

April 10, 2017

[www.valueunlockplanforbhp.com](http://www.valueunlockplanforbhp.com)

**LETTER TO THE DIRECTORS OF EACH OF BHP BILLITON LIMITED (“LIMITED”) AND BHP BILLITON PLC (“PLC” AND TOGETHER WITH LIMITED, “BHP”)**

Your attention is drawn to the important information which is set out in the Appendix to this letter. This letter and a related presentation are being made publicly available at [www.valueunlockplanforbhp.com](http://www.valueunlockplanforbhp.com)<sup>1</sup>

To the directors of BHP:

**Introduction**

We are writing to you on behalf of Elliott Associates, L.P. and Elliott International, L.P. (together, the “**Elliott Funds**”)<sup>2</sup>, which together with certain of their affiliates hold a long economic interest in respect of approximately 4.1% of the issued share capital of PLC<sup>3</sup>.

Despite being a leading global resources company with a portfolio of best-in-class large-scale diversified mining assets, in recent years BHP as an investment has underperformed a portfolio of comparable mineral and petroleum companies.

Unfortunately, despite the progressive and successful demerger of South32 in May 2015, BHP’s management still cannot deliver optimal shareholder value without (i) resolving the shareholder value inefficiencies caused by its dual-listed company (“**DLC**”) structure; (ii) monetizing the intrinsic value of BHP’s US petroleum business<sup>4</sup>, the value of which is being obscured by its continued inclusion within the group; and (iii) enhancing capital management to an optimal level.

The BHP Shareholder Value Unlock Plan, which we outline in this letter and the enclosed presentation (the “**Value Unlock Plan**”), is designed to directly address these issues with three key steps:

- **Step 1: Unifying BHP’s DLC structure** into a single Australian-headquartered and Australian tax resident listed company
- **Step 2: Demerging and separately listing BHP’s US petroleum business** on the NYSE
- **Step 3: Adopting a policy of consistent and value-optimized capital returns to shareholders** – which would also help BHP’s management to avoid any repetition of prior tendencies to make value-destructive large-scale acquisitions paid for in cash

Our analysis shows that implementation of the Value Unlock Plan **could enable management to provide BHP shareholders with an increase in value attributable to their shareholdings of up to c. 48.6% (Limited shareholders) / c. 51.0% (PLC shareholders).**

<sup>1</sup> Together with this letter we are today making publicly available a presentation that details the points set out below, including our related analysis (the “**Presentation**”). The Presentation and this letter are available at our website [www.valueunlockplanforbhp.com](http://www.valueunlockplanforbhp.com).

<sup>2</sup> Founded in 1977, Elliott Management Corporation (“**EMC**”) manages the two Elliott Funds, with assets under management totalling more than US\$32.7 billion as at the date of this letter. Elliott Advisors (HK) Limited (“**Elliott**”) is an affiliate of the Elliott Funds and EMC.

<sup>3</sup> In addition to their long economic interest in PLC, the only other BHP positions that the Elliott Funds and their affiliates hold are the rights to acquire up to approximately 0.4% of the issued shares in Limited. The Elliott Funds may at any time increase or reduce their holdings of, or economic exposure in respect of, any BHP entity’s shares or other equity or debt securities. See the important information which is set out in the Appendix to this letter for further details.

<sup>4</sup> The “**US petroleum business**” means BHP’s US onshore petroleum assets and its Gulf of Mexico assets.

We are making this letter publicly available as a follow-up to our discussions with certain senior members of BHP's management, in order to provide access to the details of the Value Unlock Plan for all of BHP's shareholders, and so that you can work openly with all shareholders with regard to our plan for significantly enhancing shareholder value.

## **BHP in context**

BHP's DLC structure dates back to 2001 and was originally put in place in order to economically combine PLC and Limited without either company actually acquiring or merging with the other in the legal sense.

Today, out of approximately fourteen major corporate groups which adopted a DLC structure over time, BHP is one of only five significantly-sized DLCs<sup>5</sup> in the world which remain, of which the largest by market value is already under review with the objective of creating greater simplification and strategic flexibility<sup>6</sup>. We, along with many other market participants, believe that BHP's DLC structure has far outlived its original utility.

One key aspect of management's inability to deliver optimal value for BHP's shareholders is that the DLC structure has led to a massive build-up of franking credits<sup>7</sup> at Limited. Australian tax resident companies like Limited should be able to pass on all of those tax credits to shareholders, but BHP cannot do that in an economically efficient way whilst it retains its legacy DLC structure. The Value Unlock Plan would rectify that.

## **A first-class portfolio of assets which are failing to deliver optimal value for shareholders**

Despite the first-class quality of most of BHP's assets, BHP as an investment has underperformed a portfolio of comparable mineral and petroleum companies in recent years across a number of metrics, including total shareholder returns – this is clear from the charts on slides 8 to 10 of the enclosed presentation.

BHP's management took an important first step towards streamlining BHP's portfolio in order to release value for BHP's shareholders by demerging South32 in May 2015. However, in isolation, we believe that the South32 demerger has actually magnified the inefficiencies of BHP's DLC structure by further decreasing the proportion of BHP's EBITDA which is generated by PLC.

In our view, most of BHP's underperformance in terms of total shareholder returns has been driven by the incomplete status of management's streamlining and value-optimization of BHP's group structure and asset portfolio. The Value Unlock Plan is designed to directly address this and would be the logical next step.

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<sup>5</sup> Based on DLC structures with a combined market capital of over US\$15bn.

<sup>6</sup> As announced by Unilever on April 6, 2017.

<sup>7</sup> When Limited, as an Australian tax resident company, pays tax on its income it can record that tax paid as franking credits. Limited then attaches those franking credits to any dividend it makes, or to any income component of a share buyback which it undertakes. Those franking credits can then be used by Australian tax resident shareholders who receive them to offset their own liability to Australian tax on the dividend income, or income component of any share buyback consideration, which it receives from Limited. Further detail on franking credits, their potential wastage in the current DLC structure and their monetization is set out in the Appendix to the Presentation.

## The Value Unlock Plan for BHP – addressing key shareholder value issues

The Value Unlock Plan is intended to directly address BHP’s key shareholder value issues for BHP’s owners, with three key steps. Each step is designed to individually contribute to unlocking significant shareholder value and we present them in the order in which they should be undertaken:

### *Step 1: Unifying BHP into a single Australian-headquartered and Australian tax resident listed company*

Following the South32 demerger, we estimate that PLC now generates only c. 8.9%<sup>8</sup> of BHP’s EBITDA, but PLC’s shares account for 39.7% of BHP’s aggregate number of issued shares. The long-term misalignment of profits vs. shareholder base in the DLC structure has led to a massive and continuing build-up of franking credits – totaling US\$9.7bn<sup>9</sup> or c. 10% of BHP’s market capitalization.

Absent a clearly defined optimal path to monetizing those franking credits, they are not being appropriately valued by the market.

Over the last 16 years since the completion of the DLC merger, PLC’s shares have traded at an average discount of **12.7%** to Limited’s shares. In our view, that sort of price dislocation stems from the economic asymmetry described above, as between PLC and Limited, which in turn undermines the fundamental principles and objectives of the DLC structure, being the achievement of equivalent economic returns on their shares as between PLC and Limited shareholders.

Unification<sup>10</sup> would:

- ✓ create a single Australian-headquartered and Australian tax resident unified BHP company which would continue to be managed from Australia. That company could retain BHP’s current stock market listings and continue to be included within key FTSE and ASX stock indices;
- ✓ put BHP’s Limited and PLC shareholders on the same footing, eliminating the current trading value mismatch between the two lines of shares;
- ✓ allow BHP to access the value represented by its existing massive US\$9.7bn franking credit balance, plus future franking credits generated by the business, for the benefit of all BHP shareholders<sup>11</sup>;
- ✓ significantly enhance the scope for, and optimize the value impact of, BHP share buybacks – unified BHP’s management could return the substantial upcoming excess cashflow to shareholders by way of 14% discounted off-market share buybacks. That would be a highly value-accretive way of management deploying a large amount of

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<sup>8</sup> Calculated by EBITDA contribution split for the last reported twelve month period, excluding third-party products and unnamed assets. Based on Elliott estimates of asset ownership between Limited and PLC, using the asset split at the time of the DLC inception and assumes (i) no subsequent intra-group asset transfers between PLC and Limited; and (ii) that assets located in Australia that were acquired from Western Mining were acquired by, and continue to be held directly or indirectly by, Limited.

<sup>9</sup> Based on last reported figures.

<sup>10</sup> Unification would be implemented by way of inter-conditional share-for-share schemes of arrangement of each of Limited and PLC under which Limited and PLC shareholders would become shareholders in a single unified BHP public company listco incorporated in England & Wales, which would 100% own both of then-delisted Limited and PLC.

<sup>11</sup> Whilst unlocked franking credits could only be used by Australian tax resident shareholders, non-tendering shareholders should benefit from incremental accretion and share demand resulting from monetization of BHP’s substantial franking credit balance.

capital without any additional operational risk – effectively buying BHP’s own first-class core assets at a meaningful discount to their market price;

- ✓ remove any need to use the Dividend Share Mechanism, thereby avoiding wastage of valuable franking credits;
- ✓ help management to avoid making badly timed acquisitions paid for in cash, given the opportunity to deploy significant cash resources in value-enhancing post-unification share buybacks;
- ✓ increase the scope for management to pursue appropriate acquisition opportunities using unified BHP’s own shares as consideration; and
- ✓ remove certain other material tax, operational and strategic inefficiencies caused by the DLC structure.

We estimate that the BHP group’s tax and other deal costs for implementing our unification plan would be both reasonable and far outweighed by the significant shareholder value unlock opportunity to which it is key. In addition, we do not see any material regulatory obstacles to BHP implementing our unification plan – for example, a unified BHP would be tax resident and headquartered in Australia, so there should be no reason for concern on the part of FIRB<sup>12</sup>.

### ***Step 2: Demerging and separately listing BHP’s US petroleum business***

Based on commonly utilized valuation metrics for comparable businesses, the indicated value for BHP’s US petroleum business is c. US\$22bn, which is well in excess of the current analyst consensus valuation for that business.

Our analysis indicates that the US petroleum business has not been able to successfully contribute to shareholder value at BHP since (i) it provides no meaningful diversification benefits to BHP as a whole; (ii) there is a lack of synergies between BHP’s US petroleum business and its mining assets; and (iii) its intrinsic value is being obscured by bundling it with BHP’s other assets.

We believe that within the confines of the existing group, BHP’s US onshore acreage opportunities are extremely limited. BHP has competing capital allocation alternatives - including its world-beating mining assets such as those within its iron ore division, and highly value-accretive post-unification off-market BHP share buybacks at a 14% discount to market price. In the circumstances, BHP’s management simply cannot justify allocating the capital which the US onshore assets would need for the US petroleum business to realize its growth potential or meaningful corporate expansion activities.

A demerger and separate listing of BHP’s US petroleum assets on the NYSE would:

- ✓ unlock the intrinsic value of the US petroleum business and provide shareholders with access to what we believe would be a much higher market value for that business;
- ✓ allow the demerged US petroleum business to be properly capitalized and pursue value-accretive strategic opportunities;

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<sup>12</sup> The Foreign Investment Review Board of Australia, which would review a unification transaction involving a resulting single unified BHP public company listco which is incorporated in England & Wales.

- ✓ allow BHP's management to fully focus on deriving value from BHP's unrivalled portfolio of first-tier mineral assets; and
- ✓ allow BHP's investors to tailor their own desired exposure to US energy and petroleum equities rather than being constrained by the fixed acreage composition and petroleum vs. minerals mix currently being offered by BHP.

We see the demerger of BHP's Gulf of Mexico assets in combination with the US onshore petroleum assets as providing a standalone US petroleum business with consistent cash flow to fund its own further expansion, allowing BHP to increase its focus on its core competencies and also helping the value of BHP's remaining core portfolio to positively re-rate.

### ***Step 3: Adopting a policy of consistent and optimized capital returns to shareholders***

BHP is expected to generate c. US\$31bn<sup>13</sup> of excess cashflow in the next 5 years, assuming the current 50% payout ratio of net income.

Unfortunately, BHP has previously used excess cash to make value-destructive acquisitions when it acquired certain Fayetteville assets and Petrohawk. Management should avoid making badly timed acquisitions for cash and instead return its substantial upcoming excess cashflow to shareholders by way of highly value-accretive post-unification 14% discounted off-market share buybacks.

A clearly defined and communicated ongoing 14% discounted off-market buyback program undertaken by a unified Australian tax resident BHP which has demerged its US petroleum business would:

- ✓ enable BHP to purchase its own shares at a substantial discount, achieving an overall cost which is c. 5.6% lower<sup>14</sup> than the price at which BHP can currently buy back its shares;
- ✓ release up to c. 66% more<sup>15</sup> franking credits to shareholders; and
- ✓ facilitate an initial off-market buyback of at least US\$6bn.

We estimate that within the five year period ending June 2022, in addition to the continuation of the current 50% dividend payout ratio, adopting this capital return policy as part of the Value Unlock Plan could result in<sup>16</sup>:

- ✓ a total of **c. US\$33bn** being returned to shareholders via share buybacks;
- ✓ **c. 29%** of core BHP's share capital being repurchased;
- ✓ total EPS accretion from buybacks of **c. 33%** in respect of the shares remaining in issue after the 14% discounted buyback program; and

<sup>13</sup> Free cash flows from operations less free cash flows from investing and dividends, assuming the current 50% payout ratio of net income. Calculated by Elliott as the average of the figures produced by analysts at major international investment banks.

<sup>14</sup> The assumptions utilized in calculating this figure are described in the Presentation.

<sup>15</sup> The assumptions utilized in calculating this figure are described in the Presentation.

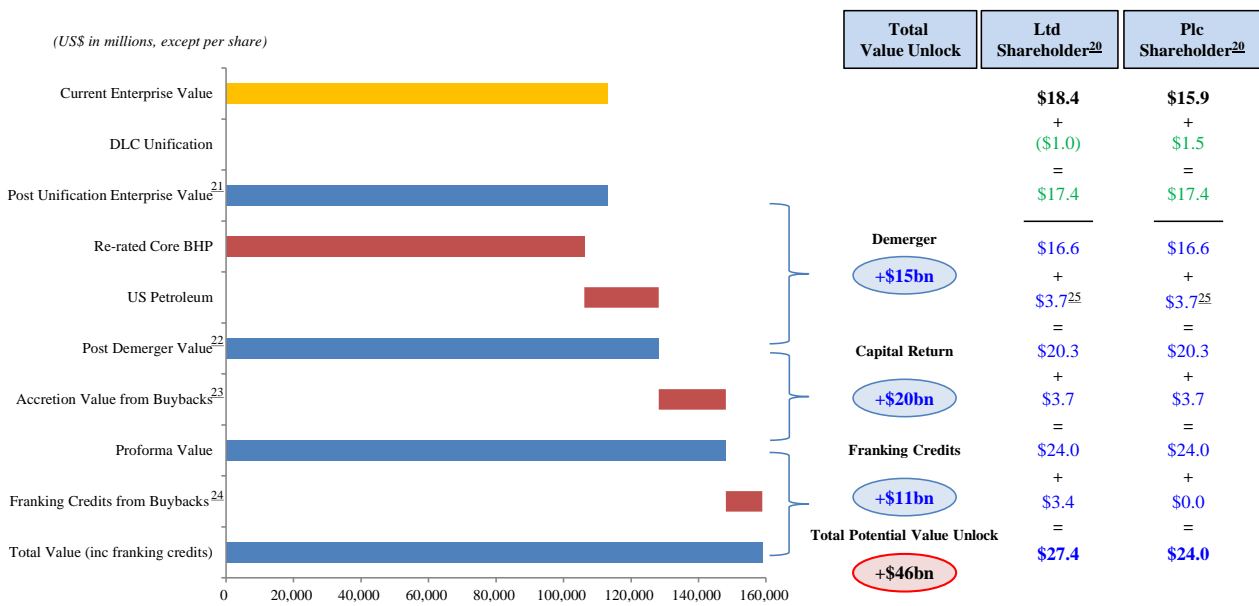
<sup>16</sup> Assumes annual off-market share buybacks starting at US\$6bn and then utilizing excess cash flow whilst maintaining a 1.3x net debt / EBITDA target thereafter. Cash flow levels are Elliott's estimates based on a 1.3x net debt / EBITDA target. Also assumes share price appreciates annually based on constant multiples and that BHP conducts annual buybacks at a 14% discount to the post annual EPS accretion share price.

- ✓ an increase in BHP’s NPV of **c. US\$20bn** (c.21% of BHP’s current market capitalization)<sup>17</sup>.

Moreover, BHP could deliver these sorts of significantly enhanced returns for shareholders whilst still retaining an “A” grade credit rating<sup>18</sup>.

**The potential to unlock a significant amount of shareholder value at BHP**

Our analysis indicates that implementation of the Value Unlock Plan could provide BHP shareholders with an increase in the value attributable to their shareholdings of **up to c. 48.6% (Limited shareholders) / c. 51.0% (PLC shareholders)**<sup>19</sup>.



Source: Company filings and Elliott’s estimates.

<sup>17</sup> The NPV is calculated in respect of (i) the increased share price implied by the EPS accretion, applied to the reduced number of shares in issue post buybacks; and (ii) the capital returned through the discounted off-market share buybacks up to June 2022.

<sup>18</sup> “A” grade credit rating means an “A-, A or A+” credit rating. This could be retained whilst maintaining a net debt/EBITDA ratio of 1.3x (or other appropriate metric).

<sup>19</sup> Please see the Presentation for further details.

<sup>20</sup> These per-share numbers are in respect of the current aggregate number of BHP shares in issue, except for the franking credits from buybacks number, which is based on the number of Limited shares currently in issue.

<sup>21</sup> Enterprise value measured before demerger of BHP’s US petroleum business. Assumes that the BHP share price post-unification would be the weighted average (by number of shares in issue at Limited and PLC) of the current share prices of Limited and PLC. The post-unification (before demerger) enterprise value is therefore assumed to remain the same as BHP’s current enterprise value.

<sup>22</sup> Valuation based on mean values of US petroleum and unified core BHP shown in the valuation slides in the Presentation.

<sup>23</sup> Valuation based on the NPV of (i) the increase in core BHP’s share price implied by the EPS accretion from the share buybacks which are proposed by Elliott in the Presentation, applied to the reduced number of shares in issue post buybacks; and (ii) the capital thereby returned to shareholders.

<sup>24</sup> NPV of franking credits released from Elliott’s proposed discounted off-market buyback program.

<sup>25</sup> Assumes US\$2.5bn of BHP’s existing net debt is allocated to the US petroleum business (c. 0.9x net debt / consensus 18E EBITDA).

### ***Independent analysts' views***

Independent research analysts have commented<sup>26</sup> on many of the issues which underpin the Value Unlock Plan and a selection of those comments is set out in the Appendix to this letter.

### **Conclusion and next steps**

BHP's management has a remarkable opportunity to significantly enhance shareholder value. We urge each of you, consistent with your duties as directors of BHP, to review the Value Unlock Plan in light of the very real and measurable benefits which we believe they can have for BHP's shareholders.

Given that our analysis shows that implementation of the Value Unlock Plan could provide BHP's shareholders with an increase in the value attributable to their shareholdings of up to c. 48.6% (Limited shareholders) / c. 51.0% (PLC shareholders), we expect that a full and open review of our plan by management in the near term would be welcomed by an overwhelming majority of BHP's owners.

We look forward to you as BHP's directors announcing on a timely basis the start of your work in formally reviewing the Value Unlock Plan, along with a commitment to publishing within a reasonable timeframe the details of the scope and results of that review.

Yours faithfully,

**Elliott Advisors (HK) Limited**

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<sup>26</sup> The analysts' views mentioned in this letter shall not be taken to mean or imply (i) that the research reports referred to are a representative sample of all research reports on the topics concerned; or (ii) that the authors of the reports or their employing banks/brokers endorse in any way the Value Unlock Plan or the views set out in this letter. We have emboldened, by way of emphasis, certain parts of the original text of the analysts' views which appear in this letter.

## APPENDIX

### *Independent analysts' comments on DLC issues*

**“DLC Structures are not permanent. Based on our analysis we have seen that DLC structures are not intended to be permanent structures and nor are they beneficial for shareholders forever. We believe that now is an appropriate time for BHP to consider unifying the DLC structure.” - UBS, July 14, 2014**

**“[A] collapse of the DLC such that all shareholders are holders of Ltd shares, would see all dividends utilise franking credits going forward. We believe that BHP will be capable of maintaining the fully franked dividend to all shareholders following a collapse of the DLC, given that the bulk of earnings are generated by the Australian assets (in particular iron ore) and the payout ratio should be maintained at ~50%.” - UBS, July 14, 2014**

**“New proposal will lead to wastage of future franking credits...: Australian shareholders can benefit from tax relief on dividends (“franking credits”). Under the proposed change to the dividend funding mechanism, Ltd's dividends to plc would have franking credits attached, but these credits can only be monetized by Australian shareholders. At 30th June, BHP Ltd had \$10.9bn of franking credits, equivalent to ~4 years of fully franked Ltd dividends. We believe certain Australian shareholders may consider the leakage of franking credits to plc shareholders, which they are unable to monetise, as disadvantaging Ltd shareholders.” - JP Morgan – September 22, 2015**

### *Independent analysts' comments on BHP's US petroleum business*

**“We have always struggled with US onshore asset as in our view they do not fit in BHP's strategy of building large scale low cost tier 1 assets and are arguably worth more to someone else.” - Citigroup – April 22, 2016**

**“On strategy, we think there is no real benefit from portfolio diversification per se and unless we see a dramatic outperformance of oil versus iron ore (clearly not the case at present) we see no reason for BHP to trade ahead of Rio Tinto.” - Bernstein – January 5, 2017**

### *Independent analysts' comments on capital returns*

**“If the DLC were to be collapsed, then every dollar returned via a buyback would be done through the buyback of Ltd shares which provided sufficient franking credits existed, could be done at a ~14% discount to the prevailing share price on the day. This is more accretive than buying back Plc shares as the discount at which Plc shares trade to Ltd shares has historically been narrower than 14%. The off-market buyback of Ltd shares also enables distribution of franking credits to shareholders that can utilise them” - UBS – July 14, 2014**

**“Despite >US\$30b spent, failed tilts at RIO and Potash Corp and overpaying for US Shale suggest M&A is not BHP's raison d'être.” - Citigroup – May 27, 2016**

**“At spot prices BHP would have even stronger free cash flow generation, largely thanks to iron ore, and be able to significantly increase shareholder returns. Dividend yield could increase to >6% and even if a more conservative balance sheet was run it would still allow for ~US\$5b to be returned per year.” - Citigroup – Feb 21, 2017**



## IMPORTANT INFORMATION

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<sup>27</sup> In addition to their long economic interest in PLC, the only other positions that the Elliott Funds and their affiliates hold in or relating to BHP are the rights to acquire up to approximately 0.4% of the issued shares in Limited.

or to correct any inaccuracies in this letter.

The information in this letter contains 'forward-looking statements.' Specific forward-looking statements can be identified by the fact that they do not relate strictly to historical or current facts and include, without limitation, words such as "may", "can", "will", "expects", "believes", "anticipates", "plans", "estimates", "projects", "targets", "forecasts", "seeks", "could", "would" or the negative of such terms or other variations on such terms or comparable terminology. Similarly, statements that describe any objectives, plans or goals of the Elliott Funds and/or Elliott and/or their respective affiliates are forward-looking. Any forward-looking statements are based on the current intent, belief, expectations, estimates and projections of Elliott. These statements are not guarantees of future performance and involve risks, uncertainties, assumptions and other factors that are difficult to predict and that could cause actual results to differ materially. Accordingly, you should not rely upon forward-looking statements as a prediction of actual results and actual results may vary materially from what is expressed in or indicated by the forward-looking statements.

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