BHP BILLITON PLC

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PORTLAND INVESTMENT COUNSEL™

Business Description:

BHP Billiton PLC reached most of its current size through the merger of BHP, listed on the Australian stock exchange, with Billiton, listed in London, UK. On May 25, 2015, the company demerged into two separate entities, namely BHP Billiton and South32 Limited. BHP Billiton's global headquarters are in Melbourne, Australia and employs 123,800. BHP Billiton will continue to trade on the Australian, London, and Johannesburg exchanges as well as maintain its American Depository Receipt program. South32 is an Australian incorporated company with its primary listing on the Australian Stock Exchange, its standard listing on the United Kingdom Listing Authority and a secondary listing on the Johannesburg Stock Exchange as well as an Over-the-Counter American Depository Receipt program in the US.

Overview and Investment Thesis:

- On May 25, 2015, BHP Billiton completed a demerger and split its mining assets into two entities entitled BHP Billiton and South32. BHP Billiton will house assets that are focused on upstream operations. These assets are quality assets with large proven reserves and low production costs that will allow BHP Billiton to remain diversified, resource long and option rich. We believe this core portfolio of assets remains well positioned to take advantage of the accelerated industrialization and growth of developing countries, particularly across Asia.
- South32 is a globally diversified metals and mining company with a complementary portfolio of high quality assets, many among the largest in their sectors, but of a different scale to those in BHP Billiton's core portfolio. The demerger allowed South32 to have the freedom to adopt a tailored strategy and regional operating model to facilitate cost reductions and improved productivity. Also, South32 will no longer be competing for capital with BHP Billiton's core assets.
- BHP Billiton has been employing a focused strategy on holding only top quality assets across all the minerals. With a limited number of world class mining assets available, some mining companies have stretched their balance sheets in search of growth through acquisitions. BHP Billiton will operate 5 core assets with a smaller geographical dispersion and a higher proportion of common operating characteristics, which may allow for streamlined operations. The simplification of operations may help BHP Billiton facilitate greater focus on improving performance and drive substantial additional productivity benefits. BHP Billiton's 5 core assets will be focused on petroleum, potash, copper, iron ore and coal.
- Ideal geographical positioning of key assets relative to the global growth drivers of China and India allows BHP Billiton to undercut the competition, as is the case in the iron ore seaborne market, where it's iron ore assets' proximity to Asia allows the company to deliver iron ore to its Asian customer more cheaply than its Brazilian rival, Vale SA. The company's core iron ore assets are located in the Pilbara region in Western Australia; the coal assets are located in Queensland and New South Wales, Australia; while the oil and gas assets are primarily located in Bass Strait and North West Shelf, Australia. Other significant operations located in Australia are Queensland Coal, NSW Energy Coal and Olympic Dam (Copper). The company has a controlling interest in Escondida, the largest copper mine in the world, located in Chile. We anticipate that growth in demand for the group's main outputs is expected to be sustained, at least for the foreseeable future.
- BHP Billiton has a solid track record of responsible management and returning value to shareholders through a progressive dividend policy. The 10 year compounded annual growth rate of its dividend exceeds 17%. Also, over the past 10 years, the company has returned US$64 billion to shareholders through dividends and share buybacks.
- We believe that the company's strong balance sheet has shown restraint by management in the near past in order to scale back a certain portion of operations and adapt to changing market conditions. For example, BHP Billiton has utilized less capital intensive methods to expand its Olympic Dam project in Australia in order to maximize shareholder returns in the current economic climate.
- The company utilizes a variety of hedging instruments and strategies in order to mitigate volatile fluctuations in cash flow quarter over quarter. Some of the company's hedging policies include utilizing derivative financial instruments on sales of commodities to customers, entering into swaps or swaption agreements when debt is issued in a currency other than the company's US dollar functional currency, and by holding a large amount of US dollars on the balance sheet since most of the company's revenues and expenses are in US dollars.
- An investment in BHP Billiton, in our view, provides exposure to a diversified basket of commodities as well as an interest in a quality, low risk, strong cash flow generating business with a focus on shareholders' returns.

Industry Growth Drivers/Trends:

- With steady industrial growth across emerging Asia, the seaborne bulk commodities (mainly iron ore and coal) market has seen dramatic developments. Under-investment earlier in the decade lead to a failure of supply to keep up with demand spurred by the industrial expansion of China. China is expected to demand 941 million metric tonnes of seaborne iron ore in 2015 and is a continued large player in the seaborne iron ore market. Also, it has become a significant net importer of coking (metallurgical) coal.
- The industrial development of the emerging nations, is by its nature, energy intensive. As emerging countries' citizens grow richer, the demand for consumer goods and services grows and the energy consumption per capita increases. This in turn causes the global demand for energy, be it oil, gas, coal, nuclear, hydro or renewable, to soar. BHP Billiton, a leading supplier of coal, oil, and gas stands to benefit from such a market dynamic.
- Thermal (energy) coal is enjoying a stable share of the energy mix and is likely to continue to be a main source of energy, especially as India and China increase their number of coal fired plant projects.
- We believe BHP Billiton is set for profitable growth as the portfolio of its assets are positioned in the first or second quartile of industry cost curves.
- Copper is another key piece of the industrial development and its demand dynamics is seen by many as a leading indicator of economic growth, is not a lot different from demand for steel and energy. China is driving demand for copper as well, as the country does not have significant domestic resources. In addition, the availability of good quality copper deposits is scarce and the project outlook is weak. The mined grades have been trending lower and technical issues at key mines are signs of a supply system stretched to its limits.

Competitive Advantages:

- Unlike some of the other global miners, which are leveraged to one or few commodities (e.g. Vale SA– iron ore, Glencore PLC – copper and coal) BHP Billiton has a diversified production base (petroleum, potash, copper, iron ore and coal).
- A unique collection of low production cost mining assets.
- The demerger of South32 was necessary in order to keep costs low at its high quality mining operations and to remain competitive in a very cost conscious industry. South32 may also enjoy a lean operating model that will allow it to have a competitive advantage in extracting manganese ore, manganese alloys, coal, aluminum, alumina, metallurgical coal, silver, lead, zinc, nickel and bauxite. It is expected that there will be annual cost savings of US$100 million (pre-tax) from the demerger.
- BHP Billiton's assets are ideally positioned geographically relative to the 'engine' of global economic growth, Asia.

Competitors:

- **Iron ore:** Vale SA, Rio Tinto PLC, Fortescue Metals Group Limited.
- **Coal**: Rio Tinto PLC, Glencore PLC, Anglo American PLC, Teck Resources Limited, Peabody Energy Corporation.
- **Base Metals:** CODELCO, Freeport-McMoRan Inc., Glencore PLC, Antofagasta PLC, Rio Tinto PLC, Anglo American PLC, Teck Resources Limited.
- **Petroleum**: Occidental Petroleum Corporation, Oil and Natural Gas Corporation Limited, Suncor Energy Inc., Apache Corporation, Imperial Oil Limited, Woodside Petroleum Limited.
- **Potash**: Potash Corporation of Saskatchewan Inc., Agrium Inc., Uralkali OAO.

Customers:

- BHP Billiton customers are primarily steel makers, oil and gas refineries and utilities. Given the size of BHP Billiton's operations, no single customer accounts for a significant portion of the total revenue.
- Geographically, in fiscal year 2014, BHP Billiton customer base was relatively well diversified, with 35% of the sales going to China, followed by North America, Japan, the Rest of Asia, South Korea, the Rest of Europe and Australia.

Officers and Directors:

- **Leadership team:** Chairman of the Board, Jacques (Jac) Nasser; Chief Executive Officer, Andrew Mackenzie; Chief Financial Officer, Graham Kerr; President, Copper, Peter Beaven; President, Petroleum and Potash, Tim Cutt; President, Coal, Dean Dalla Valle.

Barriers to Entry:

- **Long production start-up lead times:** The average greenfield mining project could take as much as eight months to go into production; combined with the potential volatility in the mineral commodities market, such long lead time to cash inflows are extremely difficult to manage for a new entrant.
- **Initial capital outlays/economies of scale:** Together with high mineral grade quality, size is essential in most mining operations; and deters most new entrants.

Corporate Governance:

- 13 member board – 12 members are independent and the functions of Chairman and Managing Director are separated.
- BHP Billiton's scope of operations causes the company to have a global environmental and social impact. The new company has set and is tracking progress towards achieving sustainability targets related to greenhouse gas emissions, energy intensity, water use, land rehabilitation and safety.

BHP Billiton operates under the belief that the world must pursue the twin objectives of limiting climate change while providing access to the affordable energy required to continue the economic growth essential for maintaining living standards and alleviating poverty.
- BHP Billiton invests one per cent of its pre-tax profits, on a three-year rolling average, in community based programs. The total recordable injury frequency (an indicator of the number of recordable injuries per million hours worked) improved to 4.2 per million hours worked in 2014 from 4.6 in 2013 and 4.7 in 2012.
- The company as a group has issued a sustainability report since 2001 and the reports are audited by independent accounting and consulting firms. BHP Billiton's sustainability reporting was rated 'A+' by the Global Reporting Initiative as well as by a third party auditor in 2014.
- The company is a part of Dow Jones Sustainability Index and a 2014 constituent of the Johannesburg Stock Exchange Socially Responsible Investment Index.
- BHP Billiton has a remarkable safety track record when it comes to being an operator of mining locations. In 2014, BHP Billiton reported a record low total recordable injury frequency and no fatalities at its operated assets. This reinforces the company's commitment to its employees' safety.
- In 2014, the total compensation for the CEO and non-executive directors of the company amounted to US$12.7 million, which represents 0.1% of net income.

Ownership:

- As of March 18, 2015, the top 5 holders of BHP Billiton's shares issued on the London exchange are: Blackrock Inc. 7.92%, Aberdeen 6.49%, Aberdeen Asset Management 4.83%, Blackrock Investment Management UK Ltd. 4.32%, and Legal & General Group PLC 3.06%.
- As of March 18, 2015, the top 5 holders of BHP Billiton's shares issued on the Australian exchange are: Blackrock Inc. 4.85%, Vanguard Group Inc. 2.12%, Norges Bank 1.97%, Blackrock Fund Advisors 1.01%, and Australian Mutual Provident Society 0.75%.

Capital Allocation/Uses:

- BHP Billiton has strong cash flow generation capabilities, which allowed the company to post record net operating cash flow for the 2014 fiscal year at US $25.3 billion.
- A significant portion of the cash flow is dedicated to sustaining production for commodities in high demand. The capital expenditure program for the current year is estimated to amount to about US $18.1 billion, with roughly $14.1 billion allocated to pre-existing growth projects, and $4 billion in new growth projects set to begin in fiscal year 2015.
- The company is committed to reinvesting in projects that carry attractive rates of return regardless of economic climate; a commitment to a solid 'A' credit rating, and returning excess capital to shareholders firstly with its progressive dividend policy and thereafter via share buybacks.
- BHP Billiton's financial flexibility is supported by its strong commitment to debt and treasury management. It is committed to maintain a solid 'A' credit rating, limit gearing to be a maximum of 40%, diversify its sources of funding/capital, and to maintain borrowings and excess cash in US dollars.
- Its net debt position has been reduced to roughly $25.8 billion, which translates into a net debt to common equity ratio of 30.2%.
- It has significant scope for increased leverage given that its stated net debt to common equity target ratio is 40%.
- The company has a progressive dividend paying policy, with dividends for the 2014 fiscal year amounting to 1.18 USD per share, representing a payout ratio of 45.5% relative to the diluted earnings.

Business Segments ($USD MM, Years Ended June 30):				
2014	**Revenue**	**Revenue %**	**Operating Profit**	**Operating Profit %**
Petroleum and Potash	14,833	22.1%	5,287	23.1%
Copper	13,868	20.6%	5,080	22.2%
Iron Ore	21,356	31.8%	12,102	52.9%
Coal	9,115	13.6%	386	1.7%
Aluminum, Manganese and Nickel	8,411	12.5%	307	1.4%
Unallocated Items	-377	-0.6%	-301	-1.3%
Total	**67,206**	**100.0%**	**22,861**	**100.0%**
2013	**Revenue**	**Revenue %**	**Operating Profit**	**Operating Profit %**
Petroleum and Potash	13,224	20.1%	5,636	24.6%
Copper	14,537	22.0%	5,639	24.6%
Iron Ore	18,593	28.2%	11,109	48.4%
Coal	9,895	15.0%	595	2.6%
Aluminum, Manganese and Nickel	9,278	14.1%	158	0.7%
Unallocated Items	426	0.6%	-207	-0.9%
Total	**65,953**	**100.0%**	**22,930**	**100.0%**

Key Profitability Ratios and Figures					
Y/E June 30	**2010**	**2011**	**2012**	**2013**	**2014**
Operating Margin	37.9%	44.3%	34.9%	31.8%	34.8%
Interest Coverage	43.6x	56.7x	36.8x	16.5x	19.9x
Return on Equity	26.4%	41.5%	24.8%	17.0%	17.8%
S&P Credit Rating					
Net Debt	3,308	5823	23549	27,510	25786
Common Equity	49,329	57,755	67,085	75,291	85,382
Net Debt: Common Equity	6.7%	10.1%	35.1%	36.5%	30.2%

Sourced from Thomson Reuters and Company Reports

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