

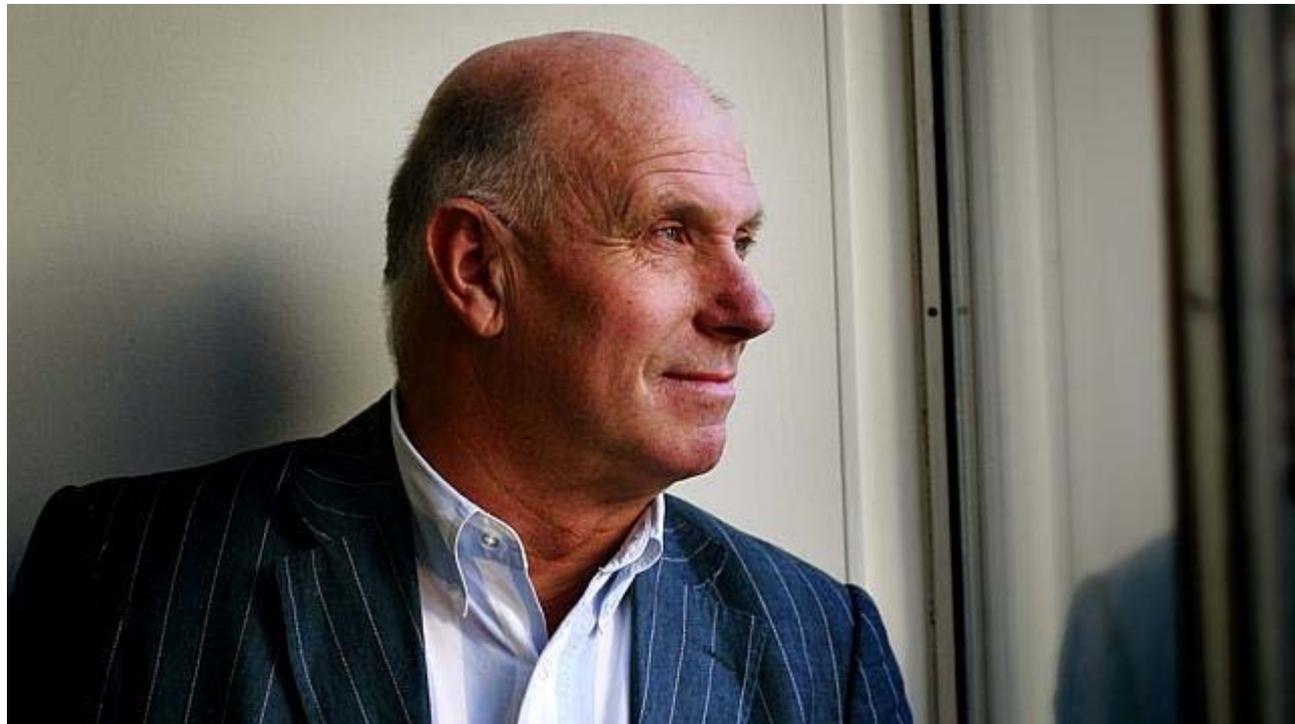
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Karoon chairman Robert Hosking faces ugly fight

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Karoon Gas executive chairman Robert Hosking. Last year shareholders voted down the company's remuneration report, ostensibly on the basis of its arrangements for executive options. **Photo: Paul Jones**

Matthew Stevens

For a pretty serious scrap metal merchant, Robert Hosking has made a fair go at being an oil and gas whisperer.

Hosking is the unlikely founding force of an emerging Australian junior called Karoon Gas Australia. A working life in the metal business came to a close around the turn of the century when Hosking decided that if the petroleum game was good enough for BHP Billiton then it was a likely diversification for him too.

His story is a classic of the oil kind. The \$900 million company that he leads as executive chairman is the product of Hosking's commercial wit, his preparedness to trust in the hunches of others and an ability to take a serious punt. The result in a company on the brink of something pretty exciting.

But success has bought its own challenges. Quite literally. For a second year in succession Karoon heads into annual general meeting season on the cusp of crisis.

Last year shareholders voted down the remuneration report, ostensibly on the basis of its arrangements for executive options. But in reality, it was because of a gathering sense that the company's governance was no longer fit for Karoon's changed circumstance.

In two weeks history could repeat itself, only this time in a far more complicated and profound way.

This time around Karoon is staring down a shareholder that claims to speak for nearly 5 per cent of the business and is trying to force three of its own nominees to the Karoon board at the expense of one of its extant independent directors, former Woodside man Geoff Atkins.

If the Jakarta-based, Swiss registered funds manager CP Pegasus is successful, its invasion of the Karoon board would most likely lead to Hosking's forced surrender of both his chair and the chief executive roles.

Wealthy Indonesia families behind board push

The trio of proposed invaders assembled include two former BP guys in the form of Colin Goodall and David Bamford and former Metgasco CFO Glenda McLoughlin.

It is suggested that Goodall, who has made a minor habit of running unwelcome boardroom challenges since he moved to Adelaide a couple of years back, would seek the chairmanship if elected to the board.

It is suggested too that Goodall would then seek to invite a new chief executive to Karoon and to replace the other three members of the extended Hosking family that currently work for Karoon here, in Brazil and in its new frontier, Peru.

Pegasus is run by former Credit Suisse banker Erwin Weinzinger and the firm is an investor of long-standing in Karoon. The Pegasus position in Karoon is managed on behalf of a small community of extremely wealthy Indonesian families. That apparently explains why Karoon states that the firm owns 2.4 per cent of the company while the funds managers says it will vote nearly 5 per cent at the meeting.

Karoon lore is that the man who introduced Pegasus to Karoon was an investment advisor named Tony McFadden. He also introduced the late Ken Talbot to Karoon's potential. The Talbot family estate still owns 10 per cent of the business.

There is uncertainty over where the Talbot estate's intentions now lie, just as there is some debate over whether McFadden remains an advisor to the trust.

The other big names on the Karoon register are Wellington Management with 13.5 per cent and Paradise Investments at 6.7 per cent. As much as 16 per cent sits with management and related parties.

This proposed invasion and its potential to both re-populate the board and change Karoon's exploration and development strategy has meet with equal levels of indignant bemusement and focused objection by Hosking.

A long journey

It would not be unfair to suggest that Hosking doesn't get what the fuss is about. Understandably, he reckons Karoon's history of performance under his watch and its recently demonstrated commitment to changes of boardroom governance should surely guarantee a broad-base of shareholder support.

That history roles with delightful, if occasionally disjointed, ease from the Hosking's memory banks.

After making a false start with the continuing mini-tragedy that is Nexus, Hosking took Karoon to the market in 2004 and over the past decade it has found and very recently sold pretty big gas in offshore north-west Western Australian, acquired prospective ground and partners in the Canarvon Basin and managed somehow to find itself drilling and discovering oil where majors dared not go in off shore Brazil.

When you run your eyes over a map of the recent drilling in the deep waters of the Santos Basin it is pretty easy to identify Karoon's little slice of the action. All of its prospects are named after Australian fauna. Lord knows what Brazilians make of wells called Bilby-1, Emu-1 and Kangaroo-1. Hosking smiles wryly when you ask him but, very typically, keeps his thoughts to himself.

Over and exciting three months in early 2013, Karoon made two oil discoveries in the Santos. The first was Kangaroo, which struck Texas Tea in January. And then Bilby came good too in March.

Kangaroo is now the first target for the appraisal necessary to assess the size of the discovery and drilling is expected to begin in a month or so. And there, oddly enough, this is where the story might just have started to get away from Hosking.

The Pegasus pitch is that Hosking was told in the wake of last year's AGM humiliation that Karoon should not pay for any of the appraisal drilling on its Brazilian discoveries.

The preference now claimed for other senior owners by the Pegasus team, was that the Kangaroo appraisal program should be run and paid for by one of the majors that apparently remains interested in acquiring a good sided chunk of Karoon's 65 per cent stake.

Hosking says the logic for rejection of this timetable for a long-planned sell-down are both simple and unavoidable. Given the state of the market, a farm-out now would not bring the value that it should. And the best way to recover momentum to the value-extraction game is to start drilling again.

The issue there, of course, is capital. Drilling where the Karoon finds are is an expensive business. The average well will set you back the better part of \$US100 million.

The current Karoon is plan is for two appraisal wells with an option over two more given any sort of success. But the Hosking's mantra is that success would breed success, and a farm-out would be made more certain and valuable given Kangaroo-2 is as successful as Karoon believes it will be.

Hosking makes his case

Just three months ago there were quite fair questions to be asked about how Karoon would finance this drilling. The cash balance just didn't stack up. But Hosking gambled and won again. He sold Karoon's Browse basin gas find to Origin in deal that left the company with a cash balance of \$690 million and with a further \$200 million to come if things go really well for the new owners.

This is the Karoon story: knowing when to hold, fold and walk away. But there is a sense that the company has now matured into something that demands more transparent and routine disciplines.

When this campaign open there was a fairly broad confidence that Karoon's boardroom consist would survive but that it needed to get on with the promised separation of powers that would see Hosking replaced by an independent chairman appointed by a majority independent board.

But half of that promise has been fulfilled. The fact that Hosking will oversee another AGM as chairman is a source of oxygen to the challengers. And the fate of this meeting is said to be a far more fluid and uncertain thing than it could and probably should have been.

On Friday, after a quick sprint to New York and back, Hosking presented his case in a terse and blunt missive to shareholders. He reviewed a past and asserted a future that justified more time to get the governance issues right and the took the long handle to the trio of boardroom challengers. He claimed Goodall was tainted by recent failure, as was McLoughlin. And he claimed that Bamford, a director of Premier Oil, was conflicted. Premier is a potential partner in Brazil.

But even if the invaders fail, there remains a chance that either the REM will voted down again. If that happens, the next step for Pegasus will be to call a full board spill at an EGM.

The Australian Financial Review



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