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Woodside Should Leave Shell

Woodside Petroleum's investors are grumbling that they will only get crumbs from a deal whereby Royal Dutch Shell is selling its **stake** in the Australian **oil**-and-gas producer. But those crumbs may ultimately add up to a better future.

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Shell announced last month that it would reduce its **stake** in Woodside from around 25% to 4%, through a US$2.68 **billion** share buyback. The deal, which also involves Shell selling some of its **stake** to institutional investors, would remove a nasty overhang. Speculation about when Shell would sell its **stake**, acquired in a blocked takeover bid in 2001, has long weighed on Woodside's stock.

Woodside would pay Shell A$36.49 (US$34.28) a share, a 14% discount to the trading price before the deal was announced. Shell also gets a load of tax credits known in Australia as franking credits.

While of little use to most offshore investors, the credits are highly sought after by Australian investors who pay little or no tax, such as domestic pension funds and charities, because the government pays excess credits as cash at tax time.

Woodside's other shareholders aren't being offered the buyback, and some think that with the franking rights factored in, Shell actually gets a premium. The deal needs 75% of votes cast to be approved.

Based on turnout at previous Woodside meetings, the deal could be torpedoed by as little as 15% of the shares being voted against it.

Investors such as Plato Investment Management, which holds less than 1% of the **company**'s shares, want Woodside to make the Shell offer open to all.

At least two large Australian funds are undecided how they will vote. Proxy advisory **firm** Ownership Matters has advised clients to vote against the deal on the basis that Shell is receiving a benefit that other shareholders would like to have.

But there is a danger of missing the wood for the trees here. Spreading the US$2.68 **billion** among all investors wouldn't realize the central aim of getting Shell out of Woodside's hair. Raising the size of the offer would increase the cost of the deal to Woodside, crimping its ability to fund its stalled Browse liquefied natural-gas project off Western Australia state and find new reserves.

The current deal also nullifies a section in Woodside's charter allowing Shell to nominate directors to the board in a number proportional to its **stake**. Woodside argues that potential project partners may be more willing to join with a **company** that is independent of a major competitor.

Shell may be more reluctant than institutional investors to stump up funds in future capital raisings to support Woodside's expansion plans, given that the U.K. **oil** major has its own capital-intensive projects to fund and has been tightening its belt after years of big spending.

The current plan also sets the groundwork for higher earnings per share down the road, as the buyback would reduce the share count. Investors interested in staying for the long haul would be wise to stand aside and let Woodside emerge from its Shell.

-- Rebecca Thurlow

Default Averted in China Again

Another default scare in China has ended with a bailout mystery.

Last week, Chinese construction company Huatong Road & Bridge Group warned it might default on a 400 million yuan ($64.5 million) bond coming due Wednesday. It would have been only the second bond default ever in China, after Shanghai Chaori Solar Energy Science & Technology missed interest payments on a bond in March. The Huatong default could have been bigger, as it involved principal as well as interest.

It wasn't to be. The construction company repaid the amount due before Wednesday's deadline.

It isn't clear how the company came up with the money so quickly after warning of impending default. The situation is reminiscent of another near default earlier this year, when a trust product backed by loans to a coal company and sold to investors by Industrial & Commercial Bank of China, the nation's largest bank, was rescued at the 11th hour by an anonymous third party. Many investors suspect local-government involvement in these types of bailouts.

The market could have absorbed the impact of an outright Huatong default without triggering much angst. Corporate-bond yields have ticked up slightly since Huatong's warning last week, but they are still down from levels just after the Chaori default, and substantially lower more than 1.3 percentage points for triple-A-rated corporate bonds since the start of the year, when financing conditions across the country were tighter.

Meanwhile, in the company's shadow-banking sector, a handful of trust products have failed to make scheduled payments this year. But a widely anticipated wave of defaults has failed to materialize. Looser monetary conditions, intended to ease the economic slowdown, have made it easier for stressed borrowers to roll over loans.

China is only storing up trouble for later. Credit Suisse estimates that over the next nine months some 4.2 trillion yuan of trust loans are scheduled for repayment. And total credit continues to expand, at around 19% in the second quarter, according to Standard Chartered. That is more than twice the pace of economic growth and inflation, meaning the Chinese economy is still levering up, not down.

Policy makers showed earlier this year they were ready to allow small-scale defaults to get investors used to assessing risk, a foreign concept yet key for a functioning debt market. But like a nervous parent, China doesn't want anyone to get hurt just yet.

It is time to take off the training wheels.

-- Aaron Back

Overheard

The centerpiece of China's state-owned enterprise reform drive is greater "mixed ownership."

That is Communist Party jargon for allowing private capital to own a slice of state assets.

This year, China has announced plans to bring in more outside investors for four centrally state-owned enterprises, including Sinopec and Sinopharm, as well as for local government-owned companies.

In theory, this should boost productivity. But many state firms already have private investment.

Capital Economics says the impact of mixed ownership has been slight.

State-owned companies with some private investment had a return on assets of 4.8% last year, Capital Economics estimated.

That compares with 3.7% for state-owned companies with no private stakes.

Wholly private firms had a return of 11.9%.

Introducing some private capital has benefits, but the results are decidedly mixed.

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