"Capital Management Presentation"
Mr Chris Lynch
Chief Financial Officer
10:30am AEST

SLIDE 1 – Title Slide

Good morning 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 Corporate Finance, who 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'll 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% to the market price, we would not have expected them to want to participate in any event. I'll 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 Billiton Limited shareholders on or around the 20th October, and will not be specifically discussed on this call.

SLIDE 3 – Capital management rationale

Turning to slide 3. Before we get into the detail of the off market buy-back, I'd 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% of the DLC shareholding 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'd 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 of value accretive growth projects. Secondly, to maintain a robust capital structure in line with a single "A" credit rating, and then once we've 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% compared to the prior year (a full 2 US cents per share increase), and as a result of paying 3 dividends during the period, actually increased our overall payout for last year by 79%.

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 increase dividends, as we have over the last 5 declarations, and return US$2 billion of cash to shareholders.

SLIDE 4 – US$2 billion capital return: impact on BHP Billiton

Turning to slide 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 the US$8.6 billion of projects currently in the development or feasibility stages, plus a range of other opportunities in the pre-feasibility 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've 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'll 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 onto the detail on slide 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've set a minimum discount level of 5% but the typical rate achieved in Australian buy-backs of this nature has been higher than this. I'll talk more in a few minutes about why we will be able to buy shares back at a discount here, 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 OneSteel from the former BHP and shortly after the merger, BlueScope Steel, or BHP Steel as it was known at the time. Capital returns generally only apply to asset sales or business re-organisations, 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 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. Whilst 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 specific 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 they 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% to 17%. A table of these is included on Slide 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$1.0 billion to A$1.5 billion off-market buy-back in BHP Billiton Limited, to be bought back at a minimum discount of 5% to market value.

I'll outline the timetable later on, but essentially following a 3 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.

SLIDE 7 – Off-market buy-back overview

Much of the detail in these next few slides will be addressed more fully in the buy-back booklet which will be sent to eligible shareholders in due course. I thought it would be useful to summarise the main points relating to the buy-back here, starting on slide 7.

We will be targeting a size of between A$1.0 and A$1.5 billion, although we reserve the right to vary this in light of demand. The A$1.5 billion represents approximately 3.2% of BHP Billiton Limited's capital, or 2.0% of BHP Billiton's overall capital assuming a buy back price of A$12.34.

We will be inviting tenders at discounts of between 5% and 14% to the Market Price. This Market Price will be calculated as the volume-weighted average price over the 5 trading days up to and including the closing date of the buy-back.

Eligible shareholders will be able to tender their shares at any of the specified discount points or submit a Final Price Tender. For illustration, based on these measures and the volume weighted average price for the 5 days to 4 October of A$14.35, the discount range would correspond to a buy back price range of A$12.34 – A$13.63.

The composition of the buy back price helps to explain why a shareholder might want to tender at a discount.

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 the buy-back price was A$12.34, for Australian tax purposes, shareholders will 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% 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 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% 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%. This minimum discount ensures that the buy-back demonstrably does not disadvantage non-participating shareholders.

Again, 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 market price.

Secondly there is the table I've already mentioned, showing the 6 completed comparable transactions in Australia over the past 18 months and the sorts of discounts that companies here have achieved.

A few words on the overall timetable - the tender will be open for 3 weeks beginning on Monday 1 November and closing on Friday 19 November.

Generally, shares acquired between now and the close of trading on Thursday 7 October should satisfy the 45-day rule for franking entitlements, and we have received advice from the ATO that shares bought on the ASX on or after Monday 11 October, the ex-date, will be excluded from the Last In First Out rule for the purposes of the 45-day rule. I'll come back to talk more about these rules in a later slide.

SLIDE 8 – Tender range

Slide 8, shows the specific discount points at which shareholders will be able to tender their shares. As an illustration only, we have shown the prices representing each discount point, based on the 5 day volume weighted average price up to 4 October which was A$14.35. The absolute price that each discount point represents will be dependent on the volume weighted average price of BHP Billiton Limited over the last 5 days of the tender period.

The Final Price Tender mechanism is designed to simplify the choice, particularly for our retail shareholders. Shareholders electing to tender in this way will automatically be accepted at the final Buy-Back Price.

To protect shareholders who may wish to tender their shares before the final week of the tender period, there will be an option for shareholders to make their tenders subject to a specified Minimum Price. We will also ensure that the market price of BHP Billiton Limited shares is easily available to shareholders over the tender period through our web site, and a dedicated shareholder buy-back enquiry line.

SLIDE 9 – Buy-back price

We realise that this discount tender mechanism is slightly different to previous buy-backs in the Australian market, so I will give you a bit more detail around the process on slide 9.

The final Buy-Back Price will be calculated on the largest discount in the tender range that enables BHP Billiton to purchase its targeted amount of capital. We believe that our structure will be transparent, easy to understand and will also allow us to present a more realistic range of tender points whilst reducing completion risk for the company.

As I've already mentioned, for Australian tax purposes the final Buy-Back Price will comprise a A$2.10 cash capital component, with the remainder being deemed a fully franked dividend.

We will announce the final Buy-Back Price and details of the number of shares bought back no later than Tuesday, 23 November.

SLIDE 10 – Buy-back rules

Turning now to the key tender rules on slide 10.

Shares acquired on the ASX before Monday 11 October, the buy-back ex-date, will confer an entitlement to participate in the buy-back.

For a number of reasons, the invitation, when made, will not be open to US and Canadian shareholders or ADR holders.

All shareholders that are successful in tendering will receive the final Buy-Back Price. Shares tendered at a price at or below the final Buy-Back Price or as a Final Price Tender will be purchased, subject to any scale back if demand exceeds the final amount we choose to re-purchase.

Any shares that may be tendered at a smaller discount, that is a higher price, than the final Buy-Back Price, will not be bought back. Shares tendered with a minimum price condition that is above the final buyback price will not be bought back.

To ensure that retail shareholders will not be disadvantaged, we will be giving priority allocation to a maximum of 200 shares per shareholder in the event a scale back is required. That is, the first 200 shares successfully tendered by each shareholder will be accepted. Furthermore, the rules will ensure that participants who successfully tender their entire holding will not be left holding 200 shares or less. In practice these two rules combined will mean that a shareholder owning 400 shares or less will be able, if they successfully tender their entire holding, to sell that entire holding through this process.

SLIDE 11 – Australian tax implications

Slide 11 summarises the Australian tax implications.
I have already mentioned the capital / dividend split, so won't go through it again.

In terms of capital gains tax, the capital proceeds will be the A$2.10 capital component plus an amount equal to the excess of the Tax Value of the shares over the buy-back price. The Tax Value will be calculated pursuant to the Australian Taxation Office guidelines, which effectively provide that the Tax Value will be A$14.35 adjusted by the movement in the S&P/ASX 200 index from this morning to the close of the buy back.

The ability of shareholders to claim the benefit of franking credits is subject to certain rules under Australian tax law. The 45-day rule, which applies to most taxpayers, requires a taxpayer to hold the shares at risk for a minimum of 45 days, not counting the day of acquisition and disposal. There will be at least 47 days between today's announcement and the finalisation of the Buy-Back Price and buy-back allocations.

In addition, as mentioned earlier, we have received confirmation from the ATO that shares bought on or after Monday 11 October will be excluded from the Last In First Out rule for the purposes of the 45-day rule. This means that shareholders will be able to participate in the buy-back with shares held prior to 8 October and buy shares in BHP Billiton after 11 October, without jeopardising their ability to claim franking credits under the 45-day rule.

SLIDE 12 – Worked Australian tax examples – Australian Residents.

On Slide 12 we have detailed a number of worked examples, which cover a range of Australian tax positions. These are to illustrate the effects of participating in the buy-back on a series of theoretical shareholders with different marginal tax rates. I do not propose to go through these in detail but would point out that shareholders should seek their own financial advice in relation to participating in the buy-back. Please note that the table is an example only and is based on a number of assumptions, set out in the Appendix (Slide 16). I'd also stress again that this just shows the tax situation for an Australian resident shareholder. Non-residents of Australia, will generally be subject to tax in their own jurisdiction on the proceeds from the buy-back, in the same way as if they sold on-market.

SLIDE 13 – Key dates for off-market buy-back

Finally on the off-market buy-back on slide 13, there are a number of key dates in relation to the tender process which eligible shareholders should be aware of.

Again, I don't propose to go through these in detail - they are on the slide and will be set out in the buy-back booklet to eligible shareholders. I think that I've mentioned most of them in any event on the way through this presentation.

We expect to begin mailing out the booklet, containing more details and tender forms, to eligible shareholders on Wednesday 20th October.

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 23rd November, with proceeds being dispatched to successful shareholders no later than Tuesday 30th November.

SLIDE 14 – Capital management programme – Phase 2

Turning finally to slide 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'll 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'd like you to take away from this.

SLIDE 15

And with that, I'd be happy to take your questions. Operator, could we have the first question, please.

Question: Thanks very much. Chris, could you let us know what sort of acceptance rate you believe you will get from your institutional investors in Australia? This appears very attractive for retail investors, but what will happen for example if you don't reach the A$1 billion lower level?

Chris Lynch: The simple answer is that we do reserve the right to vary the amount that we accept on both the bottom and the top end of the range. We're confident that we have the discount structure in place that would enable us to have a successful transaction here, so we don't see any sort of problem with that range. But we do have the right to vary on either end of the range.

Question: On the upper end of the range Chris, I understand your franking credits at the end of June 2004 were US$648 million on a tax paid basis. So that sort of limits your upper end given the franking credits that you need to be 100% franked on this dividend component?

Chris Lynch: No. I don't see any limitation on the end of the range that we're talking about, and we also anticipate being able to pay fully franked dividends going into the future, based on the progressive dividend and so on.

Question: Good morning Chris. A very nice pace this morning. On the ATO, what exactly did the ATO rule on? Was it just the capital? This particular amount of $2.10? So, if you wanted to do anything for the balance of the issue, would you have to then go back?

Chris Lynch: The $2.10 is based on a conversation. It's largely based off the construction of our balance sheet and that's the conversation we've had with the Tax Office. So I think we're pretty right on the $2.10.

Question: Did I hear you right? The very last comment you made about the balance, the money you'd like to return, that it could form part of a dividend? Did you say that or is that part of your progressive dividend?

Chris Lynch: What we've said so far is that it could include enhanced dividends, and that could take various forms so I can't really be prescriptive about that this morning. What we want to do is get this transaction executed and completed, and then we'll be talking again with the board about the specifics of the transactions for the remainder. But what the board have included in the conversation is consideration of further buy backs and/or enhanced dividends.

Question: Do you have the franking available to go that extra step of that US$0.9 to US$1.3 billion and not compromise your future dividends?

Chris Lynch: Yes.

Question: So you could frank up to another $1.3 billion and then not affect your future dividend flow?

Chris Lynch: We don't see any impediment to paying future fully franked dividends.

Question: Two questions. Firstly, if you are over-subscribed for instance, can you give us an indication of what sort of mechanism you'd use to be determining where in that $1 to $1.5 billion range you'd sit? And the second question is on a similar note. If you are over-subscribed and have to scale back, is the scale back evenly applied across the tenderers, or do you accept fully the lower price bids and then scale back at your, your bids at the purchase price?

Chris Lynch: The key in terms of the size, is between volume and discount and that's something that we will consider once we see the range of tenders and where the volumes are at the various discount points. In the event that we're over-subscribed from a scale back point of view, the key there is that we are protecting the smaller shareholders on the scale back aspects where we would take up to a maximum of 200 shares from any tenderer who is at the successful price, and we won't leave anybody with less than 200 shares if they tendered their entire shareholding. So if people wanted to sell let's say 350 shares into the buy back at the discount level, they would be able to actually do that. Whereas if we were in the scale back mode, others would be scaled back in proportion to the amount available.

Question: A couple of questions. You say you'll buy it at a minimum of 5% to the market price on the last five days of the tender, but you also say that you reserve the right to vary the amount depending on the market price. Could you just give us a bit more colour around that? I mean what happens if the share price moves up under the 10% from here for those last five days or what would happen if it moved down 10%?

Chris Lynch: I think that it's difficult to answer that, when we're sitting here today but I that there would need to be a fairly significant move to say that we wouldn't execute. You should take it that we have every full intention of execution and so on so I think that's the case there. And I think the 5% is actually a minimum discount that we will accept, so if for some unforeseen circumstance that wasn't available, then we wouldn't accept.

Question: Also, in terms of your NPV, are you comfortable buying back above what you consider to be your NPV or can we assume that your NPV is higher?

Chris Lynch: We don't publicly comment about our NPV. Our view of NPV obviously is an important metric for us and for everybody in the market place. This is clearly EPS accretive and so on. But our priority really here is to choose the most efficient way to do the return of capital and the capacity to be able to buy back at a discount makes it a compelling case. And we'd note, probably just as an aside, quite a few of the analysts are now increasing their view of NPV's. That's the case and I think that most of them have got a targeted price well above the current price notwithstanding the last couple of days. But we don't comment publicly on where we see our NPV but we believe this is a significant value enhancement for all our shareholders.

Question: I was just wondering if you could explain more why you've chosen this option and not say a special dividend which might appear a bit more simpler?

Chris Lynch: I think that the key difference here really is looking at value rather than simplicity. You know we're a value-driven organisation but we also have a very broad spread of shareholding in the DLC. We're value-driven for all of our shareholders. We have approximately 330,000 shareholders. Approximately 60% of our shareholding is held outside of Australia. I know special dividends are well received in Australia when, they're fully franked, and obviously in our case they would be fully franked. But that's not true in every jurisdiction and what we've decided on here is something that does deliver value to every shareholder across the Group, be that in South Africa or be that in the US or the UK or in Asia etc. This transaction will deliver value to every shareholder not just those who would prefer to see a special dividend.

Question: When you talk about the balance under phase two, are we talking about a set amount now of the total pay-out of US$2 billion or are you still saying it's going to be up to US$2 billion?

Chris Lynch: The intent is $2 billion and the difference would be just depend on the size that we achieve via this process. So it's really the remainder of the two. I think that it would be a safe assumption to frame your thinking around $2 billion in total and this will be the first part of it.

Question: Just looking at it from a PLC point of view. Do you have the same advantages or locations to get a discount price if you were to look at doing a PLC buy back down the track or is this Australian only? So that if you were to look at another buy back it would probably be another Limited deal? Or are you prepared to go in and do an off market buy back of PLC at an above market price?

Chris Lynch: We're driven by value so the concept of an off market buy back in PLC, or generally in the UK market, would be at a premium. We have no appetite for that. We are authorised to buy on market there should we choose to do that. And just with regard to this offer, this process is really more around seeing how much we raise via this mechanism, how much is subscribed and take it from there. But I think an off market elsewhere would probably need to be at a premium and that would therefore be unattractive to us on a value equation.

Question: How much of the share register is based in Australia now?

Chris Lynch: Of the DLC about 30% are resident in Australia.

Question: So if this proceeds as planned then that will fall to roughly 37%?

Chris Lynch: No it's not that way. The DLC structure is Limited and PLC. BHP Billiton Limited, the Australian entity currently represents, I think it's 60.4% of the DLC. And then the PLC company, the UK registrant, is 39.6%. The change would be the Limited proportion of the DLC, and would drop from 60.4 to I think it's about 59.6.

Question: This is actually related to that last comment. At the time of the merger there was talk of a lot of things, but there was talk about potentially one day equalisation between here and the UK. How far are you prepared to let that 59.6 fall?

Chris Lynch: I think that's a very academic question for this sort of purpose. A transaction of this size, you can see that it's a relatively small effect on that ratio. But the key really is that we're running the DLC on behalf of all shareholders and that's really the driver. So whether it's 59.6% or 60.4% or 61.39% and so on, that's sort of largely irrelevant. But and as you're aware there are a series of sort of other issues in the background of the DLC structure notwithstanding things like third party approvals and the like. So I think it's largely irrelevant for this conversation.

Question: What proportion of the Limited register is resident in Australia? Is that much different from the 40% you talked about for the DLC?

Chris Lynch: The total shareholding of the Limited register resident in Australia is 65%.

Question: Just to confirm, you mentioned in your presentation the deal is accretive and I think you qualified it by saying it was EPS, cash flow and returns accretive, but you won't qualify NPV?

Chris Lynch: We don't publicly discuss our NPV. Our view of NPV, we believe it's value accretive in all those ways. We believe it's value-adding to all our shareholders and we don't comment on our NPV.

Question: I just wanted to clarify, you're currently saying that you'd rather not pay special dividends because it may not benefit shareholders in all jurisdictions. But after this share buy back you're still considering enhanced dividends. Can you reconcile these two elements?

Chris Lynch: Yes, I think the key really is around doing the most value-adding transaction for all of our shareholders. That's the rationale there. If we, when we sit down to decide with the Board the construction of the remainder, that will include a conversation about enhanced dividends as well as further buy backs be that on or off market. So I think that conversation is yet to be had but what we're doing first is the most value-adding equation for our shareholders.