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HD Santos Must Pray Harder for Oil's Rebound; By keeping its prized possessions, Australian energy company Santos is betting that the oil price will recover. This is a gamble

BY By Abheek Bhattacharya

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LP There are no easy choices for a burdened oil and gas producer when oil is cheap. But in deciding to sell new shares near the bottom of the cycle instead of selling assets, Australia's Santos is betting it can hang around long enough for the cycle to turn. However, that may be longer than investors should be willing to wait.

Santos Ltd . announced Monday a [series of steps to raise a total \\$2.5 billion in capital](http://www.wsj.com.virtual.anu.edu.au/articles/santos-to-raise-2-46-billion-with-share-issue-gas-field-sale-1447024021) [http://www.wsj.com.virtual.anu.edu.au/articles/santos-to-raise-2-46-billion-with-share-issue-gas-field-sale-1447024021]. It will issue new shares to Chinese private-equity giant Hony Capital at a 15% premium to Friday's closing price. Next, it will launch a rights offering for all shareholders, including Hony, at a hefty 35% discount to the Friday price. Last, it will sell its stake in an eastern Australian gas asset to a Japanese trader, though that only fetches \$370 million.

TD These initiatives bring down Santos' net debt to about 40% of equity, in line with BHP Billiton , from a worrisome 89% as of June. This probably staves off a downgrade by credit-rating firms, resolving the big question surrounding this company's near future.

The price of this deleveraging is painful, primarily an increase in the number of its shares by some 60%, calculates Sanford C. Bernstein. Shareholders should want to know why Santos didn't exercise the alternatives. Last month, a private-equity fund backed by Brunei royalty [made a lowball offer for the whole company](http://www.wsj.com.virtual.anu.edu.au/articles/oil-bargain-hunting-remains-elusive-game-1445502742) [http://www.wsj.com.virtual.anu.edu.au/articles/oil-bargain-hunting-remains-elusive-game-1445502742], which Santos rejected.

Why not more asset sales, though? One possibility was the [sale of assets in Western Australia](http://blogs.wsj.com.virtual.anu.edu.au/privateequity/2015/10/02/eig-noble-joint-venture-bids-for-santos-assets/) [http://blogs.wsj.com.virtual.anu.edu.au/privateequity/2015/10/02/eig-noble-joint-venture-bids-for-santos-assets/] worth \$1 billion and in Southeast Asia up to \$750 million, according to Financial News. That these deals didn't materialize suggests Santos didn't get the bids it wanted. In contrast, the one eastern Australian asset it is ejecting isn't key for its portfolio.

By keeping its prized possessions, Santos is betting that the oil price will recover. This is a gamble. The company factored in an oil price of \$70 a barrel in 2016 and \$90 in 2018, when it tested for asset impairments as recently as June. But the futures curve currently shows Brent not even crossing \$56 by the end of 2016 and \$61 by the end of 2018, from \$48 today. Santos might have to write down some asset values soon.

Santos halted trading of its shares until Thursday. When the shares restart, they should immediately fall in price to account for the dilution, plus a cut in the dividend per share. The stock could rise slightly afterward if the substantial number of short sellers in Santos call it victory and close their positions, since the company has addressed the primary risk surrounding the balance sheet.

In the long term, though, the outlook for Santos is wedded to the oil price. And that doesn't yet look promising.

Write to Abheek Bhattacharya at abheek.bhattacharya@wsj.com [mailto:abheek.bhattacharya@wsj.com]

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