A ray of sunshine off Brazil's coast

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IS KAROON Gas the best investment in the Australian petroleum sector, or an indicator of more troubles ahead? This is a question that Slugcatcher suspects might also go to the heart of the 'Great Uncertainty' that has descended across the global oil industry.

The Karoon story starts with the fact that it had a cash balance of $553 million as at June 30 and a value on the stock market as at last Friday of $473 million.

Cash burned on exploration and head office costs will have depleted the cash at bank over the past three months but even if $80 million was spent the company would still be trading on a cash-backing basis – or every dollar of market value is covered by a dollar in the bank.

As Karoon is an explorer currently lacking production to bolster its cash resources there might be a reason for the stock being discounted down to a cash-backing basis.

What that discount says is that investors are not in the mood for risk of any sort in the oil and gas sector because of fears that the oil price could fall further and that development capital will remain hard to source.

In Karoon's case the capital is required to develop the company's flagship assets, the Kangaroo and Echidna oil discoveries in the offshore Santos basin of Brazil which offer the potential for Karoon to become the launching pad for a business which could become one of the Australian oil sector's leaders over the next decade.

An updated resource statement from Karoon late last week put a contingent 2C (best estimate) resource of 75 million barrels of light oil in Echidna with 49MMbbl attributable to Karoon, with the Kangaroo 2C resource revised to 54MMbbl (35MMbbl to Karoon).

Those numbers will be worked into the early stages of front-end engineering and design studies already underway, to be followed by additional appraisal drilling and an investment decision, perhaps sometime next year.

Yet all that good news of cash in the bank and oil in the ground bangs head-first into the oil price and wholesale disruption in the industry, which is leading to an outbreak of attempted merger and acquisition activity and high-profile departures from C-suite, also known as the chief executive's corner of the office.

The departures from some of Australia's better-known petroleum companies over the past three months have been nothing short of spectacular, with news media interest muted by the fact that they have been occurring in different companies on different days.

Imagine the headlines if Brad Lingo, David Knox and Rob Cole had announced their exits from Drillsearch, Santos and Beach Energy respectively on the same day, rather than on July 3, August 21 and September 16.

In less than three months three of the big names in Australian oil moved on, as they say, leaving investors to wonder just how bad the outlook is for the industry if chief executives are heading for the exit, or being gently shown the way by their fellow directors.

Admittedly, Cole's exit barely six months after he started means it was clearly personal reasons rather than market angst that saw him leave the company.

Whatever the reasons for the departures, the message being sent to the wider industry is appalling, and that's one of the reasons why an up-and-coming producer such as Karoon has been trashed on the market with a share price that has fallen from $3.69 a year ago to latest sales at $1.92.

Followers of Karoon are at least able to see that latest share price as a source of good and bad news.

The good news is that the last week's updated resource statement put a bit of zing in the stock, lifting it from a mid-week low of $1.68.

The bad news is that five years ago Karoon was trading at almost $11.

The past, as they say, is a foreign country, or in the case of the oil and gas industry a place of higher prices and a little more certainty for investors and chief executives.

So if that's the past, what of the future? In a few words, very bright, if you believe the views of six leading investment banks which analyse the stock.

Citi is the latest to sing the praises of Karoon, telling clients last week (before the resource upgrade) that it was a "buy" with a 12-month share-price target of $3.14, a tip which implies an eye-catching potential increase in value of 63.5%.

"Karoon is trading below cash value which limits the downside," is how Citi described the stock.

Morgans was almost as enthusiastic with a buy tip and a price forecast of $3.04. UBS said the same and forecast a future share price of $2.90, with other buy recommendations from Morgan Stanley ($2.66), Macquarie ($2.80), and Deutsche Bank ($2.80).

If it was just one bank signing from the Karoon hymn sheet (dare The Slug call that "karooning"?) this would be a story of little consequence, and even with six banks chiming in with positive views there is no guarantee of an uplift for the company.

But, having warned that everything could go pear-shaped (as it often does) it is interesting to find a ray of sunshine amidst the oily gloom.