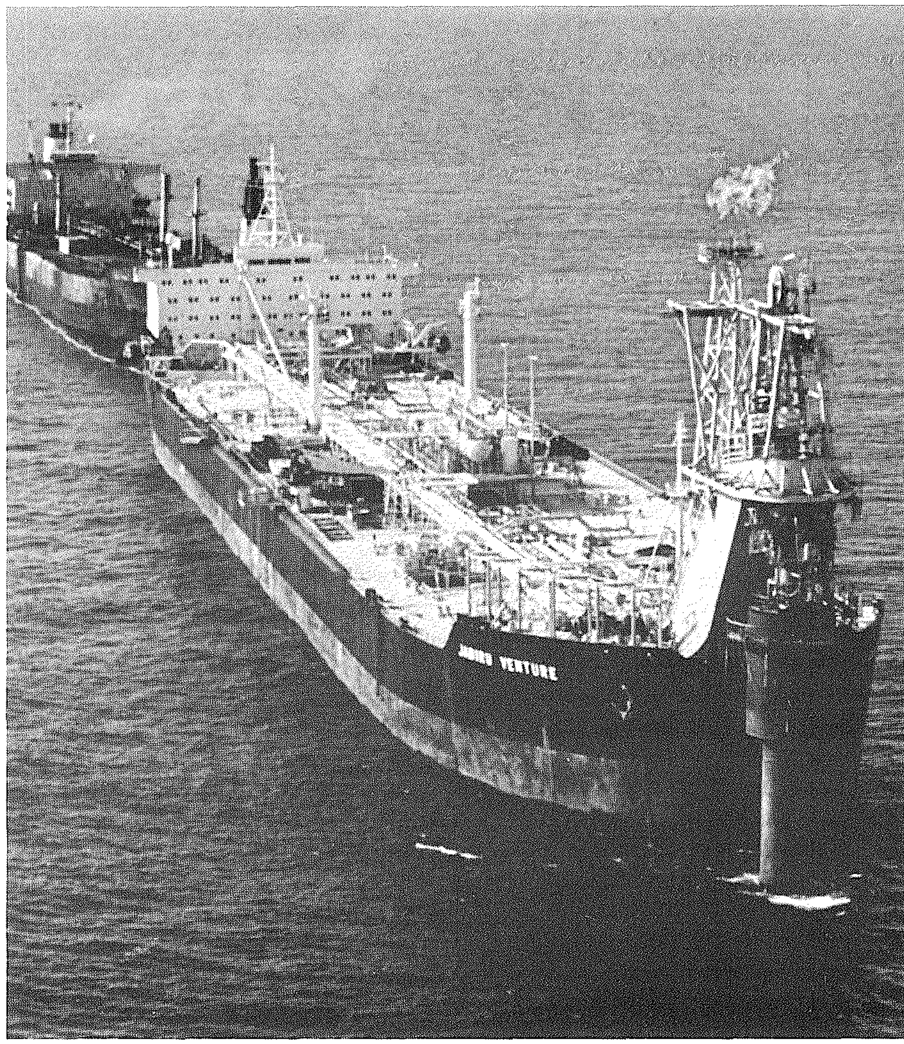
the next major base for BHP Petroleum's development.

Other exploration and development successes, ranging from Mount Newman, Groote Eylandt, Telfer and Boddington to Escondida in Chile, provide the profitable underpinning of BHP.

While acquisitions can and do offer satisfactory returns to shareholders, the real rewards for investment in resources companies comes from their being able to find and profitably develop those commodities that are needed for world-wide economic growth.

At a recent meeting with the press and financial analysts in Sydney I was questioned about BHP being in a "sell mode", alluding to our asset disposals. I responded by telling the questioner that BHP is in a "**do** mode." We are doing a whole range of things to enhance shareholder value. That may mean selling some assets that no longer fit our strategic direction. It may mean selling some assets that don't meet our return-on-investment requirements. It also means that we may acquire some other assets to which we can add value and create greater wealth than the existing owners. Having made those qualifying remarks, let me tell you what our planning process shows BHP to look like by 1993.

More than half our capital spending in the next five years will be in the petroleum business.



Jabiru Venture. . . BHP's production facility at its Timor Sea oilfield. The company intends to become one of the world's top 10 petroleum producers.

The vision of our petroleum business unit is for it to become one of the world's top 10 petroleum companies in terms of reserves and profitability. It sees major business headquarters in Melbourne, London and Houston, each managing assets around $A3 billion.

In Australia, production from Bass Strait will have halved by the mid-1990s but an improving mix of excise regimes, and the low-cost nature of our operations, mean that it will still be a major profit contributor.

In place of the revenue loss from Bass Strait, we will be earning the rewards of our long-term investment in the North-West Shelf project and the more recent exploration success in the Timor Sea. Most commentators have taken some time to appreciate what a valuable asset we have in the Timor Sea. In addition to the Jabiru field, which has operated far in excess of our initial expectations, we plan to have the Challis field in operation by September 1989. Further discoveries in the Timor Sea are still in the evaluation stage. Our planning process and capital budgets recognise the potential development of these fields: we are drilling a further 23 wells in our 1989 financial year.

The Timor Sea is an example of how BHP's particular skills in offshore exploration and development give us a competitive advantage. The knowledge base we have built up has enabled us to bid for and gain a major position in the available acreage in that most prospective area.

The North-West Shelf project should commence deliveries in October 1989, as scheduled. The project will build up over five years and should be at full production by 1995. The cash flows and profits to be generated by our direct interest will reflect our investment of almost $2 billion over several years. It will be a major leg of our petroleum business.

There will be major investments in our American and North Sea oil and gas interests over the next five years. These will bear greater fruits in the mid-1990s. Some of the acreage we acquired in the US is probably of greater value to other investors. We are therefore selling some mature acreage and will reinvest the proceeds in exploration and production properties more consistent with BHP's business objectives.

Hamilton Oil Company, our base for the UK oil business, has a large agenda of capital expenditures in the next five years to develop existing discoveries.

Our business plans necessarily cater for the possible development of other ventures such as the Iagifu project in Papua New Guinea and other investments to protect our marketing position as one of the free world's largest sellers of crude oil.

Why this concentration on the oil side of our business? The answer lies in being able to add to reserves and to produce at a lower cost than many other world producers. The conventional wisdom is that the OPEC nations will seek higher real prices for oil as other free world production shrinks in the mid-1990s due to natural depletion and several years of production above reserve additions.

We find it hard to fault that logic and continue to believe that there is a profitable future for those companies able to discover and develop oil reserves in the lower cost quartile. This requires a commitment for a large part of our exploration to be in areas that have the potential to be large discoveries, which by their nature fall into the category of "high-risk, high-reward." Through our international oil exploration program we intend to do just that.

I expect a near-term pause in petroleum earnings growth at current price levels as we gear up our exploration efforts and await the full benefits of the North-West Shelf and further Timor Sea developments.

To fill the gap in group earnings from the pause in petroleum, I am looking to a significantly improved return from our investment in BHP Steel. In the next five years I expect BHP Steel to build on its comparative advantages in a number of areas:

- it has a significant position in the domestic marketplace;
- it has favourable cost levels compared with international competitors;
- modernised facilities can produce competitive, quality products;
- we have a capable and committed group of people to run the industry.

BHP Steel will consolidate its position following a period of rapid change in equipment, technology and manning practices. To do this it will be developing its markets, mastering new technologies and pursuing improvements to its people-management. Increased training, continuing cost-reduction, productivity improvement programs and the adoption of concepts such as total quality control are all part of this approach.

I believe it can achieve the target return of 15 per cent on shareholders' equity. That will require a considerable improvement from the present return of around 7 per cent.

In an investment sense, we will be concentrating in two areas. The completion of the mini mill in Sydney will consolidate BHP's market position and provide some increased capacity to export higher quality rod and bar products from Newcastle.

By providing products that eliminate processing by our customers we add value and a price premium for those products.

Our main thrusts, however, will be to develop higher-value-added products in our coated products area. By providing products that eliminate processing by our customers we add value and a price premium for those products. We will be directing our export efforts to that end to ensure our plants operate at the highest level of efficiency and generate the greatest returns. We expect steel to generate very strong returns from the investments made in the past few years.

Similarly, BHP Utah Minerals is likely to be a cash generator for the group in the next five years despite the requirement to fund the Escondida copper development.

The Escondida development is a project that provides a good example of the time scales involved in bringing a major resource project to production. It was discovered in the early 1980s by the then Utah exploration team but it will be the early 1990s before the wealth created by that find will actually begin to be realised.

Escondida has been getting considerable press coverage, and deservedly so, because it represents a large investment and potentially significant rewards. But the fact that the minerals group is generating cash does not mean that we are overlooking other opportunities for investment. For example, one opportunity in West Africa would be largely self-funding after a modest initial capital investment. BHP-Utah is carrying out a feasibility study on a prospective gold mine in Mali. If drilling confirms earlier work, we could move quickly. We could start with a modest initial investment and expand the operation on a self-funding basis to a point where it would be an important earnings contributor five years from now.

At our current rate of expenditure, we will invest more than $250 million in minerals exploration over the next five years.

The important wild card for the minerals business, or course, has to do with what will be developed from our investment in exploration. At our current rate of expenditure, we will invest more than $250 million in minerals exploration over the next five years. Based on our past experience, we would be disappointed if our work does not pay off with important new profit centres. It is success in finding major low-production-cost ore bodies that provides major growth in earning power.

The point is that even as it generates cash, the minerals group is working on several projects that could be significant profit contributors to us five years from now. At the same time, it seeks major ore bodies to provide the big pay-off for our exploration efforts and expenditures.

The development of Escondida, combined with our gold developments and other non-ferrous discoveries, will see BHP-Utah Minerals' dependence on the world steel industry change markedly.

Just as we have sought geographic diversity with our customers in the minerals business, we have also sought to diversify from dependence on raw materials for steelmaking. By the early 1990s we will have achieved a more balanced portfolio of mineral assets. It is of interest that this change of direction for our minerals business unit was included in our planning documents some years ago.

In addition to our three main business groups, we have a business development arm. The task of this group is to create value by developing options for growth in new areas which build on the company's existing capabilities.

The two main areas at present are

engineering and transport. BHP Engineering acts as a technology skill-base that can be applied to a variety of opportunities. BHP Transport plans to capitalise on the recognition of transport costs as being a major component of the cost of raw materials in a customer's inventory. It has a modern fleet, experienced management and a large base of cargo from BHP operations. By the mid-1990s it will have added the management of large LNG vessels to its skill-base.

BHP Transport will become one of the world's largest dry-cargo shippers, blending various specialist requirements of BHP with the ability and expertise to maximise returns from chartering operations.

We were particularly pleased when the Orbital Engine Company concluded its licence agreement with the Ford Motor Company in the US. Again, we have an example of the long-term perspective needed in business development.

Other areas being examined by the business development group are in the feasibility or pre-feasibility stage. These include the Very Fast Train project, the possible spaceport development in North Queensland, several venture capital investments and involvement in Australia's defence electronics industry. We are presently seeing how the technical skills inherent in a large corporation such as BHP may be brought to bear in the higher technology areas.

Where these projects may be in the 1990s will depend on studies currently under way. They represent, for BHP, opportunities to participate in new and existing areas in addition to our three core businesses. They are, in a sense, quarantined from our core businesses so that we can review them and decide to further invest, or to divest if the opportunity does not measure up to our investment criteria. They are part of our window on the world.

In mid-1983 we had a long-term plan for BHP which indicated a likely position by 1988. In many respects the BHP of today is quite different from what we may have anticipated at that time. Certainly, I have spent a large part of my time in the past five years quite differently from what I may have planned then. But there are many elements in our 1983 plans that have come to fruition.

For example, we planned to diversify our minerals activities both internationally and in terms of product mix. The merger of BHP Minerals and Utah International achieved that aim and has created one of the largest mineral companies in the world.

Our plans for BHP Petroleum envisaged a presence in the US and the North Sea oil province. We have achieved that world-wide spread of interests.

Our steel industry was returned to profitability long before the world steel industry recovered. We also planned that.

In the 1990s BHP will have a much-enlarged petroleum element as we add to our production in the Timor Sea and the North-West Shelf and increase our international oil production.

Our minerals arm will be equally balanced by ferrous and non-ferrous metals production, due to an increased presence in gold and copper markets.

Our steel industry will be lean and profitable, concentrating on higher-quality, higher-value products.

We will have further enhanced our growth options, based on enlarged engineering and transport activities and new, as yet undefined, opportunities.

One theme is constant throughout our business units and our planning process. That theme is to create value for our shareholders and those others who share in our prosperity.

I can promise you an even more interesting next five years. ☐

COMPANIES AND SECURITIES – A FEDERAL AFFAIR

Mr Loton also spoke about the Federal Government's plan to introduce a national companies and securities scheme to replace the existing structure. He said:

BHP has expressed to the Attorney-General, Mr Bowen, its strong support for the broad trust of his initiative.

BHP has a close interest in developments in the law and administration relating to companies and securities. This interest goes beyond our position as a company which is itself subject to regulation. We have a very real concern, relevant to the health and growth of the Australian economy, with the efficiency and integrity of the securities markets. Shortcomings in this area can harm the confidence of foreign as well as Australian investors in our markets.

There is a need for a regulatory system which, while sensitive to local needs, is able to deal quickly and effectively with issues and challenges at the national and international levels. BHP is very aware that increasingly issues affecting the securities markets transcend national, let alone local, boundaries.

In our view the time has come for the national Government to assume a greater responsibility for companies and securities law and administration. This would represent an evolutionary step from the present system in which the Commonwealth and State Governments have sought to combine their efforts.

Key attributes of Attorney-General Bowen's proposals, as we see them, are the focusing of ultimate responsibility on one minister, one government and one parliament, a more accountable environment in which the Australian Securities Commission would operate, and greater capacity in the ASC to oversee administration carried out on its behalf by State offices.

The more accountable system the Commonwealth Government is putting forward should promote certainty and consistency of application in the law, qualities upon which the business community generally places great store and which, to the serious concern of BHP, have sometimes been lacking.

I am aware of concerns that have been expressed about local interests being overlooked in a national scheme. It seems to me that these concerns are capable of being met with the administrative arrangements being put forward for the Australian Securities Commission and the consultative arrangements which will contribute to the formulation of legislative changes under the new scheme.

It should be possible, in moving in the way Attorney-General Bowen proposes, to build on the experience of State Governments, the NCSC and the Corporate Affairs Commissions under the present system. I hope that all concerned will work with the Commonwealth to smooth the transition to the new system.

The legislative package which is before the Commonwealth Parliament also contains specific proposals for significant changes in the present law. These proposals call, of course, for careful consideration by interested parties.

I have made the point to Attorney-General Bowen that proposals such as for no pre-vetting of prospectuses and no access by companies to S.261 tracing orders, will place a premium for their success on effective enforcement action by the Australian Securities Commission. I also flagged the critical importance to the success of any scheme of the calibre of the people appointed to administer it. ☐