

[Slide 1]

Ladies and Gentlemen,

BHP Billiton has been in China since the 1800's. If you go to our office in Shanghai, you will see our very first invoice for sales to China - for 20 tons of lead. But it's really fairly recently, I think about 3 years ago, that we started running into what I call the “pond lily” problem. The pond lily problem is conventionally described by people in the high tech industries - that if you have very large market share and there is some disruptive technology you do not notice it until it's too late. Particularly when it has a very high growth rate. So about three years ago we started looking at China with a different set of eyes and said up to now we really treated it as a sink; how can we understand more of what is going to happen as we move forward and so of course I have to disagree with you Peter [Hickson, UBS], I am too scared that you guys are going to fund all of these new projects and so destroy the markets for us.

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My main conclusions are that we expect China to be a large sustainable consumer of imported raw materials. We expect by and large to meet demand. But I wanted to leave you at the end of my talk with a few thoughts about global balances, balance of power shift and so on. So really my talk will go into these three points where I first try to prove what China's demand situation is; what the supply situation looks like and then a couple of comments. Another element that I should just note is that I have purposely not put any aluminium slides into the pack today [as Alcan were speaking immediately prior to BHP Billiton]. But I have attempted to look at a number of industries because at the end of the day, while we think of the minerals industry as a single industry, really it is a number of related industries that will all behave differently under these conditions. So let's take a look at the demand situation in China. Let me run through the points that I am going to try and make for you.

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For most of the commodities that my company is involved with, China is a large consumer but it is short of resource. So we shall take a look at one or two slides. The “pond lily problem” is very real. The percentage of China’s consumption as a percentage of world consumption doubles every decade. I will go through a number of things of how we look at urbanisation and infrastructure in order to try and project in the long term what demand will look like and make some conclusions that the demand patterns that we are going to see in China are largely that of a maritime economy and not of an export economy. This growth has been going on for 25 years so it is not a short term phenomenon its just that it was too small for us to see in the beginning.

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So lets take a look at those slides, and I have taken some artistic liberty here with the iron ore [seaborne market only]. Really what we have got here, is that we have got China’s demand, we have got supply in the green bar and then we have got what it imports and for iron ore because we are in the seaborne iron ore business I have taken liberty with the domestic/Chinese iron ore industry. What you can see is that for Iron Ore, Copper, Alumna, Nickel, and increasingly energy, China is a large consumer but it is going to be a large importer as we go forward.

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If we look at for those same commodities, and we look at Chinese consumption as a percentage of World consumption we see that we are standing at about 15% of world total at the moment and if the current trends continue, which we believe will continue, we will see China go to 30% of global consumption over the next seven years.

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Now everyone has these graphs on urbanisation, I am going to try to draw a couple of different conclusions today. What we have got here is just the urbanisation percentage, virtually the same as your slide showed, Peter [Hickson]. We have got a number of countries around the world and we have China at about 30% [urbanisation] and about \$5,000 of purchasing power parity GDP. What you see is that if we project forward you get some slight population growth (nowhere near as extreme as in India) but what you see is that the rural population as a percentage of the total population is set to decline quite rapidly and our best projections show that about 17 million people per annum will migrate from rural areas to cities. To put this in perspective, I live in a small town – Melbourne! In Shanghai they build the same total amount of office space annually that the entire Melbourne office stock consists of. So it really is, the point that I would like to make quite strongly, is that urbanisation is the key driver for the consumption of many of our products.

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If we now go forward and look at the GDP development of the urban groups (and I have just lumped them into three groups here) you see that the urban GDP dwarfs the rural GDP and once again that tells you that what we have got to focus on when we look at raw materials demand is that we must look at urbanisation trends, the number of people urbanising and what they do with their new assets.

Let me step back a little bit and explain to you what we have done, in order to come to the conclusion that I am going to show on the next slide.

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For all of our products, we have taken a complete sectoral analysis, starting with the base line drivers of activity, things such as urbanisation growth rates, square metres of housing as the affluence curve climbs up and what you get if you put all of that together, and especially our copper guys were very worried about this and hence I will show one of their slides in a minute. Is it really that 70% of steel is used in construction or is it the propensity of the urbanising Chinese man or woman to want a larger house that drives the majority of the demand growth in our products? Capital goods are obviously an important chunk and roads another.

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Now the interesting one is the one that I show next, which is copper. Our copper guys were very worried that the copper consumption in China was displacement - that China was turning out widgets of many kinds and that growth was just being taken out of the traditional western economies. As you can see here that is not the case. Copper is written into the building code in China and the vast majority is going into permanent structures. Only 10% of the copper is re-exported as hair dryers, micro-waves, electric motors and so on. The vast majority is driven by that urbanisation trend.

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Lets now make some conclusions. Once again my apologies for using the same set of data that everybody has used today but I am going to draw a different conclusion. We have effectively got two sets of growing economies if we look back over time. We have got what I call the “export economies”, such as Taiwan and Korea where really the consumption growth was driven by re-export of copper units, aluminium units etc etc. We have then got the “maritime economies”, the USA etc, and there you see the metal intensity is at a lower rate. I am going to disappoint you and not draw a conclusion about what China’s consumption rate will be going forward, I just want to make the point that we believe China’s resource intensity is likely to be more “maritime” in nature, and our consumption intensity curves are probably lower than those which some other people have assumed. Nevertheless, given the size of the growth and the magnitude of the urbanisation it is still absolutely enormous.

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Lastly I have said already, this has really gone on for the better part of 25 years. There have been 1 or 2 years that the growth rate has been below 5% but generally it really is that we have just not noticed how strongly China has been growing.

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So now having given you some indications about demand and where the product is going to go. I want to make a couple of points when it comes to supply. Once again, for emphasis, the products that we sell will behave differently, they have different endowments, they come from a different processing route, there are different technological developments. Prices are very powerful inducers of capacity – but not only powerful inducers of capacity, prices also influence the speed to market of that capacity. If you are more sure that you are going to make a whopping return you are going to cut your front end loading a little bit and so on and so forth. By and large, my view is that the gap between supply and demand can and will be filled and I will look at a couple of examples.

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For comparison if we look back over the last 75 years (and we have got here aluminium prices and copper prices) we saw that the 70’s had a very high copper price but pretty flat aluminium prices. The correlation between the two has been increasing since the markets have become more traded and technologies have become more stable but there has been, by and large, not a good correlation between price developments and one commodity versus another.

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If I refer to latent copper capacity, there is (and the last bit is obviously quite high cost) at \$1.25/lb copper some 8 million tonnes of capacity available to be developed. You can bet that if somebody's view is that's where prices are going, then this capacity here in the middle is going to come on a lot quicker than would have been the case otherwise.

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I am not going to go too much over the next slide, but for our high demand case we look at the probable and possible copper projects and we feel that if they are actually triggered we can meet demand reasonably comfortably.

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Similarly on iron ore, a very interesting example because the big three players have an absolutely enormous amount of latent capacity available. While it takes 2-3 years or perhaps 4 years in some cases to bring on that capacity the players in that industry have communicated very well that they will supply the market. What we will see there in all likelihood is that the market share of the big three players will actually increase as a percentage of the total simply because they are capable of meeting the market demand.

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So that's my thesis. I want to leave you with one last slide. It is taken from Goldman Sachs "Dreaming with Brics" report and is just GDP versus time. Typically, we make a linear extrapolation effectively when we think about GDP growth; not completely, we tweak a couple of factors, but what we don't do is we make any assumptions about a secular change in power base and how different world economies will react to that.

I guess that the question that needs to be asked is – is that a valid assumption or can we find that as certain players grow, as the traditional balances get rearranged, are we not likely to see other changes as a result? I think that we have seen clearly over the last couple of months in the industry the immense stress that the tight supply has created. We have seen the balance of power shift and my question is should we assume that the secular growth rate of China can continue in the longer term? The scenario painted here, and it is just one scenario, shows China's GDP exceeding that of Japan in around 10-12 years times and catching up and overtaking the US by 2040...