

### BHP Billiton: FY14 results

BHP Billiton released results on Tuesday (19 August), reporting a significant improvement in productivity underpinned by a strong financial performance as underlying attributable profit increased 10% YoY to \$13.4bn.

#### Summary:

Productivity-led volume and cost efficiencies came in at \$2.9bn, exceeding the group's target by 61% or \$1.1bn. In its results release the company said it has now delivered more than \$6.6bn of sustainable productivity-led gains over the past two years and by further improving productivity and reducing capital and exploration expenditure (by 32%) to \$15.2bn it has delivered a substantial \$8.1bn increase in free cash flow despite the weaker commodity prices. As a result, the balance sheet continued to strengthen and BHP Billiton finished the period with net debt of \$25.8bn.

The group also announced plans to create an independent global metals and mining company via a demerger and, with a simpler portfolio, it was targeting at least another \$3.5bn of productivity-related gains by the end of FY17. Capital and exploration expenditure is expected to decline to c. \$14.8bn in FY15 and to be no more than \$14bn should the proposed demerger be implemented. The company said it believed an average rate of return of greater than 20% is achievable.

Looking ahead, BHP Billiton increased its full-year progressive base dividend by 4% to US\$121/share for an underlying payout ratio of 48%. The company added that it will seek to steadily increase or at least maintain the dividend per share in US dollar terms at each half-yearly payment following the demerger, thereby implying a higher payout ratio.

#### Highlights for the year include:

- Underlying earnings of \$13.4bn which is 1.4% below market expectations of \$13.58bn and 7.5% above the \$12.5bn achieved in FY13.
- HEPS of \$2.52 which was slightly below estimates of \$2.54 and 7.7% higher than the \$2.34 for last year. It was clearly a story of two halves with 1H14 coming in

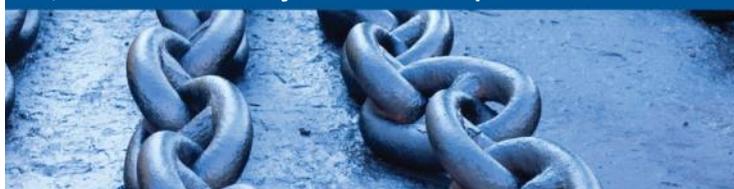
30.6% higher than the comparable period for 2013 and 2H14 being 9.3% lower than the same period last year. This highlights the sharp decline in commodity (specifically iron ore) prices in the second half of FY14.

- DPS increased by 4% to \$1.21/share. At the current share price this yields 3.7%.
- The figure on the next page gives an informative breakdown of underlying EBIT from FY13 to FY14. It is clear that lower commodity prices had a large negative impact. If prices were flat for the year, FY14 EBIT would've been up by 15% (\$3.4bn).



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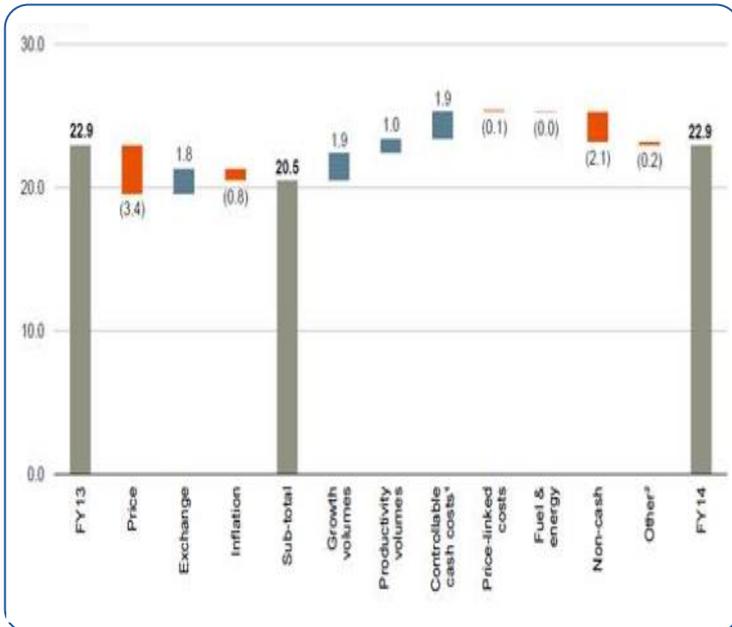


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**BHP Billiton underlying EBIT variance, FY13-FY14:**

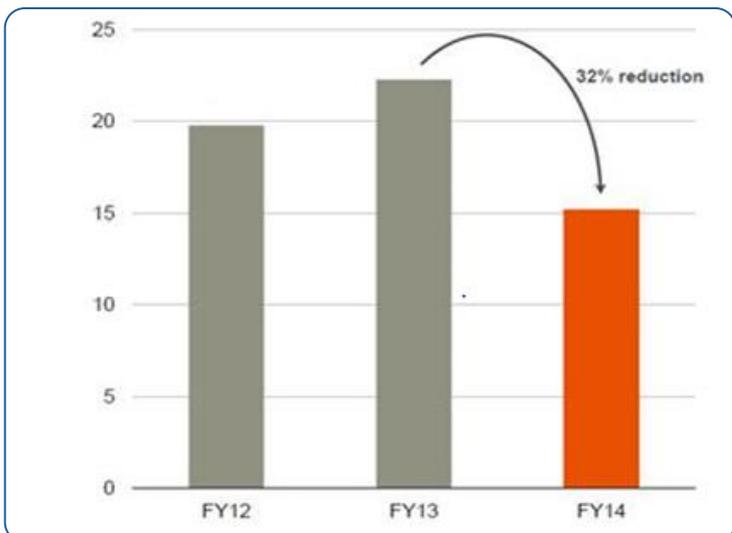


Source: Company data

1. Controllable cash costs comprises operating cash costs and exploration and business development expense.
2. Other includes ceased and sold operations, asset sales and other items

We want to specifically highlight the reduction of capex by 32% as a large positive which shows how serious the company is about streamlining and focussing on its core assets:

**Increasing competition for capital, capital and exploration expenditure (\$bn):**

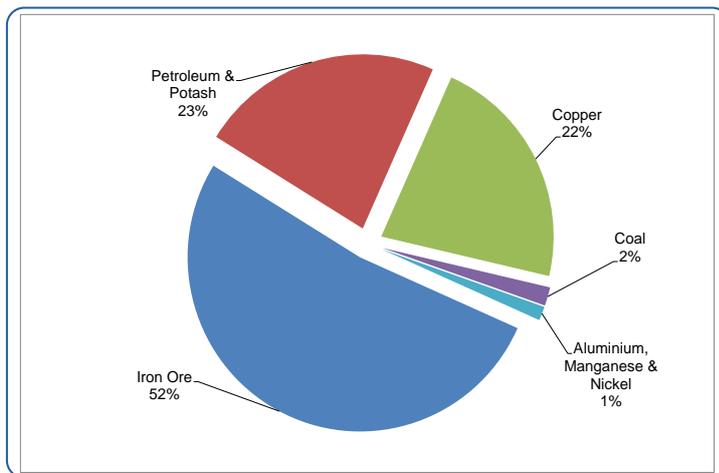


Source: Company data

When taking a look at the segmental breakdown, its Iron Ore segment continued to contribute the most towards EBIT with 52%, followed by Petroleum & Potash and Cop-

per with 23% and 22%, respectively.

**Underlying EBIT split:**



Source: Company data, Anchor Capital

**Production guidance for FY15:**

- Iron ore of 225Mt (11% higher).
- Copper of 1.8Mt (5% higher).
- Petroleum of 255 MMboe (5% higher).
- Met coal of 47Mt (4% higher).

The results were slightly below expectations, but we believe that expectations were slightly high and did not fully take into account the lower iron ore price for the second half of the financial year. Operationally the company produced very strong results, which is expected to increase in the coming year. The share currently trades at a forward 12.8x multiple and yields a 3.8% dividend and we continue to view it as the best run and "safest" business in an extremely volatile sector with exceptional long-term assets.

**Asset spin-off:**

- BHP said it would be splitting off its aluminium, coal, manganese, nickel and silver assets into a separate business that will be listed in Australia with a secondary listing in South Africa. The proposal still needs to go through a shareholder vote and be approved by regulators.
- Assets included in the spin-off are:
  - BHP's entire Aluminium and Manganese businesses (South America, Southern Africa, Australia).
  - Cerro Matoso Nickel (Columbia – South America).
  - Energy Coal SA (South Africa).
  - Illawarra Metallurgical Coal (Australia).
  - Cannington Silver-Lead-Zinc (Australia).
- Current BHP Billiton shareholders will be entitled to 100% of the shares in the new company through a pro-rata in-specie distribution.
- Summarised financial information as at 30 June 2014 and for the year ended 30 June 2014 of the businesses included in the proposed demerger:

## News: Anchor focus list

shareholders as there are still many details yet to be finalised. The share might be volatile in the short run as the terms and specifics of the spin-off get finalised, but we are confident that patient shareholders will be rewarded in the medium to long term.

**FJ Veldman**

	Year ended 30 June 2014 (\$mn)
Current assets	2860
Non-current assets	14619
Current liabilities	1897
Non-current liabilities	3950
Net assets	11632
Attributable to non-controlling interests	867
Attributable to members of BHP Billiton Group	10765
Revenue	10444
Depreciation and amortisation	1303
Profit before interest and taxation	764
Net operating cash inflows	1658
Net investing cash outflows	700

Source: Company data

### Comments on the spin-off:

Shares of BHP traded 5.5% and 4.6% lower on the JSE and in London, respectively, yesterday (19 February) following the announcement and the biggest reason for this, in our view, is disappointment about the lack of cash being returned to shareholders. The market expected the company to use \$3bn-\$5bn to buy back its own shares, or at least to do a share buyback as means of compensation for the spin-off. The problem with this is that the size of the buy-back would've effectively put a value on the new company rather than letting the market determine a price.

Another negative for the spin-off proposal is the fact that some London-based fund managers may have mandates preventing them from owning overseas shares which will instantly create an overhang on the new company's share price. The new company will be generating enough cash to cover its costs and have little debt, but there was no commitment that the company would pay a dividend, only that it would have the flexibility to do so if its cash flow was strong enough. Graham Kerr, BHP's current CFO will head the new company.

The spin-off will mean that BHP Billiton will be solely focused on its Iron Ore, Copper, Coal, Petroleum and Potash operations. It would also give the company flexibility to pay out higher dividends to shareholders who had grown frustrated at its past record of piling on investment without the returns to justify it. Jac Nasser, BHP chairman, said: "We will return excess cash to shareholders in the most efficient way. By ensuring that we start from a position of strength, we will be well placed to implement an enduring programme that can be managed in a more consistent and predictable manner."

At the moment we believe it is too early to say if the proposed spin-off structure is positive or negative for SA



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