

# Financial Risk Management

Strategy Briefing – November 2001

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**bhpbilliton**

# Agenda

- Introduction
- BHP Billiton Portfolio Model
- Financial Risk Management
- Strategy in Practice
- Future Direction
- Questions and Discussion

# Introduction



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# BHP Billiton Portfolio Model

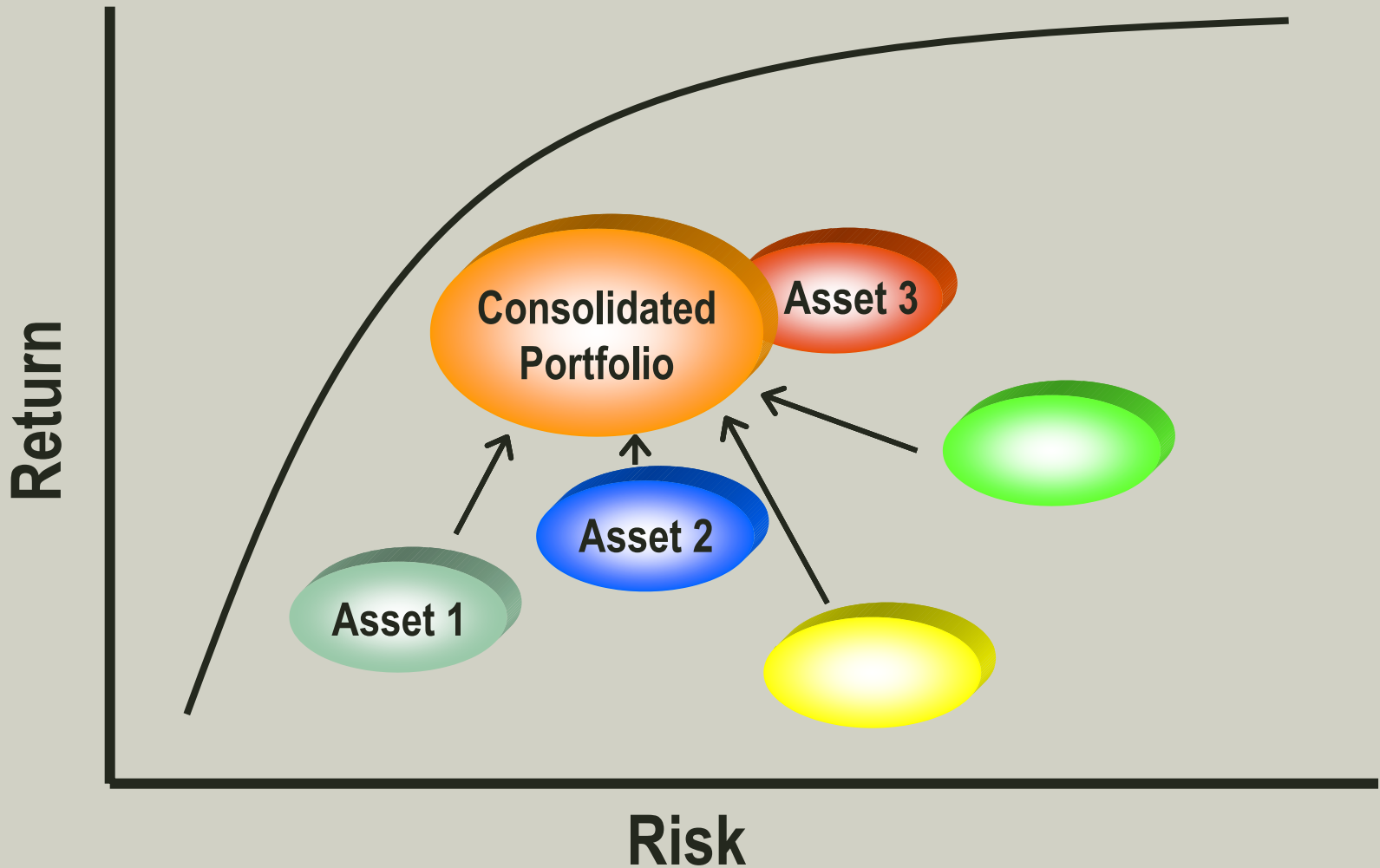
- Financial Market impacts are measured in a portfolio risk model



## **Financial Markets**

- Commodities
- Currencies
- Capital Markets
  - Debt
  - Equity

# BHP Billiton Portfolio Model



# BHP Billiton Portfolio Model

- BHP Billiton portfolio risk less than the “parts”

	<b>BHP Billiton</b>	<b>Billiton</b>	<b>BHP</b>
<b>Ratio of Cashflow at Risk to Cashflow</b>	<b>19%</b>	<b>26%</b>	<b>25%</b>

Analysis from the time of the Merger

# BHP Billiton Portfolio Model Summary

- 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.

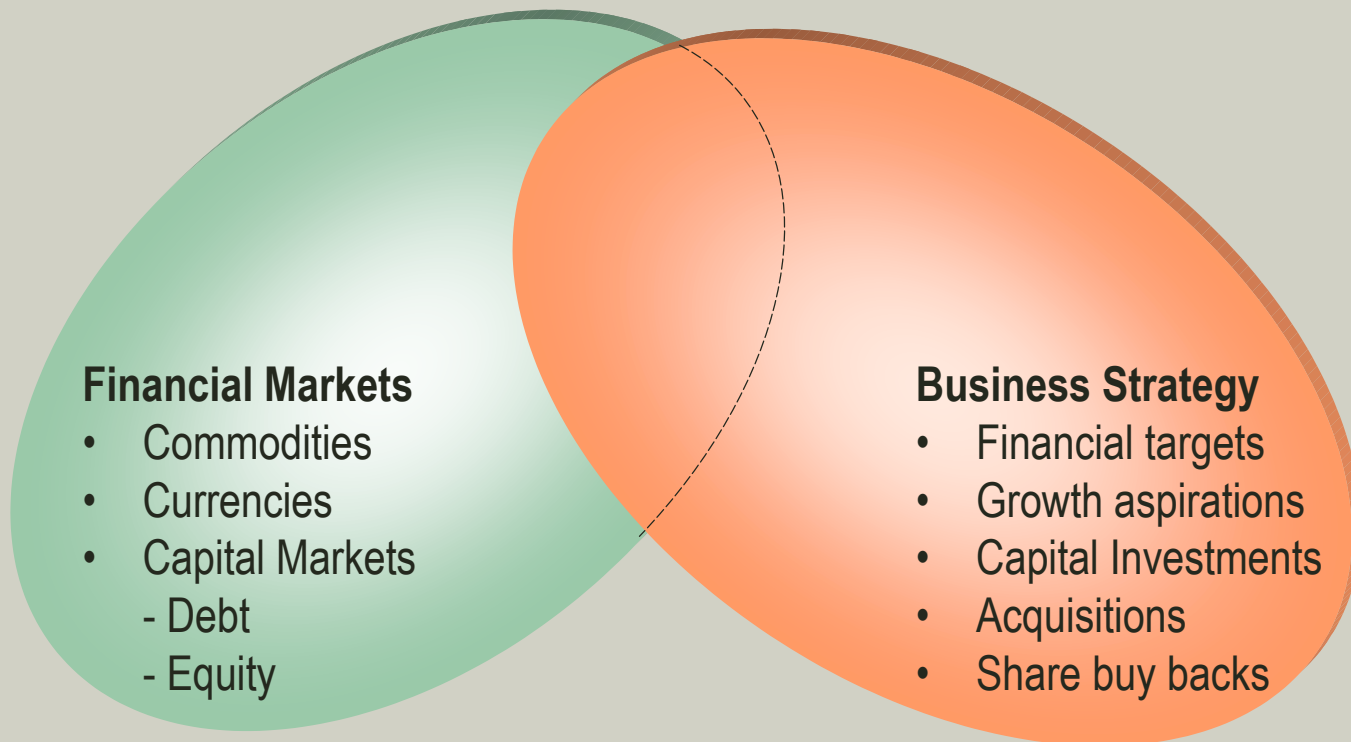


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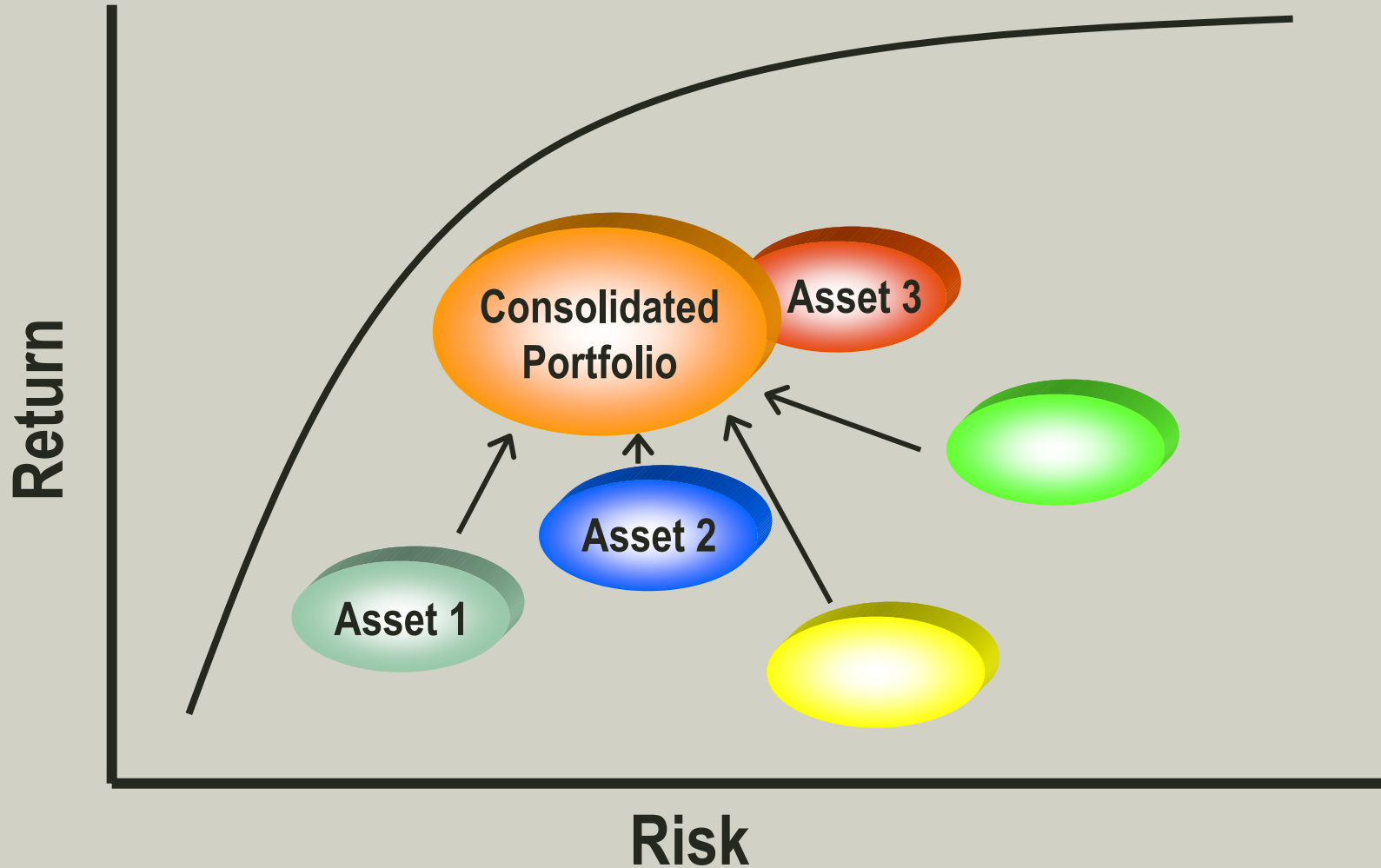
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# Financial Markets and Business Strategy

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



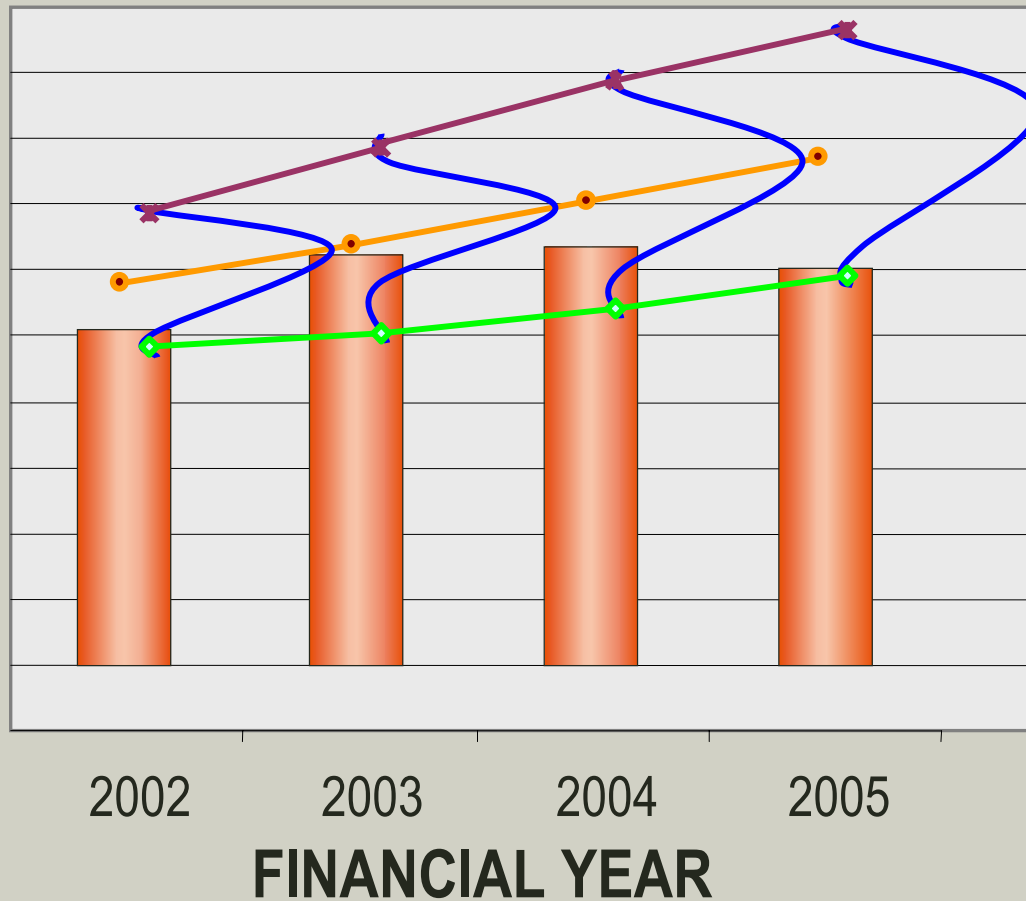
# Financial Risk Management



# Too much Financial risk can threaten corporate objectives

## CASHFLOW v's USES OF CASH

Illustrative



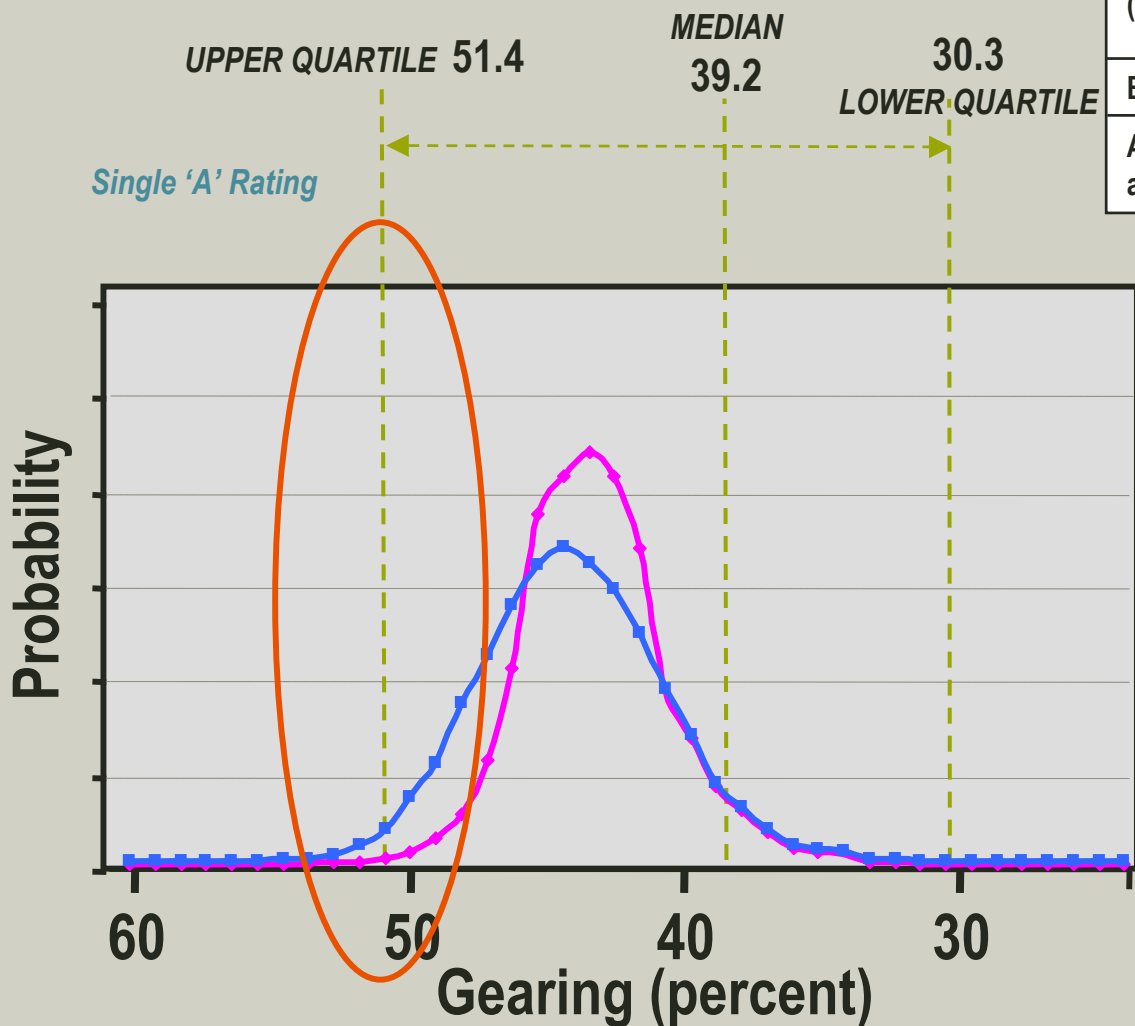
- Uses of cash
- Cash in-flow
- Cashflow high
- Cashflow low

# Financial Strength completes the picture



# Financial Risk and Management Levers

## Gearing distribution FY03 due to Market Risk



	Prob. (Key ratio > 51.4%)	With whole of company risk
Base case	2%	5%
After management action	< 1%	3%

### Possible Management Actions

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

- Base case
- After management action

Source: BHP Billiton analysis and Cashflow at Risk Model

# Financial Risk Management

“Whole of Company Risk” for the new group:

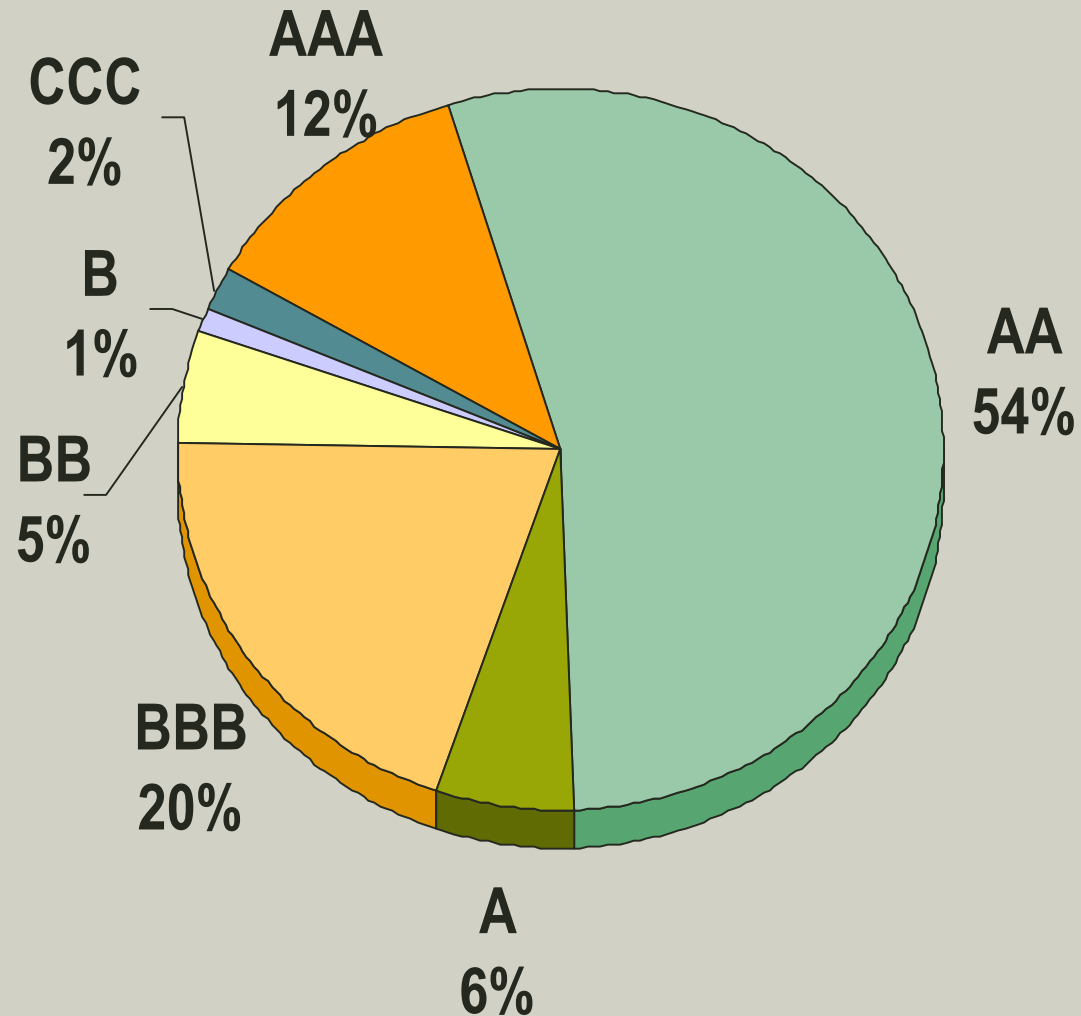
Market risk US\$ 0.81 billion

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





# Financial Risk Management

“Whole of Company Risk” for the new group:

Market risk US\$ 0.81 billion

Country risk event US\$ 0.25 billion

Operational risk event US\$ 0.25 billion

Breakdown in correlations US\$ 0.2 billion

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

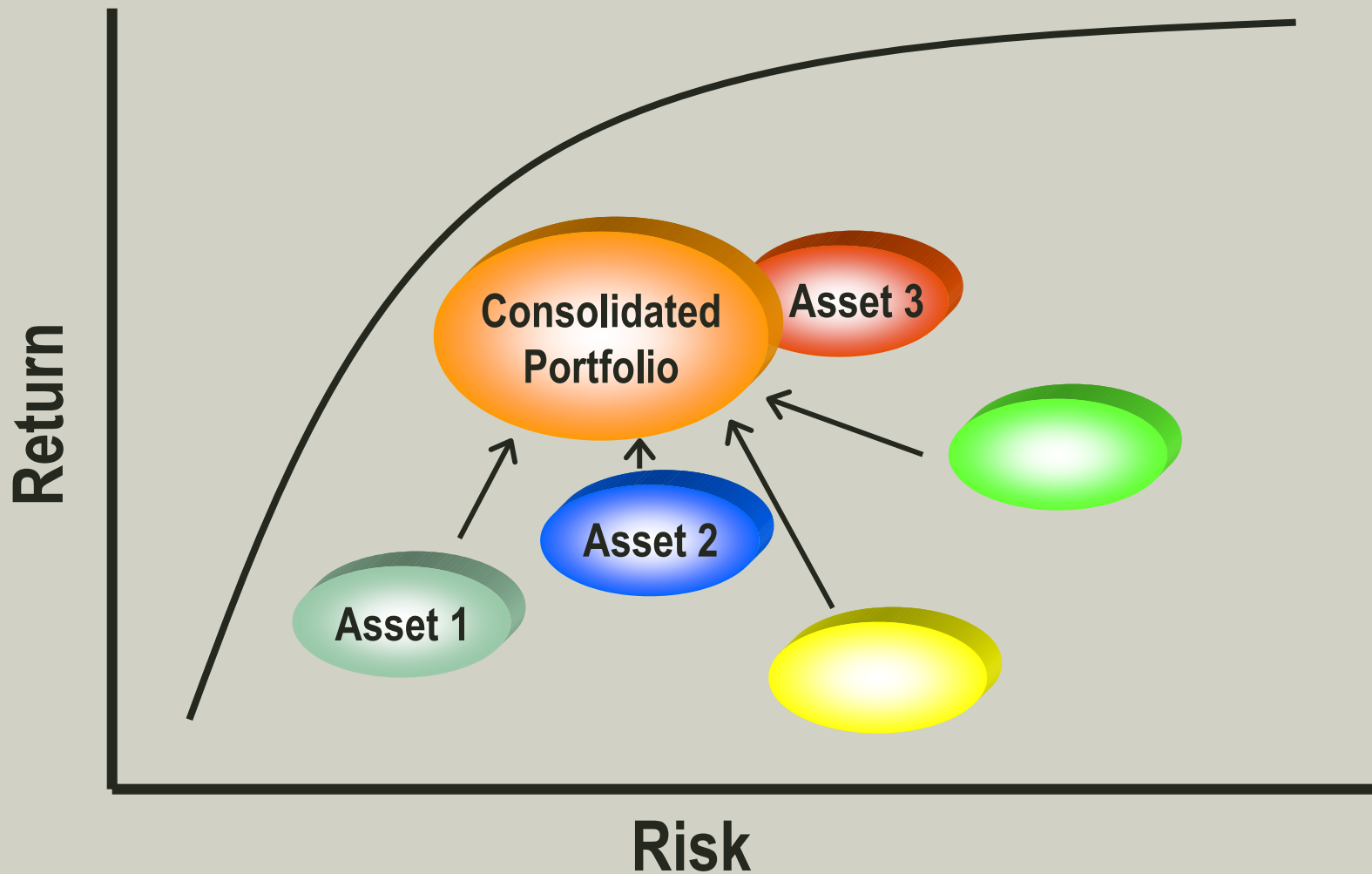
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# Capital Approval Process

- Return on a project or opportunity
- Distribution of returns on the project or opportunity
- Corporate impact (balance sheet / cashflow statement)
- Portfolio Risk Analysis

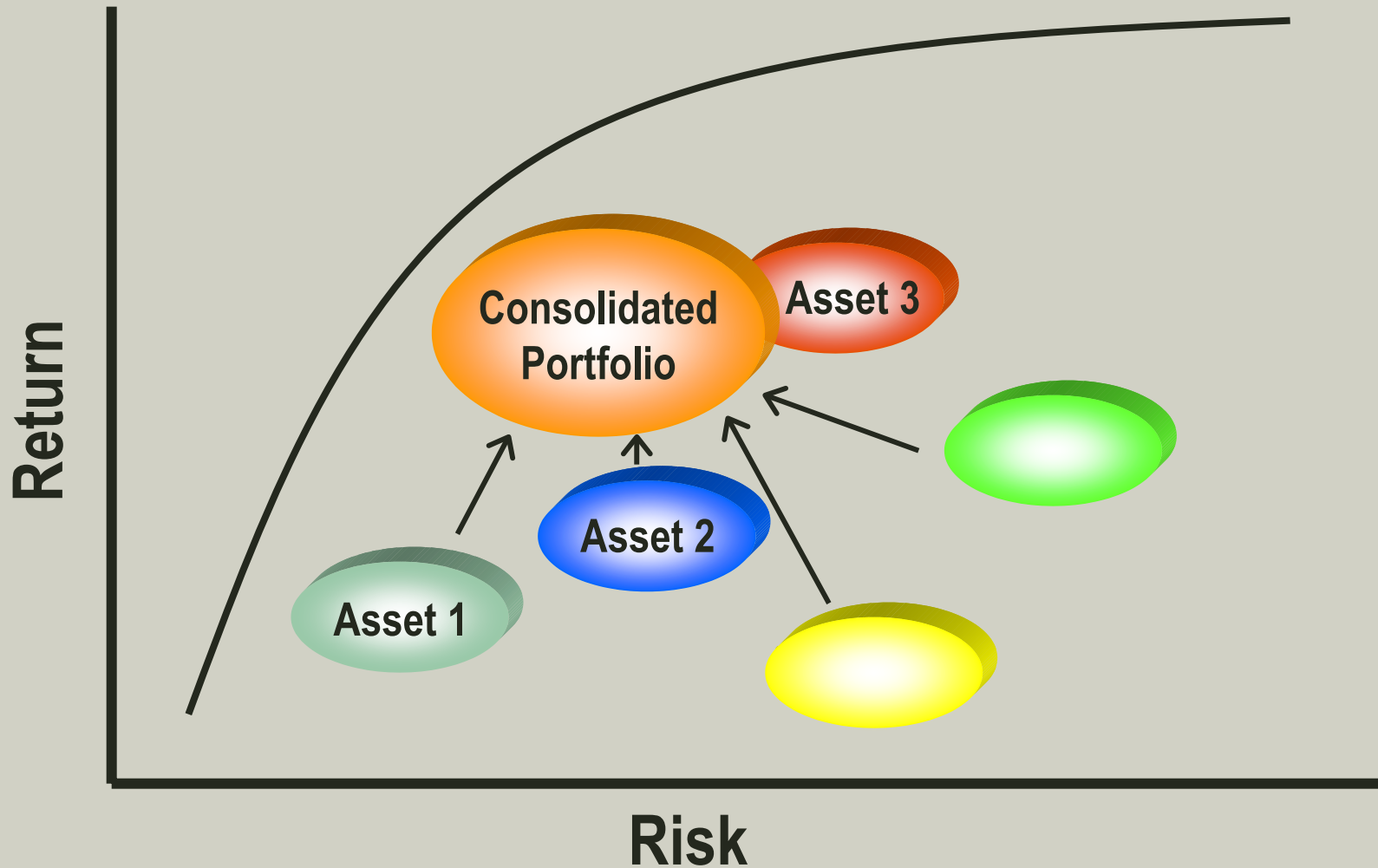
# Capital Approval Process



# 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.

# Market Risk Strategy in Practice



# 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

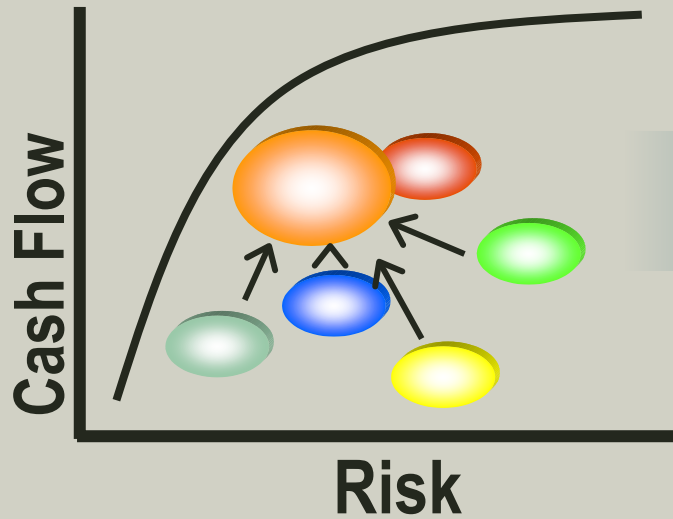
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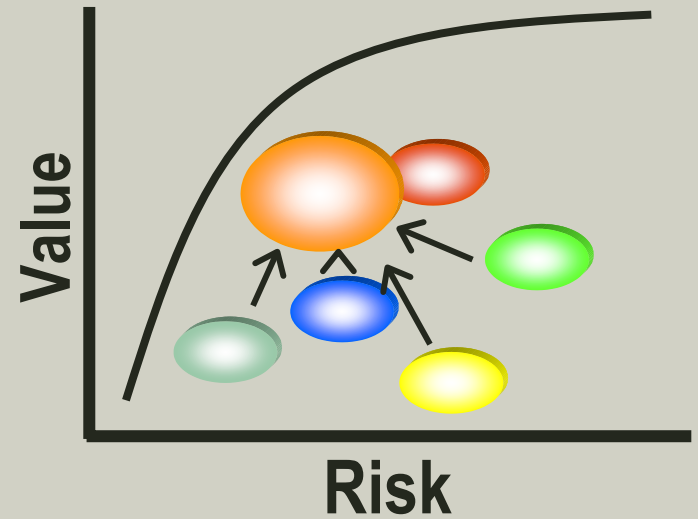
# Moving Forward - Vision

Migration from *cash flows* to *valuations*:

**Current**



**Future**



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

- 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

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