HD **Investors Chronicle - magazine and web content: BHP courts private equity approaches.**

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Separate announcements from BHP Billiton and former Xstrata chief Mick Davis could herald an upsurge in mining deals over coming months.

Last week, a report from Australia's Bureau of Resource and Energy Economics (BREE) predicted that by the end of 2019, iron ore prices would fall by around 30 per cent from last year's average of $126 (GBP76) a tonne. It capped a volatile month for industrial metals, in which doubts grew over the sustainability of global demand levels, or to be precise, those of China's.

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Prices for a range of industrial commodities slipped back in the first quarter of this year due to China's burgeoning inventory levels, but that's a regular cyclical phenomenon. The underlying reason why some analysts have expressed doubts over China's ability to soak up any excess capacity in metals markets is the heightened risk profile of its credit markets. Beijing has given assurances that enough liquidity will be pumped into the economy to underpin domestic capital flows, but the People's Republic experienced its first corporate bond default in recent history at the beginning of March - and its second followed barely a month later. The fear is that if a trickle of corporate defaults transforms into a steady stream, then lenders will take flight - and the consequent squeeze on short-term financing could perpetuate the process.

The consequent risk to bulk and base metals prices is exacerbated by the fact that around 60 per cent of China's warehoused copper is used as loan collateral (see 'Copper's Collateral Damage' IC 28 March 2014). And if you throw in expectations of tougher environmental regulations that could precipitate the closure of some of China's aging steel mills, then the BREE report could well prefigure the shape of things to come.

Yet for all the negative sentiment towards industrial metals, it has emerged that X2 Resources, an investment vehicle established by ex-Xstrata chief Mick Davis, has secured up to $3.75bn from a handful of institutional investors to finance the creation of a mid-tier diversified mining and metals group. The backers are made up of three unnamed sovereign wealth and pension fund investors, together with US private-equity group TPG Capital and the Singapore-listed commodity trader Noble Group.

The involvement of heavyweight backers such as Noble Group is more a nod to Mick Davis' industry pedigree, rather than a reflection that mining assets can be picked up on the cheap at the moment. The Xstrata business model was transformed in the early part of the millennium due to a number of low-ball acquisitions, most notably the 2003 deal that secured the Australian copper, zinc and lead miner MIM Holdings for just A$2.9bn (GBP1.6bn). It's no longer a buyers' market, but there's certainly no shortage of quality assets up for grabs. Most of the big diversified miners have been trying to hive-off non-core assets to reinforce their balance sheets, while many small caps and Aim stocks are struggling to push ahead with development projects through want of financing - step-up the likes of Mick Davis and his crew.

Curiously, the details of the X2 funding preceded an announcement from BHP Billiton (BLT), in which the Anglo-Australian mining giant effectively confirmed that it might consider canning its existing divestment programme in favour of a potentially chunky $20bn demerger. What this could mean for shareholders is anyone's guess, but in reality we believe that BHP's revelation simply represents a 'come hither' stance - for want of a better expression. After all, it's hard to imagine that institutional shareholders would countenance any spin-off that would entail them holding a stake in a demerged entity partly comprised of underperforming - and essentially disparate - mining assets. True, the newly merged miner would enjoy a diversified portfolio with some strong performing assets like the Cerro Matoso nickel mine in Colombia, but collectively these assets currently deliver an operating return well below the group average.

It's more likely that BHP's chief executive Andrew Mackenzie is sending out a signal to a hitherto reticent private **equity** industry that is reportedly sitting on **billions** earmarked for commodity-backed investments. BHP intends to clear the decks and focus its attention on just four commodities - **iron ore**, **copper**, coking **coal** and petroleum - with potash a possible fifth strand. It means that BHP's nickel businesses in Australia and Colombia must go, along with its aluminium interests in Australia and Africa. Its manganese plants and thermal **coal** assets will be sold off, along with the Cannington silver/**lead**/zinc mine in Queensland.

The aggregate book value of the non-core assets is well short of the $20bn demerger figure that is being mooted, but a spin-off would at least guarantee that BHP would not be left holding less desirable assets that couldn't attract buyers under separate unit sales. The suspicion is that BHP would prefer to sell these assets on a piecemeal basis, as it would generate enough cash to bolster the group's balance sheet and facilitate another substantial buy-back programme or a special dividend for shareholders.

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CO bkhlp : BHP Billiton Ltd | bltplc : BHP Billiton PLC | march : Glencore Xstrata PLC

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