The shaky ESG case for a Woodside-Santos mega merger

Woodside and Santos are poles apart on their ESG strategies. Would an $80 billion merger be beneficial from a sustainability lens?

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Santos' Moomba gas project in South Australia, where it is developing a CCS project.

Much has been made of the benefits of scale that can be achieved when oil and gas companies merge to become a much larger combined entity.

More projects and growth opportunities, pooled free cash flow, shared know-how and geographical diversification are just some of the benefits that have been touted by analysts if Woodside and Santos push ahead with an $80 billion merger following their early-stage discussions which were leaked last week.

A combined group would create Australia's only ASX-listed oil company, giving it scarcity benefits and potentially a lower cost of capital and a higher credit rating that would enable it to borrow more cheaply.

But from an environmental, social and governance lens, the benefits of scale are less visible. Combining two companies gives an immediate governance cost saving from merging two boards into one and only needing one of the two CEOs, although this is partly undone by the redundancy costs that would need to be paid to the departing chief, according to Climate Energy Finance director Tim Buckley.

Woodside has claimed that the scale benefits it incurred from acquiring the BHP Petroleum assets in 2022 will give it added firepower to steer it through the energy transition. In its 2022 climate report, it referred to the additional cash flows that could enable a higher spend on new technologies, and a higher geographical diversification (including to North America).

“Each of these products has different characteristics and different risk/reward profiles, improving resilience to uncertainty in the energy transition,” the report stated.

The acquisition has enabled the company to set a $5 billion investment target in “new energy products and lower carbon services” by 2030, the report added.

Based on this experience and Santos’ acquisition of the Oil Search assets, which included an interest in PNG LNG and a project in Alaska, Jarden analysts expect $200m of synergies to result from a Woodside and Santos tie-up. However, analyst Nik Burns pointed out that it’s a marginal sum when set against the actual cost of merging the companies together.

Chalk and cheese

Through the lens of their low-carbon strategies, Woodside and Santos couldn’t be more different. Santos has been an enthusiastic early adopter of carbon capture and storage, despite its chequered reputation in the Australian market after Chevron’s Gorgon CCS project famously missed its CO2 injection target.

Santos has spent millions of dollars on a sequestration facility at its Moomba gas field in South Australia. When it begins operating in 2024, it will aim to inject 1.7Mt of CO2 into disused gas wells, which is the equivalent of all of the project’s so-called “reservoir” emissions, which is the CO2 that is brought to the surface as the methane is extracted. Its emissions from using gas to power its equipment are not covered by the plan but could easily be reduced if the company switched to solar power.

Santos’ second and arguably more ambitious plan is to sequester CO2 in the retired Bayu-Undan gas field off the coast of the Northern Territory. Analysts have costed the plan at $US100/t, which means it will require a very high carbon price to economically justify. Santos says it will rely on its Japanese and Korean LNG buyers to extract the carbon when they burn the fuel, put it on ships and return it to Bayu-Undan, where Santos will sequester it.

Buckley pointed out that Japan does not have a price on carbon (although Korea does), so there is technically nothing to compel these customers from spending an extra $US100/t on their LNG. “Why would a Japanese LNG buyer fund this if there is no government impost, and if there is, why isn’t the Japanese government talking about it? This would be prohibitively expensive for Japanese industries and consumers,” he said.

He is also sceptical of the Moomba plan, referring to the area with its thousands of pre-existing wells as a “pin cushion” and reasoning that if CO2 were injected into one disused well, there is no certainty that it would remain underground.

Jarden’s Burns is less phased by this. “These are fields which have held gas volumes for millions of years - they are reversing the process. Does the CO2 escape? Yes there is always natural seepage from oil and gas fields. “The biggest risk is from the integrity of the wells and I expect they will monitor them over time. It’s whether they can achieve the injection rates they say they will.”

Woodside on the other hand, has had little to say about CCS but has instead gone large on hydrogen, tree planting and installing solar panels to replace gas at its production facilities.

The company has four hydrogen projects - H2OK in Oklahoma, Bell Bay in Tasmania, Southern Green Hydrogen in New Zealand and Perth Blue Hydrogen. All are in a holding pattern for now, with the US project awaiting confirmation it is eligible for Inflation Reduction Act subsidies and Bell Bay seeking Australian Renewable Energy Agency funding. It is awaiting approval from the Tasmanian Environment Protection Agency.

Buckley claims that the New Zealand and Perth projects have been delayed, with little customer interest in blue hydrogen (which is made from gas and requires CCS) due to limited customer interest, and the New Zealand one being uneconomic without a price on carbon. “Hydrogen is crossing the 'valley of death' - some of these projects will reach commercial viability. They will only get there with a government subsidy,” he added.

Buckley expects that if Woodside and Santos merges, a ruler will be run over all of the combined group’s low-carbon projects, and that some will be cancelled, and potentially the Moomba and Bayu-Undan CCS projects if the larger Woodside does not see the benefits.

That said, the reverse could be true, according to Burns. “There is a hypothesis out there that potentially Santos is more advanced on the CCS front than Woodside - and that it is an area of attraction from Woodside to see what they’re doing. I struggle with that theory though.”

He questions whether Santos’ offshore project will materialise. When oil and gas is extracted, over time the pressure of the field drops, as does the amount of pressure the infrastructure used to extract it can withstand. When CCS is enabled, this suddenly increases the pressure again and if the infrastructure is old, it may not be able to cope.

So while there might be benefits from a theoretical merger, ESG considerations do not appear to be one of them.

Given their ESG strategies are like chalk and cheese, and predictions of limited cost upside from a merger, it’s difficult to see how Woodside and Santos would complement each other if their businesses were combined, besides providing diversification which will increasingly be important as fossil fuel industries decline in a net zero world.

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