

BHP set to ditch its dual listing

By Adele Ferguson

February 12, 2007 12:00am

AS the BHP Billiton board moves closer to picking a replacement for chief executive Chip Goodyear, the market is bracing for an announcement that it will ditch its dual listed structure and make a bid for an oil, aluminium or diversified mining company.

Chairman Don Argus has known for more than a year that Goodyear has wanted to go - hence the decision to approach two external candidates and test two internal candidates, Chris Lynch and Marius Kloppers, by appointing them to the board 14 months ago and then giving them bigger executive roles.

Against this backdrop, the board is under increasing pressure from investors to enhance shareholder value. The \$US10 billion (\$12.8 billion) buyback is a good start but if it seriously wants to boost its price-earnings ratio and restructure its capital base, it needs to unwind the dual listed structure (DLC).

BHP adopted a DLC structure in 2001 when it merged with Billiton. Since then, its shares have consistently traded at a discount of between 3 per cent and 11 per cent on the London Stock Exchange for a number of reasons, including a smaller index weighting in Britain than Australia. (BHP splits its shares between two countries: 40 per cent of its shares are listed in Britain and 60 per cent on the Australian Securities Exchange.)

This share price differential between the two stock exchanges attracts more than its fair share of hedge fund activity, as the funds arbitrage between the two listings. The result is price volatility and that equates to uncertainty.

This has made a mockery of the main reason why companies were initially attracted to the DLC structure: increasing shareholder value by shifting to larger overseas exchanges.

What the board is believed to be considering is offering its British investors a scrip-based rollover at parity to roll their British shares into the listed Australian BHP shares. For those who don't want to roll their scrip over for an instantaneous rise (and that rise could be up to 10 per cent), it could offer a cash alternative at a 5 per cent discount to BHP's Australian price.

The more British investors that accept the scrip-based offer, the higher BHP's S&P/ASX200 index weighting will be. BHP could end up being 15 per cent of the

S&P/ASX200, the benchmark for one of the top five retirement savings pools in the world.

In the past 10 years, eight of the top 12 global companies have ceased trading as DLCs. The latest was Brambles, because the set-up was no longer relevant.

DLCs cost a lot of time, money and effort to service. They also attract more than their fair share of hedge fund activity.

Interestingly, Argus is also chairman of Brambles. Since Brambles unwound its DLC, its share price has sky-rocketed.

Besides picking a new chief executive, and collapsing the DLC, the other big issue for BHP is how best to manage the enormous cash flow coming through. Despite the recent fall in commodity prices, the thinking is that prices will continue to trade above trend for some time. Under current conditions BHP could be debt free in the next couple of years.

Back-of-envelope calculations suggest BHP will have a cash flow of \$34 billion in the next three to four years. The upshot is that it has ample room to make significant and immediate EPS-enhancing acquisitions. Given it is becoming cheaper to buy a business rather than build a project from scratch, it's only a matter of time before BHP unveils a big acquisition.

An ideal acquisition would be Woodside Petroleum, Alcoa or Alcan, any of which would catapult them from minnows in oil and aluminium to giants, or it could merge with Anglo American, which is in the process of selling off parts of its business, and would give BHP a 45 per cent stake in De Beers, the world's biggest diamond producer.

In the case of oil, BHP is well aware that the full value of BHP's petroleum division is not reflected in BHP's share price due to its small size. A bid for Woodside would give it the scale that it needs to re-rate it on the international scene. BHP explored merging with Woodside in 2001. A merger would be compelling since BHP Petroleum and Woodside have parallel exploration strategies in several areas, including West Africa, the Gulf of Mexico and the gas commercialisation of the east coast of Australia. Talks fell through in late 2001 over an inability to reach agreement on the transfer of value, strategy and control mechanisms within a merged group.

A possible option is for BHP Petroleum and Woodside to merge into a separate listed structure. Woodside's biggest shareholder, Royal Dutch/Shell Group, could throw in more assets to maintain its 34 per cent stake of the bigger group, and BHP would be the biggest shareholder, with a 50 per cent stake of the new Woodside.

Alternatively, BHP could launch a bid for Woodside, convincing Shell to sell down its 34 per cent stake in return for a bigger direct stake in Australia's biggest natural resource project, the North West Shelf.

Whatever happens, big changes are afoot at BHP and the board will make the decision about who will oversee these changes: Goodyear or a new chief executive. It is fair to

assume that the board has had long enough to test the internal candidates and is getting fairly close to a decision. Over the past year, approaches were made to two external candidates but due to a timing issue with their own contracts and goals, they turned the offer down. Right now, the most likely candidate to replace Goodyear is believed to be Lynch. But a lot could happen between now and the appointment.

Adele Ferguson works for CT Financial, a subsidiary of Crosby Textor. The views expressed here are Ferguson's alone, not of CT Financial or Crosby Textor.