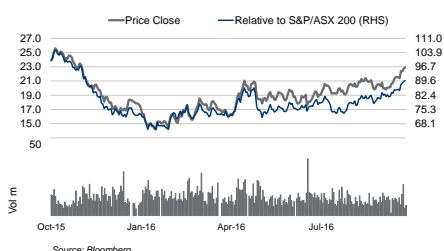


I Australia

ADD (no change)

Current price:	A\$22.90
Target price:	A\$25.30
Previous target:	A\$25.30
Up/downside:	10.5%
Reuters:	BHP.AX
Bloomberg:	BHP AU
Market cap:	US\$88,397m A\$115,415m
Average daily turnover:	US\$172.7m A\$227.6m
Current shares o/s	5,321m
Free float:	100.0%



Price performance	1M	3M	12M
Absolute (%)	15.4	17.3	1.3
Relative (%)	13.3	13.5	-7.3

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BHP Billiton

Oil a benefit not a drag

- We maintain our long-held contrarian view of BHP being an attractive investment prospect at the bottom of the cycle (due to its potential to outperform on recovering oil/metal prices) which continues to play out.
- We expect OPEC's decision to remove 750kbopd of oil supply is a positive signal that the cartel's mission to defend market share has been accomplished.
- Further upside is on offer in oil given the market now sits close to balance supply and as a result vulnerable to any near-term supply interruptions.
- We expect a detailed review of petroleum operations and strategy from BHP at its planned petroleum investor briefing in London (5 Oct) and Sydney (10 Oct).
- We have an unchanged A\$25.30 price target and Add recommendation.

The world isn't ending after all

BHP's share price has risen 28% so far in 2016, versus a broader market that has largely stalled (ASX 200 up 3%). Although sizeable gains have already been posted, we expect we are still in the early stages of a significant upgrade cycle for the resource sector. For the majority of the year we have been at the top of consensus on BHP, on the belief that expectations had become unrealistically pessimistic on commodities/miners. This thematic of an impending 'relief rally' across commodities continues to play out, with oil and bulk resources (coal and iron ore) the key gainers.

Oil adds x-factor to cash flow upside

While we have already seen a significant recovery in oil prices so far in 2016, we expect there is still further upside potential. OPEC's decision to announce an output cut of 750kbopd is important fundamentally for oil given it indicates that OPEC's strategy to defend market share by squashing oil prices has essentially been accomplished and the cartel is returning to its traditional role of supporting oil prices as a swing producer. We expect the downturn has caused permanent damage to US shale's ultimate potential.

Petroleum investor briefing

BHP's petroleum team is conducting an investor briefing in London on 5 October and Sydney on 10 October. The briefing will provide significant detail on BHP's petroleum strategy (both conventional and onshore), which has been in a state of transition from gas to liquids. In particular, we expect a lot of focus to remain on BHP's US onshore assets, where its cash flow performance has been pressured by depressed oil and gas prices.

Good mix of exposures to ongoing recovery

Our preference for BHP amongst our large-cap Australian resources coverage is driven primarily by the cash flow upside potential it holds from recovering volumes and commodity prices in FY17. We see the big miner as being ideally positioned to pursue growth at the low point in the cycle while supported by a strong balance sheet and the potential for additional upside in near-term cash flow. We maintain our Add recommendation with an unchanged A\$25.30 price target. The key risk to our call is commodity price risk.

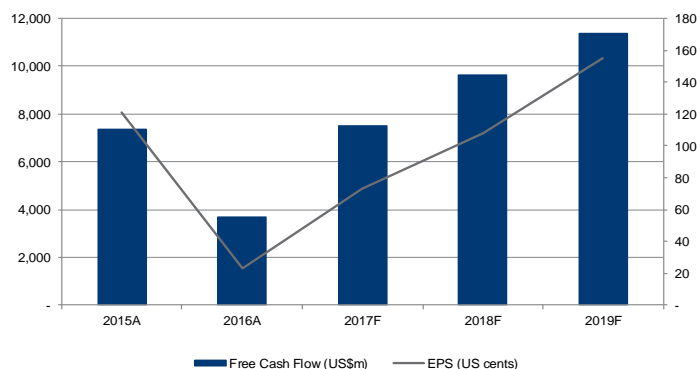
Financial Summary	Jun-14A	Jun-15A	Jun-16A	Jun-17F	Jun-18F
Revenue (US\$m)	56,762	44,636	30,912	38,755	42,494
Operating EBITDA (US\$m)	31,517	21,651	12,340	16,648	19,971
Net Profit (US\$m)	13,832	1,910	-6,385	3,897	5,738
Normalised EPS (US\$)	2.52	1.21	0.23	0.73	1.08
Normalised EPS Growth	11%	(52%)	(81%)	221%	47%
FD Normalised P/E (x)	6.96	14.54	76.81	23.95	16.26
DPS (US\$)	1.21	1.24	0.30	0.47	0.54
Dividend Yield	6.90%	7.07%	1.71%	2.67%	3.07%
EV/EBITDA (x)	3.98	5.71	10.15	7.27	5.76
P/FCFE (x)	10.98	17.24	11.68	20.12	13.37
Net Gearing	30.2%	34.6%	43.5%	35.0%	23.7%
P/BV (x)	1.18	1.44	1.72	1.64	1.53
ROE	18.0%	8.9%	2.0%	7.0%	9.7%
Normalised EPS/consensus EPS (x)				1.18	1.46

SOURCE: MORGANS, COMPANY REPORTS

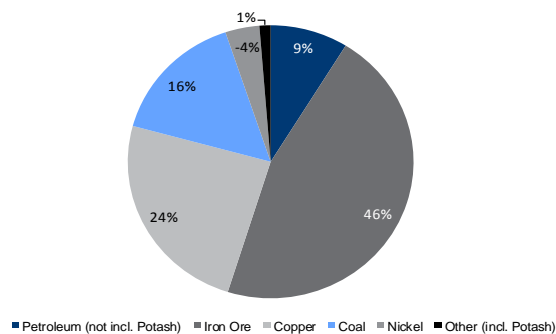
Figure 1: BHP Billiton – financial summary

Date:	05-Oct-16					Recommendation:	ADD			
Share Price:	22.90					Price Target:	\$	25.30		
Year End:	30-Jun					Valuation:	\$	25.30		
Profit & Loss - US\$m	2015A	2016A	2017F	2018F	2019F	Attributable Production	2016A	2017F	2018F	2019F
Sales Revenue	44,636	30,912	38,755	42,494	45,474	Petroleum (mboe)	241	218	223	211
Other Revenue	496	444	300	300	300	Copper (kt)	1,580	1,664	1,644	1,542
EBITDA	21,651	12,340	16,648	19,971	23,430	Gold (koz)	227	150	140	127
D&A	-9,986	-8,871	-8,930	-9,330	-9,087	Iron Ore (mt)	227	231	244	255
EBIT	11,665	3,469	7,719	10,642	14,343	Coal - Hard Coking (mt)	41	43	43	35
Net Interest	-614	-1,024	-1,258	-1,137	-961	Coal - Thermal (mt)	35	33	33	33
Net Profit Before Tax	11,051	2,445	6,461	9,505	13,382	Nickel (kt)	81	70	70	70
Tax Expense/(Benefit)	-3,666	-1,052	-2,135	-3,277	-4,541	Uranium (mlb)	9.6	8.3	7.5	7.2
Minorities/FX Impact	968	178	429	490	586					
Underlying NPAT	6,417	1,215	3,897	5,738	8,255	Valuation Summary	US\$m	A\$m	A\$ps	
Abnormals - Post-Tax	-4,507	-7,600	-	-	-	Petroleum	23,137	31,376	5.90	
Reported NPAT (US\$m)	1,910	-6,385	3,897	5,738	8,255	Iron Ore	62,960	85,210	16.01	
						Copper	26,757	36,177	6.80	
Divisional EBIT - US\$m	2015A	2016A	2017F	2018F	2019F	Coal	12,791	17,342	3.26	
Petroleum (not incl. Potash)	1,986	-431	727	2,289	2,948	Nickel	39	48	0.01	
Iron Ore	6,932	3,740	3,799	4,678	7,024	Other	-191	-262	-0.05	
Copper	3,353	1,042	2,011	2,758	3,494	Total Operations	125,493	169,891	31.93	
Coal	208	-346	1,291	862	627	Net Debt	-26,102	-35,273	-6.63	
Nickel	-74	-190	-319	-156	41	Total Valuation	99,391	134,618	25.30	
Other (incl. Potash)	135	17	104	104	60	P/NAV (x)			0.91	
						WACC			9.2%	
Balance Sheet - US\$m	2015A	2016A	2017F	2018F	2019F	Price Target			25.30	
Cash	6,753	10,319	12,465	16,576	19,136	Capital Growth Potential (%)			10.5%	
PP&E	94,072	83,975	81,320	78,427	76,439	12-month F/cast Dividend (%)			1.8%	
Assets	124,580	118,953	120,858	123,192	124,767	Total Forecast Return (%)			12.3%	
Debts	31,170	36,421	34,421	32,421	28,421					
Liabilities	54,035	58,882	58,189	56,325	52,204	Price Assumptions (June end)	2016A	2017F	2018F	2019F
Equity	70,545	60,071	62,669	66,868	72,563	Australian Dollar (AUD/USD)	0.73	0.72	0.74	0.74
Net Debt / (Cash)	24,417	26,102	21,956	15,845	9,285	Copper (US\$/lb)	2.23	2.28	2.46	2.68
						Gold (US\$/oz)	1,182	1,250	1,250	1,250
Cash Flow - US\$m	2015A	2016A	2017F	2018F	2019F	Iron Ore Fines (US\$/t, 62% Fe)	43.8	48.8	50.0	60.0
Cash Flow from Operations	19,296	10,625	13,784	16,087	18,457	Hard Coking Coal (US\$/t)	86.8	110.6	101.3	95.0
Capex (incl. Maint/Sust/Explor.)	-11,947	-6,946	-6,275	-6,437	-7,099	Thermal Coal (US\$/t)	53.5	64.5	62.6	63.5
Cash Flow from Investing	-13,154	-7,245	-7,145	-7,107	-7,769	Oil - WTI (US\$/bbl)	40.6	51.8	65.8	72.0
Incr/(Decr) in Equity	9	-	-	-	-					
Incr/(Decr) in Debt	-728	4,607	-2,000	-2,000	-4,000	Key Ratios	2016A	2017F	2018F	2019F
Dividends Paid	-6,498	-4,217	-2,494	-2,869	-4,127	Adjusted P/E Ratio (x)	76.8	24.0	16.3	10.9
Cash Flow from Financing	-8,276	284	-4,494	-4,869	-8,127	EV / EBITDA (x)	10.2	7.3	5.8	4.4
Net Change in Cash	-2,050	3,752	2,146	4,111	2,560	EV / EBIT (x)	32.6	14.7	10.6	7.9
Free Cash Flow	7,349	3,679	7,509	9,650	11,358	EBITDA Margin (%)	39.9	43.0	47.0	51.5
						EBIT Margin (%)	11.2	19.9	25.0	31.5
Earnings - US\$m	2015A	2016A	2017F	2018F	2019F	CFPS (US cents)	278.9	305.9	356.2	424.4
EPS - Adjusted (US cents)	121	23	73	108	155	P/CF (x)	6.0	5.5	4.7	3.9
EPS Growth (%)	90.9	-81.1	220.7	47.2	43.9	Dividend Yield (%)	2.7	2.7	3.1	5.3
DPS (US cents)	126	30	47	54	78	ROIC (%)	2.9	6.6	9.5	13.1
Franking (%)	100	100	100	100	100	ROE (%)	2.0	7.0	9.7	12.2
Dividend Payout Ratio (%)	104	131	64	50	50	ROA (%)	1.0	3.2	4.7	6.6

FCF/EPS Outlook



FY17 EBIT Mix



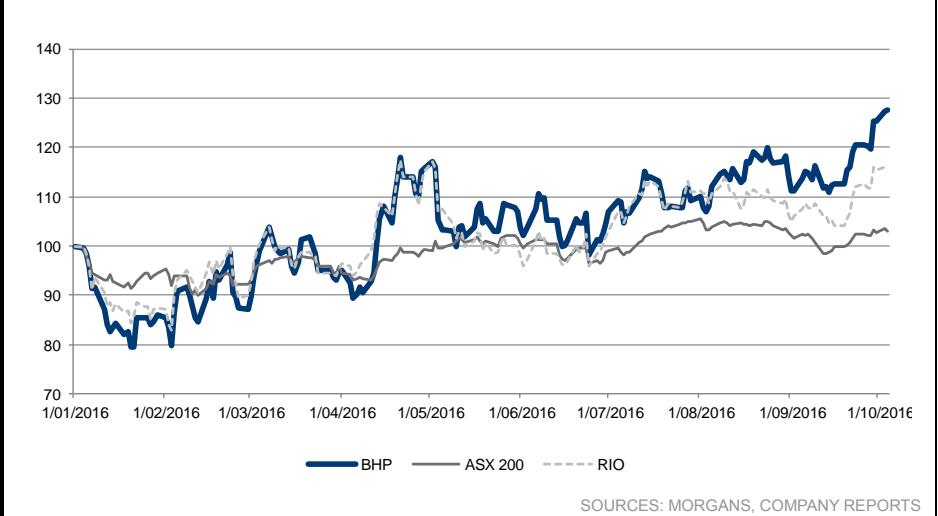
SOURCE: MORGANS RESEARCH, COMPANY

Oil a benefit not a drag

Fuelling BHP's outperformance

- So far in 2016, BHP's share price has rallied 28% versus RIO up 17%, while the broader ASX 200 index is up just 3%.
- In addition to a recovery in iron ore and coal prices, BHP has benefited from a significant surge in oil prices.
- While some pundits continue to call for BHP to divest its petroleum assets, we maintain the contrarian view that BHP's petroleum leverage will provide a positive tailwind for rising group profitability during FY16-18.

Figure 2: Share price performance (Jan 16=100)



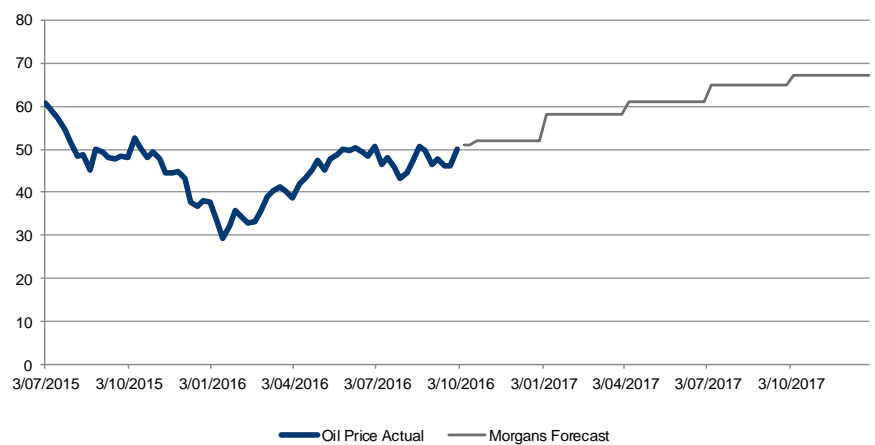
Oil's resurgence

OPEC cut positive signal

- The recent rally in oil prices follows a decision from OPEC to remove 750,000 bopd of production in an effort to support higher oil prices. While the 0.8% reduction in global supply may seem insignificant at first glance, it is material when considering at its peak the global supply surplus was only ~2%.
- If implemented, these cuts will introduce tightness to a market that is already moving closer to balance supply. The shrinking surplus will leave the oil market increasingly sensitive to any unexpected supply interruptions.
- The move to support a higher oil price comes after an extended period where OPEC abandoned its position as a swing-producer and instead opted to hold production rates unchanged, despite a surplus emerging on the back of rising US oil production. We expect OPEC's move to hold production steady was likely an effort to defend market share against the rebirth of US oil production. The situation resulted in a significant downturn for oil prices over 2014/15.
- OPEC's strategy has ultimately been successful. Despite a large number of US shale producers surviving the downturn (albeit with most in liquidation mode), they have still sustained irreparable damage by having to resort to eating through a significant portion of their best acreage to service typically high levels of debt at the bottom of the cycle (often while deep in loss making territory).
- While retreating to their best acreage has allowed US shale producers to service debt and remain alive throughout the downturn, we believe it has also created a situation in future years where they will now have smaller high-margin reserves to use to support expansion into new frontier/emerging unconventional plays. As a result we expect the US shale

industry has suffered a permanent set back and now has a smaller overall scale and life potential even in a rising oil price environment.

Figure 3: Oil price outlook (US\$/bbl)

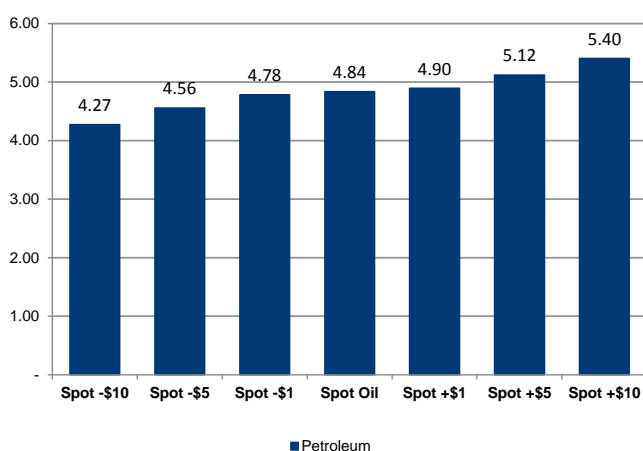


SOURCES: MORGANS, COMPANY REPORTS

BHP oil sensitivity vs major pure O&G plays

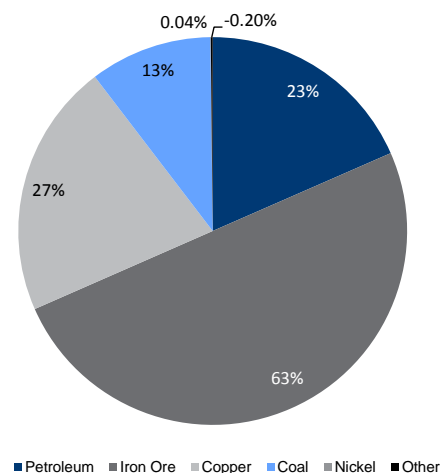
- BHP holds less earnings and valuation leverage to oil versus the pure O&G players, with a US\$10/bbl shift in oil price translating into a 14% change in FY17 EPS and ~2% change in total valuation. This compares to Australian O&G majors, where a US\$10/bbl move in oil prices results in:
 - Woodside Petroleum (WPL, Hold): +/-69% FY17 EPS change and +/-36% valuation impact.
 - Oil Search (OSH, Add): +/-205% FY17 EPS change and +/-59% valuation impact.
- Although holding significantly less leverage, oil still represents a meaningful proportion of BHP's group earnings making the diversified major an attractive way for risk-averse investors to add oil and gas exposure to their portfolios.

Figure 4: BHP petroleum division valuation sensitivity (A\$ps)



SOURCE: MORGANS

Figure 5: BHP valuation division breakdown (%)



SOURCE: MORGANS

Valuation summary

- We maintain an unchanged SOTP valuation of A\$25.30 on BHP, calculated on a group WACC of 9.2%.
- We entirely base our 12-month price target on our valuation.
- The key upside risk to our BHP valuation remains the potential for oil and coal prices to maintain higher average levels than currently represented in our assumptions.
- After years of capital preservation, BHP has built a capable balance sheet. Last reported net debt of US\$26.1bn puts BHP on track for FY17 interest cover of 13x (EBITDA), ND/EBITDA of 1.3x, and gearing of 25% (ND/ND+E).

Figure 6: SOTP overview

Valuation Summary	US\$m	A\$m	A\$ps
Petroleum	23,137	31,376	5.90
Iron Ore	62,960	85,210	16.01
Copper	26,757	36,177	6.80
Coal	12,791	17,342	3.26
Nickel	39	48	0.01
Other	-191	-262	-0.05
Total Operations	125,493	169,891	31.93
Net Debt	-26,102	-35,273	-6.63
Total Valuation	99,391	134,618	25.30
P/NAV (x)			0.91
WACC			9.2%
Price Target			25.30
Capital Growth Potential (%)			10.5%
12-month F/cast Dividend (%)			1.8%
Total Forecast Return (%)			12.3%

SOURCES: MORGANS, COMPANY REPORTS

Investment view

- Despite its recent outperformance, BHP remains our key large-cap sector preference with further upside potential on offer.
- We hold a positive view on the resource sector, believing that we have entered a recovery phase. High volatility is likely to still remain a key feature, however we see the underlying upgrade cycle as supportive of improving market expectations for BHP and its peers.
- The large diversified miner represents an attractive exposure to metals and energy, with a capable balance sheet and improving cash flow performance. We maintain our Add recommendation with an unchanged A\$25.30 valuation-derived price target.

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1574 companies under coverage for quarter ended on 30 June 2016		
	Rating Distribution (%)	Investment Banking clients (%)
Add	56.5%	7.1%
Hold	32.2%	2.9%
Reduce	9.8%	0.6%

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Definition:

- Add** The stock's total return is expected to exceed 10% over the next 12 months.
- Hold** The stock's total return is expected to be between 0% and positive 10% over the next 12 months.
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Definition:

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- Neutral** A Neutral rating means stocks in the sector have, on a market cap-weighted basis, a neutral absolute recommendation.
- Underweight** An Underweight rating means stocks in the sector have, on a market cap-weighted basis, a negative absolute recommendation.

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Definition:

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- Neutral** A Neutral rating means investors should be positioned with a neutral weight in this country relative to benchmark.
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