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HD **Laser focus amid thorny issues**

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Oh dear. So we are to call the third son of BHP Billiton's long reconstruction South32.

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Apparently it has something to do with the shared latitude of Australia and South Africa, and the idea bubbled up from a future staff member. But it all sounds more like a Pixar movie than a **mining company**. But there you go. After OneSteel, then BlueScope, BHP has added South32 to the corporate lexicon.

Much more immediately important than the name of this demerger is whether or not South32 should be released to its new freedom by June next year as is currently planned.

While the logic remains sound, the timing of fulfilment has been rendered a question by the potential concern that the assets BHP no longer wants to waste time and capital on, might end up being just as unloved by newly cautious **equity** markets.

Like everyone else getting to the pointy end of the sort of divestment cycle that routinely follows a boom gone bust, BHP has asserted that shareholder value comes before strategic priority.

So it is that deals that might make life easier, but that do not at least match internal valuation are not pursued.

A classic of that kind in BHP's case is the decision to close the Nickel West **sale** process without a deal. The bargain hunters came. But the deal could not be done.

The demerger process creates a different sort of decision making dynamic to the rather clearer mathematics generated by a vanilla trade **sale**. The process has the effect of transferring the challenge of valuation to the open market and then directly to the owners.Buyers market bargain

And there's the rub. BHP is releasing South32 into what is plainly a buyers market. The risk implicit is that the initial valuation of this business will not reflect the long term fundamentals of the minerals and metals it produces. So a trade buyer with a longer view than that of the situation-driven **equity** market could well end up with a real bargain here.

Back in August, when BHP confirmed reports that the demerger was in the making, estimates of the value of South32 ranged to about $US20 **billion** ($24 **billion**).

More recently people have talked $US15 **billion** with some downside risk to that.

In October, it was reported in London that the man who made Xstrata, Mick Davis, had come shopping for everything BHP planned to demerge.

After surrendering Xstrata to its parent Glencore in a deal laced with increasingly obvious bitterness, Davis went out and started a new resources fund. Rather pointedly, he called it X2 Resources – and then went out and raised a bundle of equity from Noble Group, TPG Capital and a bank of sovereign wealth funds including the Abu Dhabi Investment Council and Caisse de dépôt et placement du Québec.

It is estimated X2R is sitting on about $US4.5 billion in equity.

And it is speculated that Davis offered BHP $US10 billion for the South32 assets.

The gap between that and estimates of South32's listing value is eroding fast. South32X2R anyone?

The thing to appreciate here is that, for all the fun people have had with the CrapCo stuff, there are a bunch of sizeable minerals princelings sitting inside South32.

The Cannington silver-lead-zinc mine is a wonderfully reliable cash flow machine that has a life extending expansion already mapped out.Serious, expandable manganese

There is a world-leading manganese business, a very serious and expandable Colombian nickel operation, an integrated aluminium business and some pretty productive coal operations that have plenty of room for improvement under the undivided focus they will now earn from management. The other critical thing to appreciate about the South32 portfolio is that they support a second-generation China-boom story.

The boom and retreat in steel raw materials is well appreciated. Enduring structural growth in demand resulted in an extended period of higher prices.

That resulted in a natural supply side response that has mitigated pricing. But demand will stay higher for longer.

But across the mining world long bets have already been laid on China's move to a consumption driven growth story as the capital investment phase of its transformation slows.

For miners the consumption story becomes all about getting longer in lighter metals and energy. That is why BHP is so keen on copper and petroleum. And that is why Rio wants more copper, and is banking on better days for its oft-written down aluminium investment case.

The South32 upside is based on a thinner, but broader spread of commodities. It has an aluminium business that has endured serious tough times that still sits in the second cost quartile of the industry, but is reasonably well set to generate margins on the recovery in pricing that seems in train.

The fundamentals of nickel are rather more uncertain and flukey, but its Cerro Matoso operation in Colombia (latitude North 4) is a high quality and expandable business.

It is the increasing visibility of this second-gen potential and the certainty that South32 will be born with a protective bank of professional investors that leaves BHP still confidently wedded to both the concept and timing of the next big step towards it learner, laser focused future.

Talking of divestments set to endure the chill of price recession, we hear that Apache is determined to continue with the sale of its 13 per cent share of the Wheatstone LNG project and to get a deal announced before Christmas, as promised. The talk is that Woodside has moved into full due diligence of a deal once flagged as a $2.4 billion transaction.

Sources say Woodside was left the only buyer in the Apache process with the retreat this week of an unnamed second bidder that was refusing to match the growth-challenged Australian's price. Apparently, both bidders trimmed their pricing over recent days, but Woodside emerged with a more compelling set of numbers.

The deal is said to include a giant slice of blue sky in the form of Apache's 50 per cent share in a Canadian LNG project called Kitimat. Like Wheatstone, Chevron is the operator of the Canadian project.

Woodside's medium-term growth outlook remains arguably the only problem boss Peter Coleman has failed to come to terms with in his three years in control. The ramp up of the Pluto project has generated cash to burn, Woodside has been unable to fulfil the project's potential for want of the gas that would feed the second and third LNG trains that, under the original plan, would have been built by now. While chasing options to feed Pluto's growth, Coleman has successfully added a challenging slate of options for long term growth across a broader globe of the gas and oil world.

Now we hate to link the thorny issue of institutional ownership unrest and Woodside, but that is what we are hearing has been triggered by a deal that now looks pretty close.

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