FINANCIAL REVIEW

Companies and Markets

Santos saved - but from what?

Matthew Stevens
1397 words
10 November 2015
The Australian Financial Review
AFNR
First
34
English

Project Solo has certainly delivered on what was implicitly its primary mission. With its balance sheet buttressed and a new **Chinese** investor delivered to takeover-frustrating relevance, Santos has done as much as humanly possible to sustain its place as South Australia's independent **oil** and gas **company**.

Chairman Peter Coates says that the three-step recapitalisation designed by a strategic review called Project Solo means Santos is ready to thrive, not just survive. Given his standing as one of the great warhorses of Australian commerce, let's hope he is right.

... accurately anticipated package Coates delivered on Monday morning will earn as many brickbats as bouquets, not least because the cornerstone of the balance sheet recapitalisation is a $2.5 **billion** rights issue.

From the moment the **oil** price collapsed rapidly from August last year, Santos has been under pressure to entertain a rights issue to deal with the potential that it would reach peak debt of $9 **billion** just as **oil** prices tanked.

...

Remarkably, given the $3.5 **billion** worth of initiatives confirmed on Monday, much of that messaging still holds. Santos has been rescued, but it was never actually in trouble. This was all about market optics and the **company**'s need to break a cycle of negativity that had made shorting its share price such a profitable game.

Nonetheless, the incongruity of Seaton's position is stark. It is hard to see how his position at the **company** can be sustainable.

.... Only this time around the detail was all aimed at illuminating the good sense of a deeply discounted right issues whose look-through valuation was informed by a $700 **million** placement of 7 per cent of Santos to a **Chinese** private **equity** in the form of Hony Capital .

...has been solved by a rights issue that you once said was unnecessary and dilutive? And, for good measure, the deal involves construction of a near 10 per cent **stake** in the **company** to Hony, at a discount to last week's closing share price and at an even bigger discount to the metrics of the $7.1 **billion** indicative, non-binding, conditional approach made two weeks ago by Scepter Partners.

...investor that will trade in and out of Santos over time as the share price is rebased by the cash flows from the South Australian's share of the $US20 **billion** ($28 **billion**), two train LNG project in Gladstone.

So, sure, Hony will be left at 8.4 per cent of Santos as a result the opening $500 **million** placement. And sure, the investment agreement leaves Hony free to push beyond a 9.9 per cent shareholding cap after three months, and leaves it locked in at... ...a year unless Santos agrees to let them sell. And sure, Santos has a register that is 64 per cent owned by retail shareholders, which means only that a **stake** of 10 per cent or more becomes a pretty powerful weapon when it comes to hitting the 75 per cent support level needed for the approval of the sort of...

But, no, no, no, this is not a blocking **stake** or anything like it. Bollocks.

...

Coates, Seaton and everyone else from Santos who briefed on Project Solo and its conclusions on Monday, reckon that this a new dawn for the **company** . They might be right. But that dawn is going to be clouded by the introduction of a new dividend policy and by the very real potential of a new round of very big non-cash impairments because of the change outlook for **oil** prices.

... progressive dividend policy. It will instead attempt to distribute no less than 40 per cent of after-tax profit. This is a very reasonable shift given the outlook for **oil** prices is lower for much, much longer than could have been imagined before OPEC bit back at US share producers.

The change price deck for **oil** will shape how big the next round of impairments will be. Like many in the industry, Santos had banked on **oil** prices running at above $US90 over the long haul. The forward curve says this is unrealistic. According to the data released on Monday, a $US15 a barrel down shift in the long-term pricing assumptions made by Santos would generate a pre-tax impairment of $3.5 **billion** .

...

The second point to make here is that Santos rejected a whole lot of asset **sale** options because the offers received were based around an **oil** price of $US60 or less. Apparently that made them easy to reject because they did not reflect anything like the long-term value that the Project Solo team had...

...

FINANCIAL REVIEW

Features - Rear Window

Santos '15pc premium' fails to stack up

Joe Aston
302 words
10 November 2015
The Australian Financial Review
AFNR
First
48
English

Well didn't the board of Santos plate up a double-decker excrement sandwich for investors on Monday morning?!

As part of a suite of capital management initiatives (total = $3.5 **billion**) aimed at shoring up the **oil** and gas major's debt-laden balance sheet, the **company** has gone for a "private placement at a 15 per cent premium to last close (of $5.91)" to **Chinese** private **equity firm** Hony Capital .

...

Because Hony then gets to participate in the concurrent **equity** raising, priced at $3.85 (a whopping 35 per cent discount to $5.91) - indeed Hony has "provided binding commitments to take up its full pro-rata entitlement under the Entitlement Offer", which means another 43.5 **million** shares.

So Hony is actually getting a total of 117 **million** shares for $665 **million** - at an average price of $5.71 - even though the Santos board is already sitting on an indicative offer from consortium Scepter of $6.88 per share...

...more, given Hony has "agreed not to divest to any unrelated party any of its shares in Santos acquired" through this deal, the board has given away a blocking **stake** at a discount to the **company** 's trading price and at a hefty discount to an existing offer from another shareholder.

Does that sound to you like a 15 per cent premium? It's amazing the shareholder value a **company** will surrender to shore up the balance sheet. Especially given they could've shored up the balance sheet at more like $10 to $14 this time last year....

FINANCIAL REVIEW

News

Chinese rescue Santos

Simon Evans, Angela Macdonald- Smith, Sarah Thompson and Anthony Macdonald
1142 words
10 November 2015
The Australian Financial Review
AFNR
First
1
English

$3.5 **billion** capital raising ends debt crisis - Capital expands 70pc - Experienced new CEO

Santos has been accused of trying to make itself takeover-proof again by effectively selling a blocking **stake** to a **Chinese** private **equity firm** seven years after the South Australian group ditched a 15 per cent shareholder cap.

In a move designed to reduce the pressure from $9 **billion** of debt, the **oil** and gas producer will raise $2.5 **billion** from existing shareholders, sell a 35 per cent **stake** in a gas field off Victoria for $520 **million** and has agreed to sell $500 **million** in shares to **Chinese** private **equity firm** Hony Capital .

Santos executive chairman Peter Coates said the debt problem that hit the **company** when **energy** prices tumbled had been fixed and the group is now in a position "not just to survive, but to thrive".

...

He appointed a new chief executive, Kevin Gallagher , who has led engineering **firm** Clough since 2011 and was once considered a candidate to become CEO of Woodside Petroleum, where he worked for 13 years. Mr Gallagher will move to Santos from early...

The **company** has been under attack from short sellers and hedge funds as it buckled under $8.8 **billion** of debt, which was raised in part to build a giant LNG processing plant in Queensland to supply gas to Asia.

In an ominous move, Santos flagged write-downs of as much as $3.4 **billion** on its assets, including the flagship Gladstone LNG project in Queensland, which has just been finished at a cost of $US18.5 **billion** ($26 **billion**) and shipped its first LNG a few weeks ago. There may also be write-downs on its Cooper Basin gas fields in the north of South Australia and **coal** seam gas assets in NSW's Gunnedah Basin.

...managers are conducting a detailed review of those assets in line with the global slump in values and will finalise the actual impairment values in the next few weeks. The **company** 's 158,000 shareholders, in a **company** where retail holders make up 45 per cent of the register, will suffer further pain because the board has signalled lower dividend payout ratios generally, of a minimum of...

This compares with a final dividend of 15¢ in the second half of 2014. The **company** 's issued capital will expand by about 70 per cent because of the share sales, placing pressure on investment returns.

Hony has powerful backers including **China** 's state-owned Legend Holdings and Singapore sovereign wealth fund Temasek and made its first big international investment in mid-2014 by buying restaurant chain Pizza Express for £900 **million** ($1.9 **billion**) in the UK. It will invest $700 **million** into Santos because it will also take up its share of the rights issue. The average price across its investment is $5.71 a share. It has signed... ...to lift its total holding in Santos above 9.9 per cent for three months. From then on it can move above 10 per cent, potentially giving it a blocking **stake** .

Hony owned 1.4 per cent of Santos prior to the placement and rights issue. It was an underbidder in the **sale** process for Melbourne-based vitamins group Swisse, which was bought by **Hong Kong** 's Biostime International in mid-September for a whopping $1.67 **billion** .

... rejected it and on Monday; Scepter was accused of bargain-hunting by Santos management. Scepter declined to comment but sources close to the Middle Eastern group said the share **sale** to Hony was designed to prevent

Scepter or anyone else from taking the **company** over.

... 2008 to have a 15 shareholder cap removed which had been put in place in 1979 by the South Australian Government to stop corporate raider Alan Bond from taking the **company** over, and getting control of vital **oil** and gas assets.

Mr Coates rejected the notion that the Hony **stake** would prevent offers. "Suggestion that Hony's investment is a blocking **stake** is just not correct," he said. He noted that Scepter's proposal needed 75 per cent of shareholders to support it.

Bernstein analyst Neil Beveridge said the capital raising would be enough to restore balance sheet strength "but it appears more about achieving **company** continuity and independence than maximising shareholder value".

Mr Coates, says given the **company**'s circumstances, it was a smart move for Santos to go outside the **company** for its next chief executive. "A fresh set of eyes was the right approach," he said.

...

... halt on Monday morning. Chief financial officer Andrew Seaton , who six months ago was adamant a capital raising was not required, says net debt would drop to $6.2 **billion**, after factoring in the drop in value of the dollar against its US counterpart, with 90 per cent of the **company**'s debt US-dollar denominated.

The $2.5 **billion** fully underwritten accelerated, pro-rata, renounceable entitlement offer was first reported by The Australian Financial Review's Street Talk column. The 1-for-1.7 entitlement offer is... ...and the offer is at a 34.9 per cent discount to the last closing price. Santos shares were at $15.51 on September 4, 2014. The $500 **million sale** to Hony Capital is at a 15 per cent premium to Santos' closing price on Friday of $5.91. Hony is taking up 73.53 **million** new shares at a price of $6.80 each.

Mr Coates said there will be no further asset sales. Mr Coates says a whole-of-**company** review started in August, which coincided with the departure of David Knox after seven years as chief executive, tested the appetite of buyers. It changed the **company**'s thinking.

Deutsche Bank and Lazard were brought in to advise on the best options for the **company** in August when Mr Coates became executive chairman as Mr Knox was elbowed aside.

Fairfax Media Management Pty Limited

Document AFNR000020151109ebba0000d