FINANCIAL REVIEW

HD Caught between a Roc and a hard place

BY Michael Smith
WC 1,474 words
PD 14 May 2014
SN The Australian Financial Review
SC AFNR
ED First
PG 40
LA English

LP

Roc **Oil**'s management team have found themselves caught in a potentially messy situation after miscalculating the response of a key shareholder to the **company**'s proposed $800 **million** tie-up with Horizon **Oil**.

What was supposed to be a "cracking" deal to achieve the scale needed to tap **oil** and gas opportunities in **China** and Papua New Guinea is turning into a headache for Roc **Oil** chairman Mike Harding and chief executive Alan Linn.

TD

Their biggest problem is Allan Gray fund manager Simon Marais, who owns just under 20 per cent of the **company**. Marais is the type of investor most boards usually sit up and pay attention to if he appears on their register.

Marais has influenced the outcome of takeover bids for Spotless, Hastings Diversified Utilities Fund, Valad Property Group and Centro Retail, often securing a better deal for investors. He is not afraid to try to unseat directors, either, as former board members of PaperlinX, APN and Tassal will attest.

He is often described as a shareholder activist – a term he does not like. But the impact investors like Allan Gray are having on companies reflects the surge in corporate activism in the United States which is only starting to find its way to Australia.

So it seems surprising that Roc **Oil** has been caught off-guard by Marais' refusal to back its merger with Horizon **Oil**. The unique feature of this deal is a quirk in corporate law which means a listed **company** can push ahead with a scrip takeover without getting shareholder approval.

This means that while Horizon shareholders get to vote, Roc **Oil** shareholders do not. This is all perfectly legal, and Roc **Oil** management is under no regulatory obligation to consult its own shareholders on the deal.Marais to call EGM

Not consulting investors on the transformational deal before signing a binding agreement was a mistake, though. Marais is the kind of shareholder who likes to have a say in decisions affecting one of his investments. He now plans to try to do something about it.

Marais is this week finalising the paperwork to call an extraordinary general meeting of Roc **Oil** shareholders to amend the **company**'s constitution and force a vote on the merger.

Marais also wants management to provide more information about a deal which he is highly sceptical of. The outcome will be messy either way and raises the prospect of legal action if Roc **Oil** breaks its binding agreement with Horizon.

Changing the constitution would not necessarily stop the deal from going ahead, so it is hard to see what the end-game is here. It may force Roc **Oil** to provide more information about the merger and send a clear message to other companies doing deals without consulting shareholders first.

"Truth in takeovers" policy means companies (unlike politicians) cannot make false or misleading statements when it comes to takeovers. This opens up the risk of class action if Roc Oil suddenly changes the terms of the deal.

Horizon shareholders could still vote against the deal as well, although that looks unlikely as they have the most to gain in the short term.Inconsistency due for review

Roc and Horizon are old friends and have been talking about a potential deal for several years. The time is now ripe, as US players are exiting Asia to focus on shale investments back at home, and Roc sees a chance to seize on opportunities in Asia. Finding the scale to pursue growth is something many explorers struggle with.

Roc Oil would front up a bulk of the assets and end up with a 42 per cent stake in the combined company. While analysts say the deal dilutes Roc's core valuation by 16 per cent and reduces 2014 earnings per share by 29.5 per cent, the long-term gain from exposure to Horizon's PNG assets outweighs the short-term impact.

Harding, who also chairs Downer EDI and sits on the board of Santos, says he has been around long enough to recognise a good deal in what is often a risky sector. Linn, who divides his time between Malaysia and Australia, has agreed to relinquish the CEO role to Horizon chief Brent Emmett.

While the share prices of both Roc and Horizon have risen since the deal was announced, it seems like a lot could still go wrong. Roc also fears it will become the whipping boy for an inconsistency in Australia's listing rules, even though it was abiding by those rules.

What is clear is that the inconsistency should be reviewed to ensure all shareholders affected get to vote in the future. Oxiana shareholders did not get to vote on the 2008 merger with Zinifex, either, and that deal resulted in a messy legal battle over market disclosure claims.

It has been an uphill battle for Ian Smith since he embarked on a major restructure of explosives maker Orica more than two years ago. The company's shares lost more than 5 per cent on Tuesday after dampening expectations for full-year earnings, with coal markets still in the doldrums.

The company would be in far worse shape than it is now without the relentless focus on costs and margins to drive returns, but a weak coal market is the latest hurdle to Orica's recovery.

It reported weaker than expected volumes in its mining services business in the first half, while its chemicals business also underperformed.

Smith, the former Newcrest Mining chief, has been pulling every lever he can to turn the business around as the external environment remains subdued.

The strategy is to focus on costs and margins and generate more cash so the company can deliver a higher overall rate of return no matter what part of the cycle it is in. It now expects full-year earnings to meet or exceed last year's $592.5 million, compared to earlier guidance for higher profits this year.

Smith says the biggest challenge ahead is what happens to coal. If thermal coal prices fall further and parts of pits are closed, it is bad news for everyone. "Let's hope for all concerned, ourselves included, that what we are seeing in the price of coal is the bottom of the trough. But another $10 [fall in the thermal coal price per tonne] would really put this industry under pressure," he said.Conditions unlikely to deteriorate

The problem with restructures is that it takes a while before there is any meaningful payback. Smith says he wants to position the company to give it long-term continuity and security in North America and Australia, while tapping growth markets in Africa, Russia and the Pilbara, which are now starting to deliver.

The good news is that cash flow is up, rising 11 per cent in the first half, as gearing reduced to 36.5 per cent. But earnings fell 7 per cent on the back of weaker volumes. Asia performed the worst, with explosives volumes down 20 per cent. Overall volumes were off by 2 per cent.

Smith has cut headcount by 1000 people over a year and there will be more cuts this year. Orica is also looking to exit some of its smaller markets, where it can no longer justify high overheads versus light volumes.

The turnaround story at Orica has taken longer to play out than investors hoped, although there is a sense that conditions will not get any worse. Even though many analysts say Orica looks cheap, the stock fell to a six-month low on Tuesday.

Smith expects **mining** services volumes to pick up in the second half. The big unknown is Australian **coal**. A trade **sale** or market float of the **company**'s chemicals business is still on the agenda, with an update likely before the **company**'s full-year results.

GrainCorp will not be dwelling on what could have been when it releases its half-year results on Thursday.

But the failed $3.4 **billion** takeover bid for the **company** by Archer Daniels Midland continues to loom over it. While there is plenty of speculation about whether new competition will open the door for ADM to come back in with another bid, the US food giant is keeping its distance for now.

ADM will also be watching how a separate takeover bid for Goodman Fielder by its strategic partner Wilmar plays out, and whether this influences its plans for GrainCorp in the future. Wilmar is 16 per cent-owned by ADM. Treasurer Joe Hockey does not appear to have warmed to ADM, either, after referring to the **company**'s character at a business dinner last month.

michael.smith@afr.com.au Twitter @MikeSmithAFR

Tony Boyd is covering the federal budget.

CO hasduf : APA Sub Group | ppxaus : PaperlinX Ltd | rocoil : Roc Oil Company Ltd | valpgp : Valad Property Group | austpi : APA Group | blgrou : The Blackstone Group LP

IN i1 : Energy | i13 : Crude Oil/Natural Gas | i471 : Paper Mills | i81502 : Trusts/Funds/Financial Vehicles | i8150206 : Investment Trusts/Funds | i815020602 : Real Estate Investment Trusts | ibasicm : Basic Materials/Resources | icre : Real Estate/Construction | ifinal : Financial Services | iinv : Investing/Securities | ipper : Paper/Pulp | ireest : Real Estate

NS ccat : Corporate/Industrial News

RE austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania

PUB Fairfax Media Management Pty Limited

AN Document AFNR000020140513ea5e0004r

