Capital Management Presentation
Mr Chris Lynch
Chief Financial Officer
9.30am UK time

Slide 1 – Title Slide

Hello and welcome to this presentation outlining BHP Billiton's capital management programme, and in particular, detailing the announcement today of our intention to undertake the first phase by way of an off market buy-back in BHP Billiton Limited.

By way of introduction, my name is Chris Lynch and I'm the Chief Financial Officer of BHP Billiton. Joining me today in Melbourne is Gerard Bond, Vice President of Corporate Finance and he will be available to help answer questions following the presentation.

I intend to spend the first half of this call going through a brief presentation that's available on our website. I will then be happy to take your questions.

Slide 2 - Disclaimer

Just a reminder that the off market buy-back will not be made available to BHP Billiton Limited's US or Canadian shareholders or ADR holders or to BHP Billiton Plc shareholders. Since we intend to acquire shares at a discount of between 5 and 14 per cent to the market price, we would not have expected them to want to participate in any event. I will talk more about the structure and why we will be able to buy the shares back in this way a little later.

Details on exactly how to participate in the buy-back will be contained in the booklet to be sent to eligible BHP Limited shareholders on or around 20 October and will not be specifically discussed on this call.

Slide 3 – Capital Management Rationale

Turning to slide number 3, before we get into the detail of the off market buy-back, I would like to start off by talking about the rationale for the capital management programme and then spend some time outlining the various options we considered before deciding on the off market buy-back. In August this year, at the time of our results, in addition to our ongoing progressive dividend policy, we announced our intention to return up to US$2 billion to our shareholders. Today we are announcing the key features of the first phase of that programme and outlining our strategy for the remainder.

As we said in August, the DLC and the diverse nature of our shareholder base (approximately 60 per cent of the DLC is held by non-Australian residents), have made this a somewhat more complex process than might ordinarily be the case, but we believe that the strategy we have devised will provide the optimal programme to maximise value across the group to all shareholders including those who will not be directly participating in the off market buy-back.

Before I get into the detail of the programme we announced today, I would just like to draw out a few important overall points.

First and foremost, the return of US$2 billion to shareholders demonstrates our ongoing commitment to capital discipline which is a key value driver for BHP Billiton.

We have consistently, since the merger, set out our priorities for cash flow. Firstly, to invest in our strong pipeline on value accretive growth projects; secondly, to maintain a robust capital structure in line with a single A credit rating; and then once we have done those things, to return capital to shareholders through various means including our progressive dividend policy.

Just as a reminder on that dividend point, we increased the final dividend announced in August of this year by 27 per cent compared to the previous year, (a full US2 cent per share increase), and as a result of paying three dividends during the period, actually increased our overall payout for last year by 79 per cent.

Taking into account current and anticipated cash flows, we are now in a position to return up to US$2 billion to shareholders via the programme we are outlining today, which is in addition to that progressive dividend policy.

So we are in a position to fund our growth projects, maintain a robust capital structure and increase dividends (as we have over the last five declarations) and return US$2 billion of cash to shareholders.

Slide – US$2 billion capital return: impact on BHP Billiton

Turning to slide number 4, as I've just mentioned, the capital management programme is consistent with our stated strategy for the use of surplus cash flows.

Our pipeline of projects includes US$8.6 billion of projects currently in the development or feasibility stages plus a range of other opportunities in the prefeasibility or concept stage which don't yet appear on our “bubble chart”.

We will continue to invest in and add to our project pipeline. The needs of our business in that regard have been factored into our thinking when determining the US$2 billion amount. I can't emphasise that point enough. We have got good projects and the ability to find, fund and develop those projects along with other value enhancing opportunities as they arise.

BHP Billiton will remain strongly capitalised following the capital return and will maintain the targeted single A credit rating. Our progressive dividend policy remains unchanged. We will maintain or grow the underlying dividend over time and you will have seen steady increases over the past few years. As an aside, it's probably also worth mentioning that we expect to be able to continue to pay fully franked dividends for the foreseeable future.

Slide 5 – BHP Billiton considered various ways of returning capital

So moving on to the detail on slide number 5, why an off market buy-back in BHP Billiton Limited? Well, essentially, it's all about value. We can buy back shares in BHP Billiton Limited at a significant discount to market value. We have set a minimum discount level of 5 per cent, but the typical rate achieved in Australian buy-backs of this nature has been higher than this. I will talk more in a few minutes about why we will be able to buy shares back at a discount here in Australia and why the same strategy wouldn't work in other markets. It is for these reasons that the offer, when made, will not be available to BHP Billiton Plc shareholders and indeed why we feel able to exclude our US and Canadian Limited shareholders and ADR holders from participation.

Considering the alternatives, firstly, there are capital returns. We have done two of these. The spin-outs of One Steel from the former BHP and shortly after the merger Blue Scope Steel (or BHP Steel as it was known at the time). Capital returns generally only apply to asset sales or business reorganisations, which is not the case here, and the nature of the DLC can make a capital return across both parts of the company more complex. If you recall, the spin-out of BHP Steel in July of 2002 was only to Limited shareholders and a “matching action” bonus issue was given to Plc shareholders - but that was a pretty unique set of circumstances. Capital returns are also EPS dilutive.

The global nature of our share register means that we have to consider the impacts in a number of jurisdictions when making a decision. While special dividends are attractive to some shareholders, they are not favoured by all. Furthermore, one of our primary objectives was to provide an ongoing benefit to all shareholders, particularly those who are holders for the long-term. Given that special dividends only provide a discrete one-off cash benefit, we determined that this was not the best solution at this time.

We believe that share buy-backs are value enhancing and an off-market buy-back in the form that we will be undertaking will provide the optimal mechanism for maximising value to all our shareholders for a number of reasons.

Unlike capital returns or special dividends, share buy-backs allow shareholders to decide whether to participate based on their individual circumstances.
Furthermore, while participating shareholders benefit directly by selling their shares into the buy-back, all shareholders receive the ongoing benefit of increased earnings, cash flow and return on equity attributable to their shares. The benefit of improved earnings per share and returns therefore means that buy-backs reward long-term shareholders rather than being a one-off payment.

The off-market buy-back structure is an interesting one. Whereas in most markets an off-market buy-back tends to be undertaken at a premium to the prevailing market price, here in Australia, recent transactions have been at a quite significant discount. While some people on this call may be familiar with the structure, for the benefit of those who aren't, there have been a number of transactions similar to this one in recent years.

The off-market structure in Australia enables a buy-back to occur at a discount to the prevailing market price by releasing franking credits, a special feature of the Australian tax system only available to shareholders resident in Australia. Franking credits, an asset of the company, have a value to Australian resident shareholders and hence those shareholders may choose to tender their shares into a buy-back at a discount. For reference, recent comparable buy-backs have featured discounts ranging from around 8 per cent to 17 per cent - a table of these is included on slide number 19 in the appendices.

The purchase of shares at a discount will allow us to buy-back a greater number of shares than would otherwise have been the case thereby increasing earnings, cash flow and return on equity for each remaining share. This will clearly benefit all shareholders including Plc shareholders and those Limited shareholders who are either ineligible or choose not to participate.

Now, turning to the programme announced today, and looking at phase 1, the proposed off-market buy-back on slide number 6.

Slide 6 – Capital management programme – Phase 1

Our capital management programme will commence with an A$1 billion to A$1.5 billion off-market buy-back in BHP Billiton Limited, to be bought back at a minimum discount of 5 per cent to market value.

I will outline the timetable later on but essentially, following a three week tender period, the off-market buy-back will be due to complete before the end of November 2004. Following completion of this process, we would look to determine phase 2 of our capital return programme.

I don't propose to go through the off-market structure in detail on this call.
Slides 7 to 13 are included here for completeness. They are slides that were useful in talking to the Australian market this morning where we expect many of the buy-back participants to reside. I'm happy to take questions on them of course and would encourage people to look through them.

Some people may be wondering why a shareholder might want to tender at a discount and that's an important point, so I will take some time here to explain that.

Under the off-market buy-back structure, the Australian tax law operates to deem part of the buy-back price to be capital and part to be dividend. For example, if we were to buy back shares at a 14 per cent discount to the five-day value weighted average price to 4 October, the buy-back price would be A$12.34. For Australian tax purposes, shareholders would receive A$2.10 of capital proceeds and a deemed dividend of A$10.24.

As an Australian company, BHP Billiton Limited gets what are known as "franking credits" through payment of corporate tax in Australia. Dividends paid out of income that has already been subjected to Australian tax are deemed to be "franked" and shareholders receive a 30 per cent tax credit on top of the dividend payment. Depending on their individual circumstances, this tax credit may be greater than the tax they then pay on the gross dividend.

Australian shareholders may also realise a capital loss, which may have some value. Note, that this is a very different calculation to one that a non-Australian resident shareholder would undertake, where generally 100 per cent of the buy-back price would be treated as capital proceeds.

Of course, there may be other reasons why a shareholder chooses to tender their shares into the buy-back, but in the main you would typically expect that non-Australian shareholders who do not get the same tax outcomes as an Australian resident, would not participate. Hence we will be limiting the off-market buy-back to eligible BHP Billiton Limited shareholders only and setting a minimum discount of 5 per cent. This minimum discount ensures that the buy-back demonstrably does not disadvantage non-participating shareholders.

For those less familiar with the structure, there are a couple of slides at the back of the presentation that I would encourage you to look at. Firstly, slides 17 and 18 give an example of how the tax structure works in Australia versus the US and the UK, and shows pretty clearly why a non-Australian resident shareholder would generally be better off selling their shares on market, whereas an Australian resident may well see value in participating in an off-market buy-back at a discount to the prevailing market price.

Secondly, there is the table I've already mentioned showing the six completed comparable transactions in Australia over the past 18 months and the sorts of discounts that companies here have achieved.

A few other things that I should mention are the size of the off-market programme and how the buy-back price will be determined. The target size is A$1 billion to A$1.5 billion although we do reserve the right to vary it in light of demand. The A$1.5 billion represents just 2 per cent of BHP Billiton's total share capital, so it's not a particularly large programme.

As I've said, we will be inviting tenders from eligible BHP Billiton Limited shareholders at discounts of between 5 per cent and 14 per cent to the volume weighted average price over the five days prior to the close of the buy-back. Shareholders will be able to lodge a final price tender as well as tendering subject to a specified minimum price. The buy-back price will be determined by the largest discount that allows the desired amount of capital repurchase.

I won't go through the timetable for the off-market process in detail. The buy-back period opens on Monday, 1 November and closes at midnight on Friday, 19 November. We expect to announce the price and size of the tender no later than Tuesday, 23 November.
The detail of the off-market buy-back structure will be addressed more fully in the buy-back booklet which will be sent to eligible shareholders in due course. Plc shareholders won't automatically receive a copy of that booklet but can request a copy although we should point out that there are restrictions on sending the document into the US and Canada.

Slide 14 – Capital management programme – Phase 2

Turning finally to slide number 14.

Following completion of the off-market buy-back, we will take a decision on the most appropriate form in which to return the balance of the US$2 billion. We will look at the various options, further share buy-backs (in Plc and/or Limited) and/or enhanced dividends. It would be wrong to speculate at this time about what form that return might take as we are some months away from implementing it. The decision will be based on maximising value for all of our shareholders, which is the criteria we always use.

It's our clear intention however, that the balance will be returned over the next 12 months and that's a key message I would like you to take away from this presentation.

Slide 15 - Questions

With that, I would be happy to take your questions. Operator, could we have the first question please.

QUESTION: Good afternoon I suppose, Chris. As far as franking credits are concerned, you mentioned obviously that one of the advantages for Australian holders is that they can reclaim these credits. How much scope or space does BHP Billiton have to increase or to do a further US$1 billion share buy-back and still offer franking credits both for the share buy-back and for the dividend, or is this really you using up to your maximum limit for this financial year?

CHRIS LYNCH: No, the issue with regard to franking credits is there will be some consumed in this transaction but we anticipate being able to pay fully franked dividends into the future basically unaffected by the process in total. So we have surplus franking credits available at the moment and we anticipate generating more of those as we go forward as well so we anticipate being able to pay fully franked dividends in the Limited stock.

QUESTION: Right. But you mentioned sort of in closing that you were going to look at the further give or take US$1 billion. If you also decided that it was best to do that through a share buy-back using the same sort of structure, would you have sufficient franking credits to do that?

CHRIS LYNCH: We would have sufficient franking credits but, as I said on the way through the presentation, I think it would be premature to speculate about the form or timing of the remainder of the US$2 billion. But rest assured we want to get this transaction completed which we anticipate having done toward the back end of November, and then we will address what happens with the remainder post that timing.

QUESTION: Okay, thank you.

CHRIS LYNCH: Thank you very much.

QUESTION: Chris, hi, I am sorry, I came on to this call a little late. I am not sure if you have already addressed this but can you tell me what happens to the shares? Are they cancelled or will they go into treasury stock?

CHRIS LYNCH: Shares are cancelled.

QUESTION: That's all I wanted to know.

CHRIS LYNCH: Thank you. Okay, I think we will probably maybe give it one last chance for any further questions, failing that we'll close the call. Operator, are there any other questions?

QUESTION: Just a small point, but the A$2.10 capital amount. If you decide to do further share buy-backs, is that A$2.10 for the capital amount now set for the rest of the year or is there a time limit on it? In our calculations can we use that as a set?

CHRIS LYNCH: The A$2.10 is based off our balance sheet, effectively the breakdown between capital and retained earnings. It is a precedent for further off-market deliberations but it's really nothing to do with any sort of on-market activity. It's pretty much for this exercise and each and every one of these type of issues, if we were to do the same type of transaction again, we would have another conversation with the Australian tax office around that.

QUESTION: Effectively then, if you do that after six months, the balance sheet that you've got for Limited at that point would then be taken into consideration?

CHRIS LYNCH: That would be the basis of our discussions with the tax office, yes.

QUESTION: Good afternoon. Could you summarise - I am trying to get some respect of what the benefits to the BHP Billiton Plc shareholders are of this transaction?

CHRIS LYNCH: Yes. I think the key value here is that we are able to buy the shares back at a quite substantial discount. We will have a minimum discount of 5 per cent and a maximum discount of 14 per cent. So the fact that we can buy the shares at a discount to the market price is earnings per share accretive for every other shareholder in the company. The key issue about the value here is the fact that people are prepared to sell shares into this transaction at a discount. So all other shareholders benefit from the earnings, cash flow and return on equity type accretion that flows from that.

QUESTION: Hi, Chris, are there any other of sort of side effects that we are overlooking in terms of the effects of the buy-back? I mean, obviously the interest rate or the interest charge is going to change slightly, but are there any other effects maybe on the effective tax rate or anything like that? And the second question is, it does look such a good deal, why haven't you done the full US$2 billion like this? Were you limited by those franking credits?

CHRIS LYNCH: Let me perhaps address the first question. There's no unintended consequences that we are aware of obviously so on that side of things I think we have got it pretty well covered. The thing about the sizing, we have stated the target of returning up to US$2 billion. This is quite a large transaction with regards to similar sorts of transactions that have been exercised in the Australian market. It will be the largest that's been done, and the sizing really is a function of the balance between volume and the depth of the discount.
So we will have to make some judgments on the way through the tender process about what volume we accept at what discount price.

QUESTION: Thank you.

CHRIS LYNCH: Thank you.

OPERATOR: There are no further questions in the queue at this time.

CHRIS LYNCH: Okay. Well, if there's no further questions, Operator, then I think we will wrap it up with that. Thanks very much for your participation in the call. Should you have any further questions, please contact our investor relations people in the various jurisdictions. I am sure you've got those contact details for the various people.

Thank you very much for your interest. Good morning.

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