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Santos' Accounts Are Not "True and Fair"

Oil Price Assumptions Are Too High

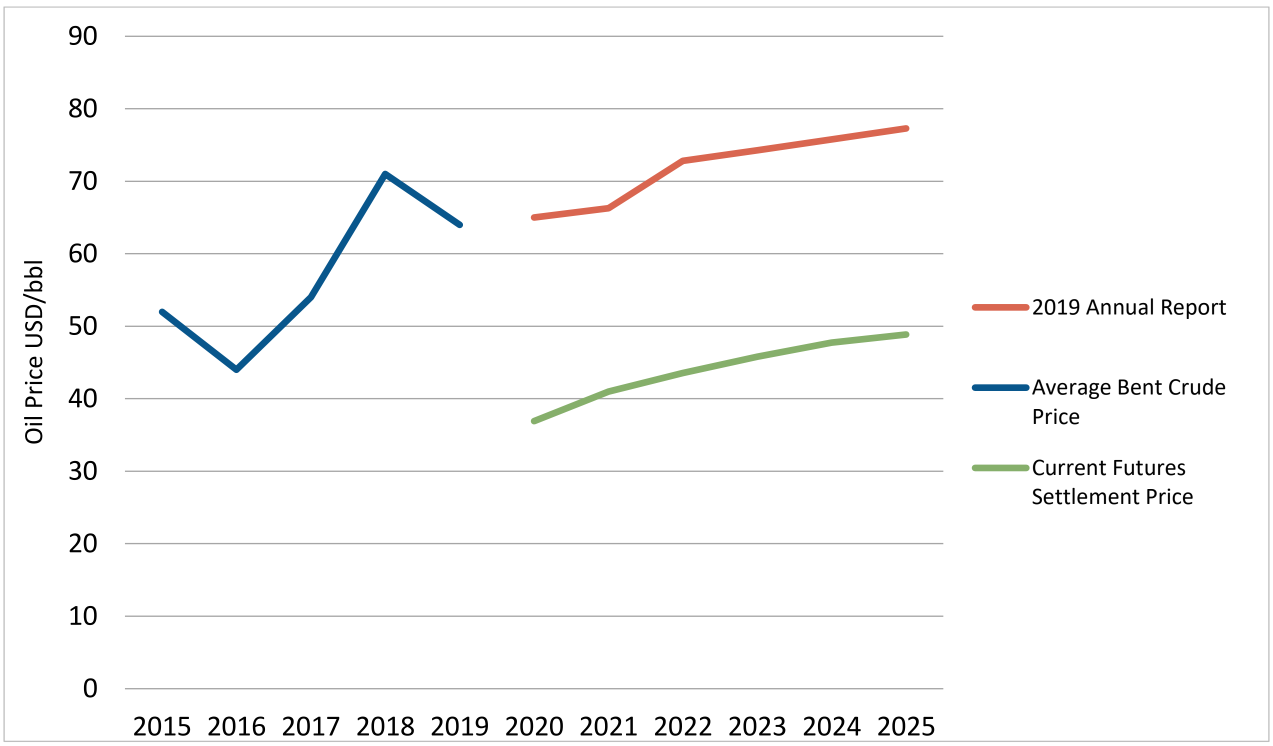
Executive Summary

Australian oil and gas producer Santos recently published their Annual Report for 2019.

In IEEFA's opinion, the accounts contain material inaccuracies in asset values, and the resources that the company relies upon to produce profit are overstated.

The ability for investors and bankers to assess the financial situation that Santos finds itself in is impaired by over optimistic oil price assumptions.

Figure 1: Santos' Oil Price Assumptions vs. Actual and Futures



Source: Santos Annual Report 2019, US Energy Information Administration, CME Group Futures.

Santos' Oil Price Assumptions

A History of Write-Offs

Santos has a long history of writing down its assets in its failed investment in the Coal Seam Gas (CSG) to Liquified Natural Gas (LNG) export industry.

Santos invested, along with its partners, over $21bn in constructing its Gladstone LNG plants in Queensland, Australia. It also developed extensive CSG fields in Queensland to feed its export plants. The plants have never operated at full capacity.

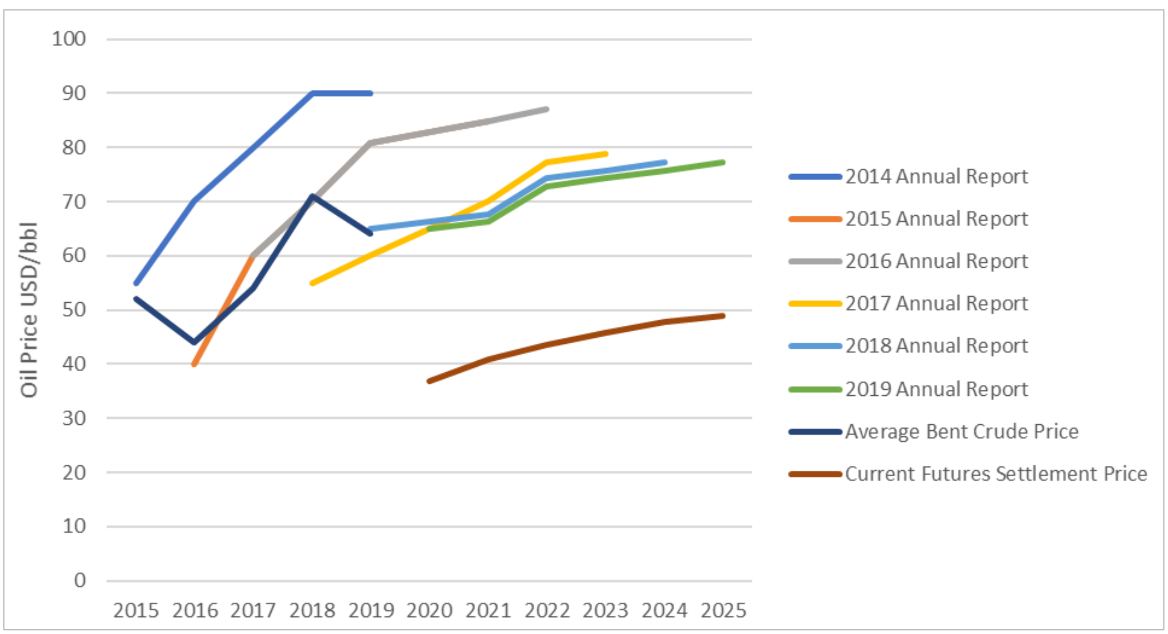
Since 2014 it has written off close to $7 billion on unconventional gas and the LNG plants at Gladstone. Its Gladstone LNG plants saw budget blow-outs and its CSG fields, also in Queensland, failed to perform as expected.

Oil Price Assumptions Are Optimistic

Part of the process to assess whether an asset has value is to look at future cashflows based on oil price assumptions.

Put simply, Santos has consistently adopted oil price assumptions that have proved to be too high, leading to an over-valued balance sheet. In IEEFA's opinion, Resources and Reserves that are not economic have been stated as if they are economic in Santos' Annual Reports. The values of the LNG plant and equipment have also been overstated by a material margin.

Figure 2: Santos' Oil Price Assumptions vs. Actual and Futures Prices 2014-19



Source: Santos Annual Reports 2014-19, US Energy Information Administration, CME Group Futures.

In Santos' 2014 Annual Report, forecast oil prices for 2019 were US$90/barrel, 41% above the actual price. In its 2015 and 2016 Annual Reports, forecast oil prices for 2019 were US$80.77/barrel, 26% above the actual price.

Looking forward from the 2019 Annual Report, the oil price forecasts are again well above the futures curve (in brown on Figure 2). The 2025 forecast is 58% above the futures market price for that year.

Table 1: Oil Price Assumptions Used by Santos

Brent Crude Oil Price Assumptions USD/bbl											
Year Ending 31 December	**2015**	**2016**	**2017**	**2018**	**2019**	**2020**	**2021**	**2022**	**2023**	**2024**	**2025**
2014 Annual Report	55	70	80	90	90						
2015 Annual Report		40	60	70	80.77	82.79	84.86				
2016 Annual Report			60	70	80.77	82.79	84.86	86.98			
2017 Annual Report				55	60	65	70	77.29	78.83		
2018 Annual Report					65	66.3	67.63	74.28	75.77	77.29	
2019 Annual Report						65	66.3	72.83	74.28	75.77	77.29
Average Bent Crude Price	52	44	54	71	64						
Current Futures Settlement Price						36.91	40.98	43.53	45.8	47.73	48.86

Source: Santos Annual Reports 2014-19, US Energy Information Administration, CME Group Futures.

As Santos and its auditors would be aware, the oil price and futures curves have fallen materially since they published their 2019 Annual Report. IEEFA notes however that their forecasts, even at the time, were very aggressive.

Santos' costs should have reduced due to the fall in the value of the Australian Dollar. The majority of Santos' operations have costs in Australian Dollars yet they report in US dollars. The 14% depreciation of the Australian dollar since December 2019 has not compensated for the 56% fall in the oil price since balance date.

The long run 30-year average for oil prices is US$49/barrel, yet in its 2019 Annual Report, Santos assumed that oil prices would rise from $64/barrel as at 30 December 2019 to $77.29/barrel in 2025. The rates of increase in prices assumed of 3.5% per annum is nearly twice the historically low inflation rates we are currently experiencing of 1.8% per annum.[1]

Some context for Santos' forecasts should be considered. Since 2014 Santos' oil price forecasts have proven to be too high. IEEFA recommends that directors and auditors review past forecasts and learn from those mistakes. It is the duty of an auditor to stress test assumptions in annual accounts. In IEEFA's opinion, this does not appear to have been adequately undertaken with regard to the oil price assumptions.

Conclusion

Due to the over optimistic oil price assumptions in Santos' 2019 Annual Report, and previous reporting inaccuracies noted since 2014, investors should vote against the adoption of Santos' 2019 Annual Report.

[1] Reserve Bank of Australia. Measures of Consumer Price Inflation. 29 January 2020.

In IEEFA's opinion, Santos' 2019 accounts do not represent a "True and Fair" view of the companies' financial and resource position.

About IEEFA

The Institute for Energy Economics and Financial Analysis conducts research and analyses on financial and economic issues related to energy and the environment. The Institute's mission is to accelerate the transition to a diverse, sustainable and profitable energy economy. www.ieefa.org

About the Authors

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