Santos says rising oil price may mean it's worth 'substantially' more

By Cole Latimer
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The rising oil price means US private equity firm Harbour Energy's $13.5 billion takeover bid for Santos may have to be lifted to get more attention from the company.

At its annual general meeting on Thursday, Santos revealed it had divested a suite of non-core Asian assets and said it was focused on its operations rather than Harbour Energy’s "uncertain" offer.

Talking points

- Santos sells non-core assets for US$221 million.
- Santos believes rising oil price could force revaluation of Harbour Energy bid.
- Every US$10 rise in oil price equates to US$250-$300 million in extra cash flow.

Santos's GLNG project in Queensland is being buoyed by a rising oil price.

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Photo: Ashley Roach

"There is no offer on the table from Harbour, and as far as we’re concerned it’s business as usual," Santos chairman Keith Spence told the AGM.

"With the oil price what it is today, the value of the company may be substantially more. [Harbour Energy's] $US4.98 bid got them in the door; getting in the door is one thing, winning that bid is another."

The Brent crude oil price has risen around 10 per cent since Harbour Energy made its $6.50-ashare bid in April and is now above $US75 for the first time since 2014. Santos’s breakeven oil price is $US32 a barrel.

"Every $US10 increment in the oil price above our free cash flow breakeven will generate around $US250 million to $US300 million in free cash flow per year," chief executive Kevin Gallagher said.

Major shareholder Argo Investments' senior investment officer, Andy Forster, said shareholders backed Santos allowing Harbour in the door for due diligence.

In terms of re-evaluating the bid, Mr Forster said the long-term view on the oil price hadn’t changed over the past few months but it had improved in the short term.

He said LNG pricing would strengthen as the supply and demand balance changed.

"[It] is tightening quicker than most people previously expected, which has impacted LNG spot markets and also the timing and probability of future projects could increase their value," he told Fairfax Media.

Pulling out of Asia

Santos has sold its Asian assets to Ophir Energy for $US221 million ($294 million), exiting several countries in the process and tightening its portfolio.

"The sale is consistent with Santos’ strategy to realise value from its late-life non-core assets and will result in Santos making country exits from Vietnam, Malaysia and Bangladesh," the company said.

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The sale does not include Santos’s 50 per cent stake in the Ande Ande Lumut oil development, which it intends to offload in a separate transaction.

Mr Gallagher said the sale allowed the company to simplify the business and "focus on our five core long-life natural gas assets in Australia and Papua New Guinea".

Funds from the sale, which will result in a dip in the company’s total output of 1.4 million barrels of oil equivalent, will be used to drive down Santos’s net debt, which stood at $US2.5 billion at the end of March.

Both Santos' chairman and chief executive remained non-committal about Harbour Energy’s bid at the AGM.

Mr Gallagher said there was no certainty a binding offer would be put on the table that was "capable of being recommended by the board for consideration by shareholders". This is despite the fact Harbour Energy is understood to be working on a proposal to take to the Foreign Investment Review Board.

The FIRB hurdles

It is understood that Harbour Energy is focusing on four major points in its FIRB application: retaining jobs, the Santos head office staying in South Australia, ensuring domestic gas supply, and restraints on the levels of Chinese ownership.

Santos remaining in Adelaide will likely be a key component in Harbour's FIRB concessions.

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Photo: David Mariuz

Santos expects Harbour Energy’s due diligence process to be completed in the coming weeks.

Sources familiar with Santos have highlighted the possibility of the bid being rejigged once more. There are expectations a renewed offer would take into account the NSW Narrabri coal seam gas project getting closer to government approval, the approval of Santos’ Barossa offshore projects, and the lifting of the fracking moratorium in the Northern Territory, which will open up the highly prospective Betaloo Basin.

Fat Prophets analyst David Lennox said it was unlikely Harbour would increase its bid to reflect the increased oil price.

"If they made a bid today then they would have to add in this price movement but they made a fair bid at the time," Mr Lennox said. "History would suggest they wouldn't change the bid, they'd just walk away."

Mr Spence confirmed Santos's above-expectation performance and debt reduction would likely put dividends back on the table this year.

"If the performance of the business continues on [its current] trend and current oil prices are sustained, the board will look to restore dividends based on 2018 financial results," he said.

Santos shares rose 2¢ to $6.22.

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