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Mitsui wins a front seat in gas

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The idea that Mitsui could or would be squeezed into surrendering the opportunity to operate the major Western Australian gas project that arrives with its now successful \$602 million bid for AWE Limited is, quite frankly, risible.

As the sliding doors of the Australian gas industry close on AWE with Mitsui's move to firm control, there has been occasional speculation that Seven Group might attempt to gather dissidents enough to stand between Japan Inc and the compulsory acquisition threshold of 90 per cent.

Just to be sure, the sliding doors we are talking about here include Harbour Energy's ambitious \$13.5 billion pitch for Santos and the complications that has created for progress of the maybe \$2 billion sale of Brookfield's half-share of the biggest supplier to Western Australia's domestic gas market, the privately held Quadrant Energy.

It is known Santos was well down the track to making a move on Brookfield's piece of the Quadrant pie. But that work stream has stopped. And if Harbour is successful, the stream will flow the other way with the alignment of shared Santos and Quadrant assets to be achieved though a sale to private equity.

There is speculation that Mitsui is watching those developments closely. It could be a buyer of either the Santos share of Quadrant projects or even of the Brookfield half of the whole business. But, let's just stick with the deal nearest to resolution for the moment.

Now, assumed motive to any last-minute resistance is that Seven is controlled by the Stokes family, that it in turns owns 25 per cent of ambitious and acquisitive Beach Petroleum, and that Seven chief executive and Beach director Ryan Stokes has repeatedly expressed an interest in that business assuming operatorship of Western Australia's biggest ever onshore gas find, the Waitsia project.

AWE and Beach share equal ownership of the Waitsia project but the management rests with Mitsui's new domain. Stokes reckons Beach is a more natural operator of their project. Well, as they might say in Japan if they had seen The Castle, "Kare wa yumeda kare ni limasu" (Google's translation of "Tell him he's dreaming").

Even if Beach's sub-5 per cent stake in AWE could be converted into a block of resistance big enough to stall Mitsui's rapid progress to 100 per cent control, it is simply unimaginable the Japanese would be corralled into hasty or value diluting action.

We have been assured that Mitsui, having crossed two key thresholds of ownership, is not about to surrender self-restraint in the face of attempts to frustrate its march control.

The first of those ownership milestones was getting beyond the 50.1 per cent acceptance hurdle that freed Mitsui of the final condition of its offer. The second came early last week when Mitsui cross the 75 per cent acceptance level, which is the company's stated trigger for a move to delist AWE.

As of Friday, Mitsui had 78.24 per cent of the target and its offer is currently due to close on Wednesday though further extension is likely should Seven & Ors maintain their apparently strategic tardiness.

Wherever this ends up though, Mitsui will retain its rights to manage the future of the Waitsia project. That, after all, was one of the redefining ambitions of this transaction. It is a deal that introduces the Japanese keiretsu into the mainstream of the Australian petroleum business.

Mitsui E&P owns an interest in six Australian production licences, two development projects and 16 exploration permits. But it is the operator in none of them. This profile is matched across all of its 12 other oil and gas constituencies outside of Japan, where it runs its own exploration efforts. This time around Mitsui wants to be in the front seat.

Mitsui's progress on AWE is arguably a natural extension of some deep-pocketed investment in Australian gas that began with its \$US1.5 billion acquisition of BHP Billiton's 14.7 per cent interest in the Woodside-operated Browse project back in 2012. More recently, Mitsui paid \$520 million for Santos' 35 per cent stake in the Kipper condensate field in an opportunistic deal that saw it add substance to a Gippsland Basin footprint that was limited to a 25 per cent stake in the Cooper Energy-operated Casino project. The other participant in that one is Beach.

Mitsui is also carrying its full 40 per cent weighting of the Woodside-led \$US1.9 billion Greater Enfield oil project in offshore Western Australian waters. Mitsui is a half-owner of a 6 per cent block of the Woodside operated North West project, whose domestic gas contracts expire in 2020. The end of those obligations and the potential that gas from Waitsia's expansion project will be flowing from 2021 creates a world of value-adding opportunity for those exposed to both size of the domestic and export value chains.

Just finally on the AWE situation, it is worth reflecting and expanding on the fact that Mitsui had to fend off China Inc's interest in AWE to secure the chance to operate the Waitsia's growing footprint of production wells and the increasingly critical infrastructure that will push its gas south, north and east to commercial customers around Western Australia.

Now, just three days before Christmas, the Foreign Investment Review Board gave the green light to China Inc's potential acquisition of AWE. It would seem likely that approval arrived with full understanding of the potential strategic importance of Waitsia's gas to the Western Australian energy market.

Since then, of course, US private equity in the form of Harbour Energy has come to the market with a \$13.5 billion bid for Santos. Who might own and influence the South Australian gas company has long been a politically sensitive subject and there is a body of opinion that says that FIRB and the federal Treasurer might find it a whole lot more difficult to indulge Harbour's ownership of Santos than it did China's interest in AWE.

There are two points of contest here.

The first is that aligned Chinese investors that own 15.1 per cent of Santos are being given the chance to roll their equity into the Harbour controlled acquisition vehicle. It is estimated that China Inc could own up to 40 per cent of NewCo given most other Santos investors are likely to eschew the swap alternative.

The second potential bone of contention (which is influence by the first) is that since 2016 Australia's foreign investment regime has a critical infrastructure test. This test was used to prevented Chinese involvement in the sale of the NSW state grid and there are those that say that Santos owns a choke-point asset that should not be transferred to private ownership.

Former Woodside chief executive Don Voelte is one who believes any deal should be predicated on a sale of Santos' original legacy asset, the Cooper Basin liquids and gas processing facilities at Moomba.

We might discount Voelte's commentary given that his life after Woodside included a stint as chief executive at Seven, which is an active player in the shifting tectonics of Australian gas. But others have not. There is a gathering view that Harbour might well struggle in a FIRB process that will kick off in maybe two weeks when it files its application.

But for the life of me, I just don't get it.

The Copper Basin is 40 years old and it has a limited amount of high cost gas left to support the liquids and gas processing streams that is owned jointly by Santos and Origin.

Now, most of the Santos gas in ground around the Cooper has been pre-sold to export. Harbour management has made a commitment to increase Cooper production with an aim to driving more gas into the domestic market.

By some estimates, the Santos corners of the Copper supply less than 10 per cent of east coast's requirements. BHP, ExxonMobil and Quadrant are bigger domestic suppliers. Needless to say, BHP is subject to foreign investment tests, Exxon is patently foreign owned and Quadrant is, for the moment at least, wholly owned by private equity.

The politics of foreign investment is rarely easy to anticipate and this is a pioneering process for a takeover in the energy sector under the critical assets test. But a move to make disposal of the Cooper infrastructure a condition of approval would seem totally unwarranted. Mind you, given that Harbour principal Linda Cook has said that her deal is all about the gas in the ground and Santos' ability to point large volumes of liquid natural gas at regional energy markets, then the machinery of the Cooper is a sacrifice that could be acceptable collateral damage.

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