Financial Risk Management

Strategy Briefing – November 2001
Charles Goodyear
Chief Development Officer
Rowen Bainbridge
Vice President Market Risk Management
• Introduction

• BHP Billiton Portfolio Model

• Financial Risk Management

• Strategy in Practice

• Future Direction

• Questions and Discussion
Agenda

- Introduction
- BHP Billiton Portfolio Model
- Financial Risk Management
- Strategy in Practice
- Future Direction
- Questions and Discussion
Financial Market impacts are measured in a portfolio risk model.

- Commodities
- Currencies
- Capital Markets
  - Debt
  - Equity
BHP Billiton Portfolio Model

- Asset 1
- Asset 2
- Asset 3
- Consolidated Portfolio

Return vs. Risk
BHP Billiton Portfolio Model

- BHP Billiton portfolio risk less than the “parts”

<table>
<thead>
<tr>
<th>Ratio of Cashflow at Risk to Cashflow</th>
<th>BHP Billiton</th>
<th>Billiton</th>
<th>BHP</th>
</tr>
</thead>
<tbody>
<tr>
<td>19%</td>
<td></td>
<td>26%</td>
<td>25%</td>
</tr>
</tbody>
</table>

Analysis from the time of the Merger
BHP Billiton portfolio diversification reduces risk.

- Oil, Aluminium, Copper, Coal and Currency exposures dominate.
- New combined portfolio stronger than the “parts”.
- Steel spin-out improves portfolio risk profile – but small
- Petroleum’s diversification value in the portfolio demonstrated.
Agenda

• Introduction

• BHP Billiton Portfolio Model
  • Financial Risk Management

• Strategy in Practice

• Future Direction

• Questions and Discussion
Financial Markets and Business Strategy

- Company risk profile is a function of business strategy and market environment

Financial Markets
- Commodities
- Currencies
- Capital Markets
  - Debt
  - Equity

Business Strategy
- Financial targets
- Growth aspirations
- Capital Investments
- Acquisitions
- Share buy backs
Financial Risk Management

- Asset 1
- Asset 2
- Asset 3
- Consolidated Portfolio

Return vs. Risk graph.
Too much Financial risk can threaten corporate objectives

CASHFLOW v's USES OF CASH

Illustrative

FINANCIAL YEAR

2002  2003  2004  2005

Uses of cash
Cash in-flow
Cashflow high
Cashflow low
Financial Strength completes the picture

Financial Markets
- Commodities
- Currencies
- Capital Markets
  - Debt
  - Equity

Financial Strength
- Credit Rating
- Liquidity profile
- Interest cover
- Gearing

Business Strategy
- Financial targets
- Growth aspirations
- Capital Investments
- Acquisitions
- Share buy backs
Financial Risk and Management Levers

Gearing distribution FY03 due to Market Risk

<table>
<thead>
<tr>
<th>Prob. (Key ratio &gt; 51.4%)</th>
<th>With whole of company risk</th>
</tr>
</thead>
<tbody>
<tr>
<td>Base case</td>
<td>2%</td>
</tr>
<tr>
<td>After management action</td>
<td>&lt; 1%</td>
</tr>
</tbody>
</table>

Possible Management Actions
- Discretionary CAPEX
- Acquisitions
- Exploration
- Funding requirements
- Dividend policy
- Share buy-backs
- Discretionary investments/distribution

Source: BHP Billiton analysis and Cashflow at Risk Model
“Whole of Company Risk” for the new group:

Market risk US$ 0.81 billion

Country risk event US$ 0.25 billion
BHP Billiton has a diversified portfolio of country risk

Share of EBITDA by Major Credit Rating
FY 2002

- AAA: 12%
- AA: 54%
- A: 6%
- BBB: 20%
- BB: 5%
- B: 1%
- CCC: 2%

Total: 100%
Financial Risk Management

“Whole of Company Risk” for the new group:

<table>
<thead>
<tr>
<th>Risk Event</th>
<th>Amount</th>
</tr>
</thead>
<tbody>
<tr>
<td>Market risk</td>
<td>US$ 0.81 billion</td>
</tr>
<tr>
<td>Country risk event</td>
<td>US$ 0.25 billion</td>
</tr>
<tr>
<td>Operational risk event</td>
<td>US$ 0.25 billion</td>
</tr>
<tr>
<td>Breakdown in correlations</td>
<td>US$ 0.2 billion</td>
</tr>
</tbody>
</table>

**Total**  US$ 1.3 billion

*Cashflow at Risk* - “worst expected loss relative to projected business plan cashflows over a one year horizon, at a confidence level of 95%.”
Financial Risk Management Summary

- Integrated approach to Financial Risk Management
- We have a well diversified portfolio of countries and commodities
- Powerful combination of diversity, financial strength and flexibility
- Approach uses “know how” from Financial Institutions
Agenda

• Introduction
• BHP Billiton Portfolio Model
• Financial Risk Management
• Strategy in Practice
• Future Direction
• Questions and Discussion
Capital Approval Process

• Return on a project or opportunity

• Distribution of returns on the project or opportunity

• Corporate impact (balance sheet / cashflow statement)

• Portfolio Risk Analysis
Market Risk Strategy - Update

• To manage risk through the **strength, flexibility and natural diversification** in the BHP Billiton Portfolio.

• As a general principle to **only hedge** when the residual risk in the portfolio may **compromise the delivery of corporate objectives**. **Referred to as “Risk Mitigation”**.

• To enter into strategic financial transactions only **to a limited extent**, when commercial circumstances within the portfolio **deviate significantly from long run** expectations. **Referred to as “Risk Leverage”**.

• To **communicate** to BHP Billiton’s policy and resultant risk profile to stakeholders in a **clear, precise and responsive** manner.
Portfolio Risk managed within Board approved limits and performance measured and reported

Risk limits for the portfolio

- Cashflow at Risk limit;
- The risk that BHP gearing will exceed target gearing
- Ratio of Cashflow at Risk to projected Cashflow
- Risk limits for strategic financial transactions

NOTE: *Other risks are also included to keep total risk within an acceptable level*

Clear and transparent disclosure

- Policy updates and quarterly information on outstanding hedge book
- View based activities taken to the P&L
Financial Risk Management Committee (FRMC)

- Executive Committee (ExCo), Treasurer and Vice President Corporate Finance & Vice President Market Risk Management
- Monitor Financial Risk
- Owns Financial Risk Policy and Limit Framework
- Decision making efficient - Quorum of 3 members
- Covers Financial Policy, Markets Risk, Credit Risk, Funding, Risk Capital Investment, Risk Leverage opportunities, Country Risk
- Meets regularly as part of monthly ExCo agenda
Strategy in practice summary

- Portfolio risk management part of capital allocation disciplines
- “Self insurance” model for commodity price risk retained
- Constant market monitoring and portfolio evaluation process
- Commitment to communication remains
Agenda

• Introduction

• BHP Billiton Portfolio Model

• Financial Risk Management

• Strategy in Practice

• Future Direction

• Questions and Discussion
Migration from *cash flows* to *valuations*:

**Current**
- Cash flow based
- Medium term market impacts
- Risk assessment

**Future**
- Longer term market impacts
- Value assessment
Conclusions

- An integrated approach to Financial Risk Management
- Portfolio tool has evolved from commodity price risk assessment to a financial risk management approach
- Analysis demonstrates the diversity, strength and flexibility in the BHP Billiton portfolio
Agenda

• Introduction

• BHP Billiton Portfolio Model

• Financial Risk Management

• Strategy in Practice

• Future Direction

• Questions and Discussion