

FINANCIAL REVIEW

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HD **Karoon's Brazilian oil excitement**

BY Matthew Stevens

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Matthew Stevens

Karoon Gas is one of those delicious Australian success stories that is made all the more delightful by its improbability.

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Having made a wealthy fist of a life in scrap metal, a bloke called Bob Hosking latched on to BHP's expansion from steel to petroleum as a theme for his investment future.

Then, after making not quite a false start with Nexus **Energy** at the turn of the century, Hosking collected wit and wisdom enough for a second crack at gas through Karoon, which he took to the market in 2003.

Introduced to the Browse Basin as an opportunity by a former BHP Petroleum executive named Mike Smith, Karoon arrived at one of the future well-springs of Australian export wealth just ahead of the increasingly international pack now crowding into the space.

Smith's hunch proved spot on and the net result is the **sale** of Karoon's 40 per cent **stake** in the Poseidon gas discovery to Origin **Energy** for \$600 **million** up-front and a further \$200 **million** in future-dated milestone payments.

But, as it was with Nexus, so the end of one Hosking dream only fuels another. By monetising Karoon's Browse gas position, the **company** makes far more affordable the development of its impressive little fleet of offshore **oil** discoveries in Brazil and its aspiration to repeat that success in Peru.

As it was in the Browse, so Karoon's success in Brazil gets down to the ability of Hosking and his intimate management team to back the right hunches by the right people.

This time the blokes were current chief operating officer Ed Munks and a septuagenarian Argentinian geologist Carlos Urien.

Hosking decided to drive Karoon into international waters when the **company** was thoroughly outbid by Hess Corporation in a tender for WA offshore tenements.

After a lot of careful plotting, Hosking's sights settled on Argentina. One of the first conversations about its potential was with Spain's **oil** international Repsol. So Munck was told to find new South American horizons. And his first point of call was Urien and then a bunch of ex-ConocoPhillips guys. Their advice was to look offshore Peru and Brazil.

Which explains why Karoon of Mount Martha in Victoria now owns 65 per cent of five blocks in the Santos Basin and why Brazil's **oil** basin of legend is host to highly prospective **oil** finds called Kangaroo and Bilby.

The effect of the Origin deal then, is that Karoon has replaced its Western Australian gas dreaming with some shorter term Brazilian **oil** excitement.

There was some surprise at the fact that Karoon was prepared to sell all of its position in the Greater Poseidon. But the logic is unavoidable, it seems to me.

Gas in the sort of licks that discovery holds is a very rich, long-term game.

Translating that gas into real production and cash flow was going to take five and more years. And that is time that Karoon does not have, given the drilling programs required to sustain its South American ambitions. By its nature, **oil** is a far less complicated and costly development option for the likes of Karoon.

So, having hoovered up \$600 **million** with upside yet, Karoon has the financial resources now to complete an appraisal of its Brazilian finds with an initial focus on the Kangaroo find.

As with all things Hosking related, the investment thesis is admirably uncomplicated. Karoon wants to become a producer as rapidly as possible and then aim cash flow at growth and shareholders.

Meanwhile, Grant King's plunge on a still expanding bank of Western Australia's deep water gas comes as a bigger surprise than it should.

Well before he committed Origin **Energy** to its \$20 **billion** liquid natural gas project at Gladstone, King had made it clear he was attracted by the idea of going very, very long gas, whenever and wherever there might be the infrastructure needed to export the stuff. And Grant is a guy well worth listening too. He neither minces nor wastes words.

So it is that, barring last minute intervention by either ConocoPhillips or PetroChina, Origin is to acquire the 40 per cent share of the Poseidon gas discovery from its original finder, the remarkable little success story that is Karoon Gas.

The complication there is that Karoon US and **Chinese** partners in Poseidon have pre-emptive rights over the Australian junior's position. And while it does seem unlikely that ConocoPhillips might want to rain on King's parade, it was interesting to hear King on Monday morning suggest that PetroChina has a long-standing interest in becoming an operator of international assets.

To that end, it rather looks like the Origin deal has been done at a small but perhaps meaningful discount to the price paid by PetroChina to get its 20 per cent share of the Poseidon action. The price Origin has paid works out at about \$3.17 a share for Karoon shareholders. But the metrics of the PetroChina buy-in imputed a value of about \$3.30 a share for the 40 per cent Karoon has agreed to deliver to Origin.

So the issue of pre-emptives might be more live than usual in deals of this strategic substance.

But given this works out as King plans – and things usually do – then the Poseidon investment becomes Origin's first major play in the big gas winds that sit on the north-west coast. And, typically, it is a play loaded with options.

Karoon's pitch over recent times is that the gas could be developed as back-fill for ConocoPhillips's Darwin LNG project, and with further appraisal success it could play host to the US **company's** first floating LNG facility.

Currently, the Darin project is supplied by the Bayu Undan gas field, but production is expected to peak and decline over the next few years. King made a good deal of the simple, profit-enhancing efficiency of connecting Poseidon to the existing infrastructure and feeding Darwin LNG's extended functional life.

Poseidon is currently reckoned to contain upwards of 2.5 trillion cubic feet of gas with appraisal upside rated at maybe 5TCF. At that level the field might justify the deployment of the floating LNG processing technology that ConocoPhillips has been working on for the past few years and more.

Exploration of the Poseidon tenement, which hosts at least five other plays of quality, according to Karoon, might further drive that option.

But, however the gas is developed, the Poseidon play illustrates plainly the King strategy.

He is committed to deploying the \$1 **billion** a year in free cash flow that will be generated by Origin's Gladstone plant from maybe 2018 at growth. And the most assured way to do that, he reckons, is to

acquire discovered and appraised gas assets that are supported by the quality of export infrastructure that Conoco commands in Darwin.

One very ugly crisis over, two more ugly ones to deal with. That is where Metgasco chairman Len Gill finds himself after the NSW Independent Commission Against Corruption said it had no reason to pursue a referral by the NSW resources and **energy** minister Anthony Roberts.

Having cost Metgasco \$3 **million** by abruptly cancelling approval for a protester-bound gas exploration at Bentley in the state's distant north, Roberts told the world he had referred the **company** to ICAC because of claimed links to Eddie Obeid.

Metgasco's biggest shareholder is ERM Power. Its chairman is Tony Bellas. He was once a director of Australian Water Queensland. It is a subsidiary of Australian Water Holdings. And, for his sins, Bellas is a shareholder of Gasfields Waste Water and Services. Dennis Jabour is also a shareholder. He is Eddie Obeid's nephew. But none of that is "indicative of corrupt conduct", as ICAC made clear in its letter to Metgasco's lawyers, Gilbert & Tobin.

CO bkhlp : BHP Billiton Ltd | boral : Origin Energy Ltd | entity : Nexus Energy Ltd | karoon : Karoon Gas Australia Ltd | bltplc : BHP Billiton PLC

IN i1 : Energy | i13 : Crude Oil/Natural Gas | i16 : Electricity/Gas Utilities | i162 : Gas Utilities | i211 : Metal Ore Mining | ibasicm : Basic Materials/Resources | imet : Mining/Quarrying | iutil : Utilities

NS cnatrd : Natural Reserves/Resources Discovery | ccat : Corporate/Industrial News | c24 : Capacity/Facilities

RE braz : Brazil | austr : Australia | apacz : Asia Pacific | ausnz : Australia/Oceania | bric : BRIC Countries | devgcoz : Emerging Market Countries | dvpcoz : Developing Economies | lamz : Latin America | samz : South America

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