

# BHP Billiton

BHP

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Special



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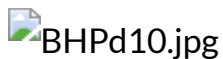
BHP Snapshot



## Solid December quarter production results

BHP Billiton (BHP) is the largest diversified resources company in the world, with around 37,000 employees working in more than 100 operations in 25 different countries. BHP produces a range of natural resources and is the world's number 1 or 2 producer of commodities such as aluminium, energy coal and metallurgical coal, copper, manganese, iron ore, uranium, nickel, silver and titanium minerals. BHP also has substantial interests in oil, gas, liquefied natural gas and diamonds.

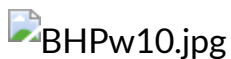
The company maintains a widely diversified portfolio of world-class assets, where the objective is to provide consistent cash flow and stability in revenues throughout typical resource cycles. During the 2005 financial year, BHP generated turnover of US\$31.8 billion, earnings before interest and tax (EBIT) of US\$9.3 billion, attributable profit of US\$6.5 billion and available cash flow after interest and tax of US\$8.7 billion.



In our opinion, the resource sector will enjoy above average returns over the next five years, with many commodities now in what we believe to be a super cycle. With China and India the key members amongst a host of industrializing nations, the world is facing a massive shortage in raw materials for years to come.

The industrialisation of China has played an important role in underwriting the demand for commodities over a number of decades. Growth in China has been instrumental in causing commodity growth to increase from around 2.5% during the 1980s to close to 5% in the last five years. Growth in China is anticipated to be sustained annually at more than 8% per annum.

With respect to the underlying valuation of BHP, we believe the stock offers compelling value at current levels, trading on an average forecast price earnings multiple of around 11.5 times, which is a considerable discount to the market. This price/earnings multiple is close to a historic low for BHP, despite the strong commodity price outlook. We believe these forecasts face considerable upside risk, with spot prices of many commodities significantly higher than those used in the average estimate. We are of the view that BHP is fundamentally cheap at current levels and justifies a price/earnings ratio of around 15 times, based on the strong commodity price upside.



Over the next 12 months we believe BHP will benefit from ongoing upward revisions in long term commodity prices by brokerage firms. In the past year alone, the average broker has revised the underlying value estimate (or net present value) of BHP upwards by around 30%. We believe this trend is set to continue with key commodities such as copper, iron ore, and energy remaining stubbornly high.

In our opinion, BHP has sound growth prospects through a diversified portfolio of projects that will drive earnings growth over the next decade. Unlike other large diversified resource companies, BHP is unrivalled in the size and scope of its portfolio, which effectively frees the need to grow through making new acquisitions. One of the rare exceptions was the acquisition of WMC Resources, which consolidated BHP's position in copper whilst expanding its exposure to uranium at a time of record historic prices for both commodities. Typically though, we anticipate BHP's growth over the next decade being provided by organic growth opportunities.

BHP's portfolio is highly leveraged to the commodity cycle, with large exposures to the energy sector, steel, base metals and industrial minerals. In base metals, BHP has in particular large exposures to copper, nickel, manganese, as well as coking coal. ^

In the past year copper prices (like other commodities) have continued to rise, defying even the most optimistic forecasts. If copper prices and other commodities continue to remain buoyant, then we anticipate earnings estimates to be sharply upgraded for BHP, which would in our opinion, lead to a sharp re-rating.

Copper is one of BHP's biggest commodity earners and during the December 2005 quarter production reached record levels.

 Copperd10.jpg

Our copper chart analysis shows the major upward trend that was launched from the 2001 to 2003 base has been reinvigorated over the past eight months. The positive investor sentiment has recently seen prices surge to a record high of 4630 on the London Metals Exchange (LME). While the copper market appears to be defying gravity, there are no immediate signs of a pause in the upward trend. Given the strong momentum underpinning the copper price, we believe further gains are likely in the near term.


Energy accounted for around one fifth of BHP's earnings for the year to June 2005.

Petroleum is not only one of the highest returning divisions for the company (around 40% return on net assets in the last financial year), but has excellent growth prospects. While the Petroleum division's earnings declined in the 2005 financial year, production is forecast to grow by around 50 percent over the next five years. This growth will be driven by a number of projects including Mad Dog, Atlantis South and Neptune in the Gulf of Mexico and in the North West Shelf. Longer term, opportunities for BHP exist in liquefied natural gas where a number of countries such as the United States will face energy shortages in the future.

As with other commodities, most earnings forecasts for BHP incorporate a predicted oil price which is significantly below the current spot price. We have long been bullish in our outlook for oil, and we believe BHP Petroleum has considerable upside risk as oil price estimates continue to be revised upwards.

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Last August, the price of oil hit an all-time high of US\$71 a barrel before embarking on a three month correction. However the respite from higher prices only proved temporary, and over the past month upward momentum has once again been restored. The latest gains have seen most of the lost ground recouped, with prices currently trading marginally below last year's record high.

 OILd263.jpg

The most significant development on the charts has been the bullish break from a short term downward trend channel. The channel formed during the recent correction and the breakout indicates the presents of solid buying interest. While prices have already trebled since 2002, we believe that levels beyond US\$85 are achievable in the future. Primary bull markets have a history of surprising investors with their sheer size, and we believe the current trend in oil will prove no different.

In terms of relative returns, BHP has significantly underperformed other large cap diversified resource companies such as Rio Tinto over the last year. We believe that in time this underperformance gap will close, especially considering that BHP has superior growth prospects with a robust project pipeline. In addition BHP could benefit considerably over the short to medium term if commodity prices continue to remain high and analysts begin to upgrade forecast earnings.

We believe that BHP will report a solid profit result for the first half of the financial year towards the middle of next month. Comments from BHP over the past six months suggest that cash flow has been strong and ahead of expectations, which could result in higher than expected dividends to shareholders.

Additionally, with the WMC Resources acquisition almost fully digested and gearing levels now falling, we anticipate the company to deploy significant capital management initiatives towards the end of the year. This would most likely involve higher dividend payments to shareholders along with sizable share buy backs.

We believe, BHP offers compelling value at current prices. In addition to an attractive valuation, the company has a solid pipeline of projects that should underpin growth in future years, and a high probability of earnings upgrades eventuating because of persistently high commodity prices. **Accordingly, we recommend BHP for the first time to all Members as buy around \$25.**

### **December 2005 quarter production report**

BHP announced a solid December quarter operating report this week, with the only negatives being anticipated one-off disruptions in petroleum and coal. Our decision to initiate coverage of BHP for the first time was largely confirmed and influenced by its strong production performance.

There was plenty of good news, with record production levels for copper and nickel. Copper production was 6% above the previous quarter on the back of record production from Escondida in Chile, Antamina in Peru and Olympic Dam in Australia. Record production from the company's Western Australian nickel assets helped boost nickel output. Other production records were achieved in aluminium and silver.

As predicted, petroleum division production was impacted by the recent hurricanes in the Gulf of Mexico, as well as natural field decline in Bass Strait and Liverpool Bay in the UK. Overall production was 11% below that during the September quarter, but with prices edging back towards US\$70 a barrel we anticipate a strong performance during the March quarter.

Coking coal shipments were steady compared to the previous quarter and in line with expectations, with production affected by maintenance issues. Thermal coal production was 11% below the previous quarter, but was impacted by one-off seasonal demand issues.

The company's growth path seems assured, with a total of 14 projects in the pipeline for commissioning between 2007 and 2008. In its quarterly report BHP commented that all of these are on schedule in terms of commissioning, with the exception of the Atlantis oil development in the US, which has been affected by delays due to hurricanes.

Five of these new projects are petroleum projects, comprising the Atlantis and Neptune offshore fields in the Gulf of Mexico, and three developments offshore Australia, including the expansion of the North West Shelf Gas project. Nine projects are 'hard rock' developments, comprising iron ore, copper, aluminium and nickel.

Happily, the report also showed that the bedding down of the WMC Resources has been seamless, with strong increases in copper and nickel production levels as a result of the acquisition.

## **Background information**

BHP Billiton was created nearly five years ago through a merger between BHP Limited and Billiton Plc. The merger involved a Dual Listed Company, whereby two different BHP Billiton company structures are maintained in London and Melbourne, with the group headquarters domiciled in Australia. Both companies have identical boards of directors and are run by a unified management team. Shareholders in each company have equivalent economic and voting rights in the BHP Billiton Group as a whole.

The company is organised into a number of business divisions which are aluminium, base metals, carbon steel materials, energy coal, stainless steel materials, petroleum, diamonds and specialty products.

In aluminium, BHP Billiton is the world's fifth largest producer of primary aluminium, with a total operating capacity in excess of one million tonnes of aluminium, approximately 9.5 million tonnes of bauxite and four million tonnes of alumina per annum. The company is also the world's largest non-integrated producer of primary aluminium. The price of aluminium is currently at a 17 year high and we expect further gains during 2006.

In base metals, the company is one of the world's top producers of copper, silver, lead and uranium, and a leading producer of zinc. The business division provides base metal concentrates to custom smelters and copper cathodes to rod and brass mills and casting plants along with uranium oxide to power utilities.

BHP Billiton has excellent growth opportunities in base metals, with a robust portfolio of world-class, low-cost mining operations such as the Escondida mine in Chile. Escondida is the world's largest source of copper. The company also has a range of growth projects – both greenfield (new sites) and brownfield (developments on existing sites). These projects should ensure the company has the capacity to expand copper production significantly in the years ahead.

BHP Billiton produces major quantities of silver and significant amounts of gold within the base metals concentrates as well as gold and silver bullion at the Olympic Dam operation in South Australia. BHP inherited Olympic Dam following the successful takeover of WMC in 2005. Located 560 kilometres north of Adelaide, the Olympic Dam ore body contains a number of minerals and is the world's fourth-largest remaining copper deposit and the largest uranium deposit. Olympic Dam also contains significant quantities of gold and silver. Olympic Dam is Australia's largest underground mine.

In Northern Queensland, the Cannington mine is one of the largest and lowest cost producers of silver in the world. Cannington is an underground mine using both open-stope and bench mining methods with metallurgical processing incorporating grinding, sequential flotation and leaching to produce high-grade marketable products. Cannington is a robust profit-earner for BHP at a time of escalating silver prices.

BHP Billiton is one of the world's largest producers and marketers of export thermal coal. The company provides steaming coal for use in the electric power generation industry and general industrial concerns such as cement production.

BHP Billiton is a leading supplier of core raw materials and services to the international steel industry producing and marketing a full range of steel-making raw materials – iron ore, coking coal and manganese ore and alloys. Globally, BHP Billiton is ranked number one in the seaborne supply of coking coal and manganese and number three in iron ore. Iron ore price negotiations are underway with Japanese and Chinese steelmakers and we anticipate a price rise of around 10%, reflecting strong world steel production, following on from last year's substantial 71.5 percent price hike.



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