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TRANSCRIPT

BHP Eschews Oil for Farming

Featuring:
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Mike Disabato:

What's up everyone and welcome to the weekly edition of ESG Now where we cover how the environment, our society and corporate governance effects and are affected by our economy. I'm your host, Mike Disabato. And this week we have one big story for you. We're going to discuss the moves by the biggest mining company in the world to sell its oil and gas reserves and basically get into farming. So thanks as always for joining us, stay tuned. A company you might never have heard of, but have definitely been impacted by has made a massive change to its business practices this week, BHP Group, which is a mining giant, the largest in the world and is based in Australia and it used to be sold on two markets. One in Australia, the other in Britain, on Tuesday announced that they were going to make three impactful moves to how it does business.

First, it would sell its oil and gas operations to oil and gas company, Woodside Petroleum in exchange for shares that it would distribute to its own investors. It approved a $5.7 billion US dollar investment to build a massive new Potash fertilizer mine in Canada called the Janssen Potash project. And third, it was going to collapse its dual listing across London and Australia and focus only on its Australia listing. That dual listing change in the investment industry is really big news. It removed one of the largest companies in the London Stock Exchange. All these indexes and portfolios are now going to have to change their weighting. So that means billions of dollars of capital are in flux, but it has not yet been approved by the board. And it's a bit too wonky for this podcast. So we're not going to really focus on the dual listing change today.

We're going to focus on the other two changes, which I think signal a new environmental reality that BHP is setting for itself. And maybe the global economy is moving toward because it seems like what BHP is doing is it's trying to position itself to meet two big themes that may define the next couple of centuries. First it's going to be the electrification of the planet to tackle climate change. BHP is already well set to deal with this. They're are mining giant. They have all the materials needed to kind of help in this renewable energy transition. But the second thing they're doing, the potash mine. That's needed in their assumption to lift food production, to meet the growing demand from a bigger corporate population. So they're selling oil and gas. They're going to focus on materials and they're getting into the food game. Whether the company will be successful in this is to be seen and not really for us to say, but the move away from oil and gas and the investment into fertilizers is definitely worth a discussion, especially as it pertained to the world carbon reduction goals.

So what we're going to do is we're going to focus on the more known change first, the selling off of its oil and gas assets to Woodside. In doing this BHP actually made Woodside one of the top 10 oil and gas producers. And you might be thinking to yourself, how does making a top 10 oil producer equate to reducing more carbon? Well, according to my colleague, Kevin Kwok who covers the energy industry for us and I called to ask about this exchange, the move gave Woodside the financial cloud to ensure it can assist in the transition to clean energy. If an energy company has a lot of capital and it's dedicated to reducing its emissions. Then the more money the better, because it will hopefully pour it into low carbon projects or so Kevin says here.

Kevin Kwok:

The thing with this clean energy economy transition is the expectations are really on the energy companies to fund themselves. So there is a lot of debate right now in the conversations of why would Woodside, which is a AAA ESG company, an ESG leader in the space take on more oil and gas assets. But at the same time, they do need increased cash flows and a strong balance sheet. And this is what the merger will offer.

Mike Disabato:

The reason the balance sheet is improved for Woodside is simple, oil still has high margins. If a company gets more of it and it's the right kind of oil, they will get more capital and Woodside insists that with this capital, it can improve its climate change credentials by increasing its ability to invest in new low carbon energy opportunities, such as blue and maybe green hydrogen and ammonia, a CO2 free fuel. And when it comes to ESG to sustainable business strategies, as Kevin said, Woodside is at the top of its game. So there isn't really a reason yet for us to doubt its ambitions to continue to lower its emissions while still obtaining oil and gas assets.

Kevin Kwok:

So Woodside, they actually have a board level sustainability committee that oversees the company's ESG risk management strategy. They do have a clear focus on the alignment with the United Nations sustainable development goals, and they do have quite a few policies and practices for managing ESG risks, which does appear much stronger than some of its peers. And in the end, over the last six months or so, Woodside had announced that they have a goal of reducing emissions to 15% by 2025. And actually they have said in news media that they do have the carbon offsets even post-merger to reach 15% by 2025 and ultimately to become carbon neutral by 2050. So they have very ambitious goals and I don't think that they would have taken this on if they don't believe that they would have been able to reach these goals with the merger in place.

Mike Disabato:

Aside from the shift in BHP's business, what has made this exchange also fascinating is that the environment has played a main role in the discussion around the move. Whereas, the focus used to be mainly on the economics of the deal. There seems to have been a shift in society's attention toward what the carbon effects of the exchange was. BHP CEO, Mike Henry even had to state publicly that pressure on his company to cut its emissions by 30% was not why it sold its oil and gas assets, still the company and its CEO has made it clear in the past and currently that it is trying to move away from high carbon assets, such as oil production.

Kevin Kwok:

So BHP made it pretty clear that they see their future in the zero emissions technology really providing the minerals needed for the production of renewable energy technologies, batteries and electric vehicles. So selling the petroleum business will actually help BHP focus on the mining and the commodities. So such as like the iron ore, the coal, the copper and nickel. And as a reminder, we have to remember that BHP is the world's largest mining company, not the world's largest oil and gas company. So what that means is really less than 10% of the revenues come from their oil and gas business. So the exit from petroleum is actually not really that bad of a strategy.

Mike Disabato:

But how does potash, a crop fertilizer made up mostly a potassium and chloride, which is mined from ancient sea beds on the ground, play into this low carbon future. And why does BHP think it's worth a $5.7 billion US dollar investment into a potash mine that is meant to last for around a century? Well to answer that, I called on my colleague Cole Martin, who has a background in agriculture and agribusiness, the agriculture sector being the primary user and purchaser of potash. And I asked him to walk me through this decision.

Cole Martin:

The first thing to understand is that potash demand tends to be correlated with planting growth. Now it's true that you can change the various combinations and concentrations of fertilizer you're using depending on what you're doing. But for the most part, if you're buying more fertilizer, it's because you're planting more stuff. But the thing is, it is necessarily clear to me that we're all of a sudden going to be seeing an explosion in the area dedicated to crops over the next few decades. Some of this is for idiosyncratic reasons, like for example, palm oil, which is a considerable demand driver for potash, but faces all sorts of sustainability challenges and has also geographically constrained to an extent. Now that's just one case, right?

Palm oil is only one crop, but on a broad level, there's going to be a lot more emphasis going forward on biodiversity and land use including things like afforestation, in government policy over the next several decades. And what's that going to mean, I think is that it will ultimately constrain the area and the growth in the area dedicated to crops over time. And then obviously on top of all that, as climate change accelerates the amount of arable land where you'd use fertilizer may shrink altogether

Mike Disabato:

There's also the push by some in the agriculture sector and policy makers to incorporate more regenerative agricultural practices in the sector. Part of which involves the reduced use of fertilizer or pesticides. And if that doesn't take hold, the sector has already moved toward more precision agriculture systems. Those that use less inputs per unit of growth output.

Cole Martin:

I think what you're going to see is that both of these things are going to constrain fertilizer demand growth over time, right? Because if you're wasting less fertilizer or using it more efficiently, you may need to not buy as much next time around or you'll have higher stocks or whatever. Now, CEO Henry called out increased demand for biofuel as a key driver for potash demand going forward. But even then, I don't think that's going to mitigate the issues that I mentioned previously. Maybe in 30 years from now, when we're all eating cell-based cheeseburgers and all those crops that went to animal feed initially are now going into biofuel production instead that might happen. But even if it did again, is it going to lead to a surge in crop plantings? Probably not, right. Because overall demand may end up being weaker and consequently grain prices are going to be lower and that's going to mean the demand for fertilizers like potash is going to be lower as well.

Mike Disabato:

Still, a CEO Mike Henry is convinced the move will see growth. He told reporters this week that he believes the demand for potash will increase by 2% annually. That's a larger number than it sounds. Which does run counter to the International Fertilizer Associations prediction of 1.6% growth for potash. But the IFA has a different timeline than the century long project undertaken by BHP. But what does this move do to BHPs carbon footprint, selling oil for potash? Does it help or hurt it? Well, potash mining is actually a high scope one and two emissions footprint activity as high as oil and gas, according to our collected data. So that's not amazing. What this move does do is it gives BHP a renewed focus on the things that it is good at, mining. And it is the process of simplification that might be useful in lowering our economies collective footprint. Less sprawling corporations trying to cut margins and more concentration and a sustainable way forward.

Or it just might be a company trying to avoid the burden of oil and gas holdings since not many, especially not many investors are looking too fondly upon the industry, only time will tell. And that's it for the week. I wanted to thank Kevin and Cole for discussing the news with an ESG twist with me this week. And I also wanted to give a special shout out to Sophia Chang. We did a really good story with Sophia, but we weren't able to put it into this episode. So Sophia, thank you so much for all your help. I'll get to you next time. And thank you so much for listening. If you like what you heard, don't forget to rate and review us that always helps and subscribe wherever you get your podcasts, if you haven't already done so. And don't forget, we are not the only MSCI podcasts on the block. We also have a podcast called The MSCI Perspectives podcast, and here is what they're talking about this week.

Adam Bass:

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