

HD BHP flags split to spur buyers

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BHP Billiton has introduced competitive tension into its long-planned divestment of non-core aluminium, **coal** and nickel assets.

The introduction of a demerger as a **firm** divestment option comes as private **equity** funds are variously said to be holding \$US15bn-\$US50bn for investment in resource assets, most notably those to be discarded by BHP and Rio Tinto under its parallel strategy of shedding non-core assets.

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BHP is out to extract best value from its proposed divestments and including the demerger option is a clear signal to cashed-up but reticent PE resources funds and trade buyers that now is the time to come forward with proposals.

Assets that could make their way into a demerged **company** — or be sold off to trade buyers or PE funds — include aluminium in Australia and Africa, nickel in Australia and Colombia, manganese in Australia and South Africa, thermal **coal** in South Africa and New Mexico, and the Cannington silver/**lead**/zinc mine in Queensland.

While some, such as Cannington and the Cerro Matoso nickel mine in Colombia, are strong performers and have real trade and PE fund appeal, the task of finding buyers for the other collection of assets is more of a challenge. The demerger option at least creates a more diversified portfolio, one where the differing price cycles of the commodities could appeal to BHP shareholders with a holding in what would be tantamount to a “mini me” BHP.

The planned divestment of assets considered non-core to BHP’s four “pillars” of **iron ore**, **copper**, petroleum and coking **coal** was first flagged by its previous chief executive, Marius Kloppers.

The simplification strategy has been adopted with gusto by new chief executive Andrew Mackenzie, who has also confirmed continued heavy investment in Canadian potash as BHP’s potential fifth pillar.

BHP has used the demerger process in the past to get rid of unwanted assets — the long products business of OneSteel in 2000, which was followed by the demerger of the flat steel business into BlueScope.

Speculation that the demerger of assets that fall outside its current four pillars was now under active consideration was not dismissed by BHP yesterday.

Rather than waiting for a query from the ASX, the **company** took it upon itself to indirectly confirm the demerger talk by not dismissing it out of hand. But it made clear that a demerger was only one of the options under consideration, and that no decision on the best way to achieve its simplification ambitions had been made.

Individual asset sales to trade buyers or emerging and well-funded private **equity** funds, such as the X2 Resources fund headed by former BHP finance chief and later Xstrata chief executive Mick Davis, are considered by the market to be the likeliest outcome.

In response to the market speculation on the demerger, BHP said that “simplification of our portfolio is a priority and is something we have pursued for several years”.

"In the last two years alone, the group has announced or completed divestments in Australia, the United States, Canada, South Africa and the United Kingdom, including petroleum, **copper**, **coal**, mineral sands, **uranium** and diamond assets."

The remaining non-core assets are yet to go down the same path flags because they are difficult to sell. Their appeal sitting inside a demerged organisation without the cashflow to meet long-term sustaining capital requirements is why the demerger option has not received much of an airing until now.

"We believe that a portfolio focused on our major **iron ore**, **copper**, **coal** and petroleum assets would retain the benefits of diversification, generate stronger growth in free cashflow and a superior return on investment," BHP said.

"By increasing our focus on these four pillars, with potash as a potential fifth, we will be able to more quickly improve the productivity and performance of our largest businesses," BHP said.

It said it would actively study the next phase of simplification, including structural options, but will pursue only options that maximise value for BHP shareholders. "Any course of action remains subject to detailed review and an assessment of alternatives," BHP said.

The common feature of the key assets up for **sale** is that with the exception of manganese in Australia and South Africa, the Cannington base and precious metals mine in Queensland, they all are struggling because of weak prices, most notably aluminium and nickel.

The rise of aluminium smelting and nickel processing in **China** has changed the global industry's cost curve.

In essence, a demerger to shareholders — they could presumably opt out in or out — would be offering them the worst of the BHP businesses, shored up here and there by a profitable Cannington and manganese business, and a thermal **coal** business that could have better days with more cost-cutting.

The suggested \$US20bn value of the demerger option was widely discounted by analysts. A research note by Macquarie last month put a fair value on the aluminium business of \$US3.67bn and \$US4.6bn for nickel.

Manganese was put at \$US3.84bn and the non-core **coal** assets came in at \$874 **million**. Cannington was said to have a fair value of \$1.8bn.

That comes to less than \$US15bn, but BHP could enhance any demerger with some cash. But that would fly in the face of BHP's plan to increase returns to shareholders through share buybacks/dividend increases.

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