Metallurgical coal: Markets remained very tight due to strong Indian demand and tightening Chinese markets, leading to a record contract price settlement for metallurgical coal, with an average price increase of 206 per cent effective from 1 April 2008. Chinese coke prices hit another record in excess of US$650 per tonne.

Energy coal: Global energy coal consumption has increased at an average rate of 7.4 per cent per annum since 2002. FY2008 witnessed strong growth in the energy sector on the back of significant rises in oil prices and this saw coal, despite the near record prices across all energy coal indices, remain the cheapest fossil fuel for electricity generation in most seaborne markets, ahead of gas and oil, even when emissions costs (credits) are accounted for. Energy coal prices continued to strengthen as global seaborne supply struggled to match strong growth in demand, particularly in the Pacific. Other factors contributing to high energy coal prices include a surge in freight rates, a weaker US dollar relative to some of the key coal exporting country currencies and equally large increases in global oil and gas prices.

The following table indicates the estimated impact on FY2008 profit after taxation of changes in the prices of our commodities. With the exception of price-linked costs, the sensitivities below assume that all other variables, such as exchange rate, costs, volumes and taxation, remain constant. There is an inter-relationship between changes in commodity prices and changes in currencies that is not reflected in the sensitivities below. Volumes are based on FY2008 actual results and sales prices of our commodities under a mix of short-, medium- and long-term contracts. Movements in commodities prices can cause movements in exchange rates and vice versa. These sensitivities should therefore be used with care.

Estimated impact on FY2008 profit after taxation of changes of:	US$M
US$1/bbl on oil price	32
US¢1/lb on aluminium price	24
US¢1/lb on copper price	26
US¢1/lb on nickel price	2
US$1/t on iron ore price	62
US$1/t on metallurgical coal price	27
US$1/t on energy coal price	24

The impact of the commodity price movements in FY2008 is discussed in section 3.6 'Operating results'.

3.4.2 Exchange rates

We are exposed to exchange rate transaction risk on foreign currency sales and purchases as we believe that active currency hedging does not provide long-term benefits to our shareholders. Because a majority of our sales are denominated in US dollars, and the US dollar otherwise plays a dominant role in our business, we borrow and hold surplus cash predominantly in US dollars to provide a natural hedge. Operating costs and costs of local equipment are influenced by the fluctuations in the Australian dollar, South African rand, Chilean peso and Brazilian real. Foreign exchange gains and losses reflected in operating costs owing to fluctuations in the abovementioned currencies relative to the US dollar may potentially offset one another. The Australian dollar, Chilean peso and Brazilian real generally strengthened against the US dollar throughout FY2008, while the South African rand generally weakened.

We are also exposed to exchange rate translation risk in relation to net monetary liabilities, being our foreign currency denominated monetary assets and liabilities, including debt and other long-term liabilities (other than closure and rehabilitation provisions at operating sites where foreign currency gains and losses are capitalised in property, plant and equipment).

The following table indicates the estimated impact on FY2008 profit before taxation of a weakening of the US dollar against the Australian dollar or South African rand, which are the two principal currencies outside of the US dollar to which we are exposed in terms of our net monetary liabilities. The sensitivities give the estimated impact on profit before taxation based on the exchange rate movement in isolation. The sensitivities assume all variables except for exchange rate remain constant. As outlined above, there is an inter-relationship between currencies and commodity prices that is not reflected in the sensitivities below. Movements in commodities prices can cause movements in exchange rates and vice versa. These sensitivities should therefore be used with care.

Table of Contents

Estimated impact on FY2008 profit before taxation of a weakening US dollar against local currency:	US$ M
Australian dollar (US¢1/A$)	
Net monetary liabilities [1]	(18)
South African rand (0.2 rand/US$)	
Net monetary liabilities [1]	(13)
Rand debt [1]	(4)

(1) Impact based on difference in opening and closing exchange rates for the period.

The impact of exchange rate movements in the current year is discussed in section 3.6 ‘Operating results’.

3.4.3 Interest rates

We are exposed to interest rate risk on our outstanding borrowings and investments. Our policy on interest rate exposure is for interest on our borrowings to be on a US dollar floating interest rate basis. Deviation from our policy requires the prior approval of our Financial Risk Management Committee, and is managed within our Cash Flow at Risk (CFaR) limit, which is described in note 26 ‘Financial risk management’ in the financial statements. When required under this strategy, we use interest rate swaps, including cross currency interest rate swaps, to convert a fixed rate exposure to a floating rate exposure. As at 30 June 2008, we had US$1.6 billion of fixed interest borrowings that had not been swapped to floating rates, arising principally from legacy positions that were in existence prior to the merger that created the DLC structure.

3.4.4 Growth in product demand

The demand for our products is directly related to the strength of the global economy. However, the diversification of our portfolio of assets and commodities we extract limits the impact of a particular industry or region.

The global economy has remained resilient in the face of significant structural weaknesses in developed economies. The continuing massive industrialisation in China is providing solid support to the global economy.

Over the past financial year there has been considerable weakening in most major developed economies. The deflation of asset values within these economies has led to a reduction in wealth effect for consumers. This appears to have ended the past decade’s unsustainable consumer debt driven economic growth, particularly in the US.

However, a direct spill over into emerging market economies has remained largely contained. Emerging market economies have contributed more than their industrial counterparts to global growth since the year 2000. Led by China and India, economic growth in these economies has been strong with solid support from growth in domestic demand and strong trading activity with other emerging market economies.

We expect short-term global economic growth to slow as developed economies experience further weakening in the coming quarters. Liquidity is likely to remain low, and risk premiums high for some time into the future. Rising inflation, particularly in food and energy, alongside weakening economic growth has restricted the flexibility of central banks to inject liquidity and stimulate their economies.

Higher inflation will also have a likely negative impact on emerging market economies through their adoption of tighter monetary policies. However, we believe that emerging market economies should remain relatively strong on the back of continued domestic infrastructure investment and regional trade. While short-term disruptions may occur, we expect that their long-term economic growth will remain robust as they continue on the path to industrialisation.

3.4.5 Operating costs and capital expenditures

Strong global demand for resources continues to provide cost challenges for the whole industry. Rising prices for inputs such as diesel, coke and explosives, labour and contractor charges, shipping and freight costs added to already tight market conditions. Severe weather disruptions in Queensland also had an adverse cost impact. However, our world-class orebodies, strong supplier relationships, internal systems, the capabilities of our people and our continuing focus on our ‘Business Excellence’ improvement program have provided some relief against significant cost pressures.

3.4.6 Exploration and development of resources

Because most of our revenues and profits are related to our oil and gas and minerals operations, our results and financial condition are directly related to the success of our exploration efforts and our ability to replace existing reserves. However, there are no guarantees that our exploration program will be successful. When we identify an economic deposit, there are often significant challenges and hurdles entailed in its development, such as negotiating rights to extract ore with governments and landowners, design and construction of required infrastructure, utilisation of new technologies in processing, and building customer support.

3.4.7 Health, safety, environment and community

We aspire to Zero Harm to people, our host communities and the environment and strive to achieve leading industry practice. Sound principles to govern safety, business conduct, social, environmental and economic activities are integral to the way we do business. Our Charter highlights that we care as much about how results are obtained as we do about delivering good results. Our Health, Safety, Environment and Community Management Standards provide the basis for developing and applying management systems at all levels of our Company and are a driver of our contribution to sustainable development.

As a global company, operating in many different countries, we are subject to extensive regulation surrounding health and safety of our people and the environment. We make every effort to comply with the regulations and, where less stringent than our standards, exceed applicable legal and other requirements. However, regulatory standards and community expectations are constantly evolving, and as a result, we may be exposed to increased litigation, compliance costs and unforeseen environmental remediation expenses, despite our best efforts to work with governments, community groups and scientists to keep pace with regulations, law and public expectation.

3.5 Application of critical accounting policies and estimates

The preparation of our consolidated financial statements requires management to make estimates and assumptions that affect the reported amounts of assets and liabilities and the disclosure of contingent liabilities at the date of the financial statements, and the reported revenue and costs during the periods presented therein. On an ongoing basis, management evaluates its estimates and judgements in relation to assets, liabilities, contingent liabilities, revenue and costs. Management bases its estimates and judgements on historical experience and on various other factors it believes to be reasonable under the circumstances, the results of which form the basis of making judgements about the carrying values of assets and liabilities that are not readily apparent from other sources. Actual results may differ from these estimates under different assumptions and conditions.

We have identified the following critical accounting policies under which significant judgements, estimates and assumptions are made and where actual results may differ from these estimates under different assumptions and conditions and may materially affect financial results or the financial position reported in future periods:

- reserve estimates
- exploration and evaluation expenditure
- development expenditure
- property, plant and equipment – recoverable amount
- defined benefit superannuation schemes
- provision for closure and rehabilitation
- taxation

In accordance with IFRS, we are required to include information regarding the nature of the judgements and estimates and potential impacts on our financial results or financial position in the financial statements. This information can be found in note 1 ‘Accounting policies’ in the financial statements.

3.6 Operating results

During FY2008, we adopted the policy of recognising our proportionate interests in the assets, liabilities, revenues and expenses of jointly controlled entities. All such interests were previously equity accounted. Full details of the impact of this change in policy may be found in note 1 ‘Accounting policies’ in the financial statements. Results for FY2007 and FY2006 have been restated on the same basis.

3.6.1 Consolidated results

Year ended 30 June 2008 compared with year ended 30 June 2007

We have achieved another year of record earnings, driven by excellent operating performance, cost control and the delivery of high-margin growth projects into strong market conditions.

Annual production records were set in seven commodities and production increased in a further six commodities. Strong volume growth has allowed us to capture the benefits of very high prices. Most of the records were set in consecutive years, as we reaped the benefit of our drive to deliver consistent, predictable and sustainable performance across all of our businesses. This provides a stable platform as we continue to develop and deliver world-class projects that are expected to add significant shareholder value.

Our strong performance demonstrates the power of our uniquely diversified and high-margin portfolio across the energy, steelmaking and non-ferrous product suites. This performance also reflects the success of our unrelenting focus on our strategy to create lasting shareholder value by owning and operating a diversified portfolio of upstream, large, long-life, low-cost, expandable, export-oriented assets.

Our profit attributable to members of BHP Billiton of US$15.4 billion represents an increase of 14.7 per cent over the prior year. Attributable profit excluding exceptional items of US$15.4 billion represents an increase of 12.4 per cent over FY2007. It is our seventh consecutive record annual result, with record Underlying EBIT generated by the Petroleum, Base Metals, Iron Ore, Manganese and Energy Coal CSGs.

Revenue was US$59.5 billion, up 25.3 per cent from US$47.5 billion in the corresponding period.

On 18 August 2008, the Board declared a final dividend of 41.0 US cents per share, thus bringing the total dividends declared for FY2008 to 70.0 US cents per share. During the year, 96,904,086 shares, or 1.7 per cent of the issued share capital of the Group, were repurchased. Capital management initiatives are discussed in section 3.7.6 of this Report.

Year ended 30 June 2007 compared with year ended 30 June 2006

Our profit attributable to members of BHP Billiton of US$13.4 billion represented an increase of 28.4 per cent over FY2006. Attributable profit excluding exceptional items of US$13.7 billion represented an increase of 34.7 per cent over FY2006. Revenue was US$47.5 billion, up 21.4 per cent from US$39.1 billion in FY2006.

On 22 August 2007, the Board declared a final dividend of 27.0 US cents per share, bringing the total dividends declared for FY2007 to 47.0 US cents per share. During FY2007, we announced US$13 billion of capital management initiatives. Under that initiative, 287,820,269 shares, or 4.8 per cent of the issued share capital of the Group, were repurchased, at an approximate average price of US$20.26.

Underlying EBIT

In discussing the operating results of our business, we focus on a non-GAAP (IFRS or US) financial measure we refer to as ‘Underlying EBIT’. Underlying EBIT is the key measure that management uses internally to assess the performance of our business, make decisions on the allocation of resources and assess operational management. Management uses this measure because financing structures and tax regimes differ across our assets, and substantial components of our tax and interest charges are levied at a Group, rather than an operational, level. Underlying EBIT is calculated as earnings before interest and taxation (EBIT), which is referred to as ‘profit from operations’ on the face of the income statement, excluding the effects of exceptional items.

We exclude exceptional items from Underlying EBIT in order to enhance the comparability of the measure from period to period and provide clarity into the underlying performance of our operations. Our management monitors exceptional items separately.

Underlying EBIT is not a measure that is recognised under IFRS and it may differ from similarly titled measures reported by other companies.

The following table reconciles Underlying EBIT to profit from operations for the years ended 30 June 2008, 2007 and 2006.

Year ended 30 June	**2008** **US$M**	2007 US$M	2006 US$M
Underlying EBIT	**24,282**	20,067	15,277
Exceptional items (before taxation)	**(137)**	(343)	439
Profit from operations (EBIT)	**24,145**	19,724	15,716

Table of Contents

The following tables and commentary describe the approximate impact of the principal factors that affected Underlying EBIT for FY2008 and FY2007.

	US$M	US$M
Year ended 30 June 2007		20,067
Change in volumes:		
Increase in volumes	805	
Decrease in volumes	(596)	
New operations	1,619	1,828
Net price impact:		
Change in sales prices	6,693	
Price-linked costs	(134)	6,559
Change in costs:		
Costs (rate and usage)	(1,183)	
Exchange rates	(1,133)	
Inflation on costs	(532)	(2,848)
Asset sales		28
Ceased and sold operations		(154)
Exploration and business development		(404)
Other		(794)
Year ended 30 June 2008		24,282

	US$M	US$M
Year ended 30 June 2006		15,277
Change in volumes:		
Increase in volumes	438	
Decrease in volumes	(220)	
New operations	368	586
Net price impact:		
Change in sales price	7,101	
Price-linked costs	(979)	6,122
Change in costs:		
Cost (rate and usage)	(859)	
Exchange rates	(271)	
Inflation on costs	(416)	(1,546)
Asset sales		(61)
Ceased and sold operations		(198)
Exploration and business development		(149)
Other		36
Year ended 30 June 2007		20,067

Year ended 30 June 2008 compared with year ended 30 June 2007

Profit from operations (EBIT) for FY2008 was US$24.1 billion compared with US$19.7 billion in FY2007, an increase of 22.4 per cent. Underlying EBIT for FY2008 was US$24.3 billion compared with US$20.1 billion, an increase of 21.0 per cent.

Base Metals, Iron Ore, Manganese and Energy Coal had record Underlying EBIT at a time when prices were high, reflecting strong demand. In Petroleum, newly commissioned projects in fiscally stable regimes, 93.8 per cent operational up time and record high oil prices led to record Underlying EBIT. The following commentary details the approximate impact of the principal factors that affected EBIT and Underlying EBIT for FY2008 and FY2007.

Volumes

Strong volume growth reflected our commitment to deliver more product, more quickly to our customers. During the year we delivered strong growth in sales volumes, allowing us to take advantage of continued strong customer demand.

Newly commissioned petroleum projects and the continued ramp-up of the Spence (Chile) and Pinto Valley copper projects contributed US$1,619 million to Underlying EBIT.

Higher sales volumes of copper, iron ore, manganese ore, energy coal, diamonds, alumina, and aluminium increased Underlying EBIT by US$805 million. This was partially offset by lower nickel and metallurgical coal volumes, as well as oil and gas volumes from existing operations.

Prices

Net changes in price increased Underlying EBIT by US$6,693 million (excluding the impact of newly commissioned projects). This was due to higher iron ore, oil, manganese, energy coal and base metals prices. Additional detail on the effect of price changes appears in the Customer Sector Group summary in section 3.6.2.

Higher price-linked costs reduced Underlying EBIT by US$134 million primarily due to higher royalties and LME-linked costs in the aluminium business. This was offset by decreased charges for third party nickel ore and more favourable rates for copper treatment and refining charges (TCRCs).

Costs

Strong global demand for resources continues to provide cost challenges for the whole industry. This is mainly due to shortages of skilled labour and rising prices for other inputs such as diesel, coke and explosives. However, our world-class orebodies, strong supplier relationships, systems and capabilities of our people have provided some relief against cost increases. In this environment, costs for the Group have increased by US$1,183 million.

Approximately US$575 million of the increase in costs was due to higher fuel, energy and raw materials costs. Severe weather interruptions in Queensland also had an adverse cost impact. Other areas of cost increase include labour and contractor charges and shipping and freight costs. Our continued focus on the 'Business Excellence' improvement program has delivered US$225 million of cost reductions.

Exchange rates

Exchange rate movements had a negative impact on Underlying EBIT of US$1,133 million. All Australian operations were adversely impacted by the stronger Australian dollar, which reduced Underlying EBIT by US$986 million. The appreciation of South American currencies against the US dollar also adversely impacted Underlying EBIT by US$158 million.

Average and closing exchange rates for FY2008 and FY2007 are detailed in note 1 to the financial statements.

Inflation on costs

Inflationary pressures on input costs across all our businesses had an unfavourable impact on Underlying EBIT of US$532 million. These pressures were most evident in Australia and South Africa.

Asset sales

The sale of assets increased Underlying EBIT by US$28 million. This was mainly due to the sale of the Elouera mine (Illawarra Coal, Australia) and other Queensland Coal (Australia) mining leases. Asset sales in the corresponding period included the sale of one million tonnes of annual capacity at the Richards Bay Coal Terminal (South Africa), Moranbah Coal Bed Methane assets (Australia), the Koornfontein energy coal mine (South Africa) and the interest in Eyesizwe coal mine in South Africa.

Ceased and sold operations

The unfavourable impact of US$154 million was mainly due to lower insurance recoveries and movements in the closure and rehabilitation provisions for closed operations in the corresponding period.

Exploration and business development

We continued to focus on finding new long-term growth options for our business. Exploration expense was US$906 million during the year, an increase of US$284 million. We increased activity on nickel targets in Western Australia, Guatemala, Indonesia and the Philippines, on diamond targets in Angola and iron ore targets in Western Australia. The main expenditure for the Petroleum CSG was on targets in the Gulf of Mexico, Colombia and Australia.

Expenditure on business development was US$119 million higher than last year, mainly due to the pre-feasibility study on the Olympic Dam expansion along with earlier stage activities in Base Metals and Iron Ore.

Other

Other items decreased Underlying EBIT by US$794 million. The start-up of operations at Ravensthorpe and the Yabulu Expansion Project (both Australia) adversely impacted earnings by US$313 million and contribution from third party trading was US$458 million lower compared to last year.

Year ended 30 June 2007 compared with year ended 30 June 2006

Profit from operations (EBIT) for FY2007 was US$19.7 billion compared with US$15.7 billion in FY2006, an increase of 25.5 per cent. Underlying EBIT for FY2007 was US$20.1 billion compared with US$15.3 billion, an increase of 31.4 per cent.

The increase in EBIT and Underlying EBIT was due primarily to higher commodity prices. Nickel, copper, aluminium, iron ore and petroleum product prices contributed significantly to the increase in revenue and Underlying EBIT. The following commentary details the approximate impact of the principal factors that affected EBIT and Underlying EBIT for FY2007 compared with FY2006.

Volumes

Continued strong demand underpinned increased sales volumes of metallurgical coal, petroleum products, nickel, manganese ore, alumina, zinc, iron ore, aluminium and energy coal, which contributed approximately US$438 million more (measured at FY2006's average margins) to Underlying EBIT than in FY2006. Sales volumes of base metals were lower at Olympic Dam (Australia) due to a smelter shutdown and at Cannington (Australia) due to the temporary closure of the southern zone. However, this was more than offset by copper sales from Spence (Chile), which commenced operations in December 2006, and added US$363 million, and the ramp-up of the Sulphide Leach project at Escondida (Chile). We experienced a decrease in diamond sales for the year as a result of inventory sales in FY2006.

Prices

Net changes in prices increased Underlying EBIT by US$7,101 million. Lower prices for metallurgical coal and manganese ore had a negative impact. Additional detail on the effect of price changes appears in the Customer Sector Group summary in section 3.6.2.

Higher price-linked costs reduced Underlying EBIT by US$979 million with increased charges for third party nickel contributing US$658 million to this amount. Higher royalties for nickel, iron ore, and higher LME-linked power charges in aluminium were offset by lower metallurgical coal royalties (in line with lower prices) and more favourable rates for copper TCRCs, including the removal or limiting of price participation in new contracts.

Costs

Continued strong global demand for resources led to increased costs across the industry for labour, contractors, raw materials, fuel, energy and other input costs. In addition, port congestion and other third party infrastructure constraints resulted in increased demurrage costs and shipping, freight and other distribution charges. In this environment, our costs increased by US$859 million in FY2007 compared to FY2006.

Specific areas of cost increases include labour and contractor charges, consumables and fuels, business development expenditure, maintenance and other operating costs. Changed mining conditions, particularly at Cannington where we had a temporary closure of the southern zone and higher strip ratios at Queensland Coal (Australia), had a negative impact. However, we generated savings of US$203 million on our 2006 cost base through a wide range of business improvement initiatives across the Group.

Exchange rates

Exchange rate movements had a negative impact on Underlying EBIT of US$271 million. The stronger Australian dollar had a negative impact of US$478 million. This was partially offset by the favourable impact of a weaker South African rand on operating costs for our South African businesses. The Western Australian Iron Ore and Queensland Coal operations were both significantly impacted by the strength of the Australian dollar.

Average and closing exchange rates for FY2007 and FY2006 are detailed in note 1 to the financial statements.

Inflation on costs

Inflationary pressures on input costs across all of our businesses had an unfavourable impact on Underlying EBIT of US$416 million. These pressures were most evident in Australia and South Africa.

Asset sales

The sale of assets and interests decreased Underlying EBIT by US$61 million compared to FY2006. FY2007 was principally impacted by the sale of one million tonnes of annual capacity at the Richards Bay Coal Terminal (South Africa), the Moranbah Coal Bed Methane assets (Australia), the Koornfontein energy coal mine (South Africa), the interest in Eyesizwe (South Africa) and Alliance Copper (Chile). In FY2006, we had higher profits arising largely from the divestment of our interest in the Wonderkop chrome joint venture (South Africa), the Vincent Van Gogh undeveloped oil discovery (Australia) and the Green Canyon oil fields (US).

Ceased and sold operations

FY2007 was negatively impacted by the loss of US$343 million of Underlying EBIT from Tintaya (Peru) (divested in June 2006) and the Southern Cross Fertiliser operations (Australia) (divested in August 2006). This was partly offset by a US$82 million year-on-year impact of movements in closure and rehabilitation provisions for closed operations.

Exploration and business development

Gross exploration expenditure increased to US$805 million during FY2007. We increased activity on nickel targets in Western Australia, Guatemala, Indonesia and the Philippines and on energy coal targets in New South Wales (Australia). This increased expenditure, however, was offset by a higher level of capitalisation of oil and gas exploration expenditure, primarily in Australia. This resulted in exploration expense being US$17 million lower than in FY2006.

Expenditure on business development was US$166 million higher than in FY2006 mainly due to the pre-feasibility study on the Olympic Dam expansion and other Base Metals activities.

Other

Other items increased Underlying EBIT by US$36 million. These included higher insurance recoveries than in FY2006, partially offset by a lower contribution from freight and other activities.

Net finance costs

Year ended 30 June 2008 compared with year ended 30 June 2007

Net finance costs increased to US$662 million, from US$512 million in the corresponding period. This was driven predominantly by lower capitalised interest and foreign exchange impacts.

Year ended 30 June 2007 compared with year ended 30 June 2006

Net finance costs decreased to US$512 million, from US$600 million in FY2006. This was driven predominantly by higher capitalised interest, partially offset by higher average interest rates and foreign exchange impacts.

Taxation expense

Year ended 30 June 2008 compared with year ended 30 June 2007

The total taxation expense on profit before tax was US$7,521 million, representing an effective rate of 32.0 per cent (calculated as total taxation expense divided by profit before taxation).

Excluding the impacts of royalty-related taxation, non-tax-effected foreign currency adjustments, translation of tax balances and other functional currency translation adjustments and exceptional items, the underlying effective tax rate was 30.4 per cent, compared to the UK and Australian statutory tax rate (28 and 30 per cent respectively). Royalty-related taxation represents an effective rate of 3.1 per cent for the current period.

Year ended 30 June 2007 compared with year ended 30 June 2006

The total taxation expense on profit before tax was US$5,716 million, representing an effective rate of 29.8 per cent (calculated as total taxation expense divided by profit before taxation).

When compared to the UK and Australian statutory tax rate (30 per cent), the effective tax rate included a benefit of 2.2 per cent due to the impact of foreign exchange and other translation adjustments (US$395 million), and a benefit of 1.4 per cent due to the recognition of prior year US tax benefits (US$282 million). Royalty-related taxation represented an effective rate of 2.1 per cent for FY2007.