

# SANDON CAPITAL

Sandon Capital Pty Ltd

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Mr Peter Botten, Chairman  
The Directors  
Karoon Energy Ltd

Via email: [peter@peterbotten.net](mailto:peter@peterbotten.net)

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CC: Fred Woollard, Samuel Terry: [fred@samuelterry.com.au](mailto:fred@samuelterry.com.au)

**1 May 2024**

Dear Mr Botten,

Entities managed by Sandon Capital Pty Ltd (**Sandon Capital, We, Our**) control 4,516,290 Karoon Energy Ltd (**Karoon**) shares. Having first purchased shares in March 2020, we are long standing shareholders of Karoon. We are also associates with Samuel Terry Asset Managements Pty Ltd as disclosed in a notice of initial substantial holder lodged with ASX on 30 April 2024. Together, the associates control 44,718,234 Karoon shares, representing 5.6% voting power.

We have carefully considered the Notice of Meeting for the Karoon Annual General Meeting (**AGM**) to be held on 23 May 2024. We are communicating our current voting intentions to you as a matter of courtesy. We consider that the reasons for our voting decisions have bearing on all shareholders. As such, we will actively seek to persuade other shareholders to vote in the same manner as Sandon, including by sharing this letter.

We currently intend to vote as follows:

	<b>Resolution</b>	<b>Vote</b>
Item 1	Election of Ms Melissa Holzberger as a Director	UNDECIDED
Item 2	Election of Ms Joanne Palmer as a Director	UNDECIDED
Item 3	Re-election of Mr Peter Turnbull as a Director	AGAINST
Item 4	Re-election of Mr Carlos Tadeu da Costa as a Director	FOR
Item 6	Adoption of Remuneration Report	AGAINST
Item 7	Increase to Aggregate Fee Pool for Non-Executive Directors	AGAINST
Item 8	Issue of Performance Rights to Dr Julian Fowles	AGAINST
Item 9	Refresh of Placement Capacity	AGAINST

## Background

The AGM provides an opportunity for shareholders to make clear their views on the Board's stewardship of Karoon. The items being put forward for shareholder consideration at this year's AGM are, in different ways, clearly connected to the Board's goals and ambitions for Karoon. Votes cast on these resolutions will provide the Board with direct feedback from shareholders.

Our current voting intentions are determined by our views on:

- the recent performance of Karoon;
- the goals and objectives the Board and management have set themselves;
- and as a consequence, the prospects for future shareholder returns.

We consider that the Board and Management have failed to properly adapt to Karoon's evolution from an exploration company to a fully-fledged oil and gas producer which is now generating attractive free cashflows. Whilst we acknowledge the improvements to corporate governance that have taken place in recent years, this does not mean shareholders are safe from value-destructive "empire building". Indeed, the recent acquisition of Who Dat, partly funded by what we view as a poorly-executed equity raising, the threat of further acquisitions and the prospect of further significant investment in the development of Neon, leads us to fear that Karoon's Board and Management do not understand the basics of shareholder value creation.

Further, the Board's past statements<sup>1</sup> regarding the possibility of dividend payments have been expunged, replaced by the more vaguely-defined consideration of "*capital management*"<sup>2</sup> adding to our fears of a return to prior form.

The extent of Karoon's free cashflows from existing projects provides it with an opportunity to deliver substantial, low-risk returns to Karoon shareholders by way of dividends or on-market buy-backs (or a combination of both as circumstances allow).

Karoon trades at a substantial discount to its listed Australian producer peers that pay regular dividends. Looking beyond Australia, for a number of years, global oil and gas producers have recognised the importance of dividends and returns of capital in delivering superior shareholder returns.

We expect this gap would narrow considerably if Karoon were to allocate free cashflow from its existing producing assets to regular dividend payments. We also expect that the increase in share price would lead to a reduced cost of equity capital.

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<sup>1</sup> Contained in the Explanatory Memoranda accompanying the 2022 and 2023 Notices of Annual General Meetings.

<sup>2</sup> Item 6 of the Explanatory Memorandum accompanying the 2024 Notice of Annual General Meeting

Yet this path stands in stark contrast to Karoon’s long-term strategic growth plans:

*“Karoon’s strategic goals include delivering attractive shareholder returns, driven primarily by a **substantial increase in its future hydrocarbon resource portfolio and production.**”<sup>3</sup>*

We consider this statement to be at odds with Karoon’s prior statements regarding the prospects of shareholder returns arising from the payment of dividends. These recent statements indicate a Board and Management committed to increasing Karoon’s exposure to value-destroying acquisitions and risky exploration opportunities.

We believe that only changes to the composition of the Board will allow for shareholder return-focused goals to be set. This year’s AGM is an opportunity to begin this process.

## **2024 Annual General Meeting Current Voting Intentions**

The rationale for each of our current voting intentions is detailed below.

### **Items 1 & 2 – Election of Ms Melissa Holzberger & Ms Joanne Palmer as Directors**

Ms Holzberger and Ms Palmer are new additions to the Board and have not yet had an opportunity to demonstrate their capabilities as directors to Karoon shareholders. We would appreciate the opportunity to meet with Ms Holzberger and Ms Palmer before we decide our voting intentions regarding their candidacies.

We will contact you separately to make arrangements for these meetings.

### **Item 3 – Re-election of Mr Peter Turnbull as a Director**

We currently intend to vote AGAINST Mr Turnbull’s re-election.

Mr Turnbull has been a director since 2014, which will represent a tenure of almost 10 years at the time of the AGM. We consider this tenure to be far too long for an independent director.

Mr Turnbull’s role as chair of the People and Culture Committee, and our views on Karoon’s remuneration practices, detailed in our rationale for voting AGAINST Items 6 and 8, is another factor in our decision to vote AGAINST his re-election.

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<sup>3</sup> Karoon 2023 Sustainability Report, page 23, emphasis added.

## **Item 4 – Re-election of Mr Carlos Tadeu da Costa Fraga as a Director**

We currently intend to vote FOR Mr Fraga's re-election.

Although we have not had the opportunity to meet with Mr Fraga, we consider his relatively recent appointment to the Board as well as his industry experience (including in Brazil) warrants shareholder support.

## **Item 6 – Adoption of Remuneration Report**

We currently intend to vote AGAINST the resolution to adopt the Remuneration Report for two reasons.

First, we consider that a company's remuneration practices provide incentives to support the achievement of its strategic goals and objectives. In the case of Karoon, we do not support the current stated strategic goals and objectives, making it impossible for us to support the Remuneration Report.

In the Explanatory Memorandum accompanying the 2022 Notice of Meeting, Karoon began acknowledging that it had transitioned from explorer to producer. It also stated a recognition that *"shorter term shareholder returns, such as dividend payments, will also be considered."* This phrase was repeated in the Explanatory Memorandum accompanying the notice of meeting for the 2023 AGM. As a long-standing shareholder, we are extremely disappointed that a dividend is yet to be paid.

In the explanatory memorandum for this year's AGM, there is no mention of dividends, simply a vague statement about capital management: *"...it is recognised that capital management initiatives should also now be considered."*

We consider that Karoon is paying lip service to concerns about shareholder value and may be hoping shareholders have missed this change.

Having regard to Short Term Incentives (STI), we do not consider Karoon's existing STI framework to be appropriate to its status as a producer. Notwithstanding the recent acquisition of Who Dat, the Baúna project accounts for more than 75% of Karoon's revenues, yet only 55% of STI criteria weightings can plausibly be connected to this asset. Of those, none of the financial and operational objectives relate directly to the application of Karoon's substantial free cashflows to shareholder returns.

We note that *"Production"* only had a 20% weighting in the 2023 STI scorecard, despite the vastly greater significance of production to potential shareholder returns relative to almost any other item on that scorecard.

By contrast, the strategic objective of “*Acquiring a substantial second production asset*” also had a 20% weighting in the 2023 STI scorecard. We consider this another example of inappropriate incentives. Simply being rewarded for making an acquisition pays no regard to the eventual outcomes shareholders will see from that acquisition. For something as significant (and risky) as an acquisition, we believe the acquisition itself should serve as a gateway for longer-term incentives should the acquisition prove its worth to shareholders.

We also consider the Long-Term Incentive (LTI) plan to be flawed. As it stands, 50% of the LTI performance conditions related to Relative Total Shareholder Returns (TSR) and the other 50% is determined by an Absolute TSR measure. The Relative TSR performance condition does not include a positive return criteria. This means that Karoon executives would have part of their LTI vest on the basis that Karoon shareholders *only lost less* than the peer group. We consider it reasonable that the relative TSR measure should include a “floor” of 0%.

We also do not consider a 10% absolute TSR as an appropriate threshold for triggering LTI vesting. Such rewards should be for exceptional performance, not performance that largely reflects the long-term returns of the share market.

Given what we see as conflicting statements about dividends, capital management and Karoon’s objectives, we consider the current remuneration structure as unsuitable and unsustainable. The objectives it seeks to support, particularly in respect of shareholder value, are vague and unclear.

## **Item 7 – Increase to Aggregate Fee Pool for Non-Executive Directors**

We currently intend to vote AGAINST the proposal to increase the aggregate fee pool for non-executive directors.

We note that Karoon has directors who should consider retiring given their very long tenures. When announcing the appointment of two new directors, Karoon did not mention whether any of those long-serving directors might be stepping down after an appropriate transition. Three Karoon directors have served between approximately 8 and almost 14 years. The retirement of the two longest serving directors would provide the Board with the aggregate fee pool flexibility it seeks.

Another aspect of concern is the reference to “*expansion into new geographic areas.*” Once again, given the changes in language from “*dividends*” to “*capital management*” cited above, we fear the current Karoon board has simply, and without clear disclosure, abandoned plans to pay dividends to its long-suffering shareholders, in favour of continued allocation of free cashflow (and the borrowings it might support) to making further acquisitions in “*far flung*” places.

The rationale provided in the Explanatory Memorandum for the proposed increase to the fee pool raises similar issues to those we've cited in our reasons for voting against other resolutions. Given we do not support Karoon's goals and objectives, we cannot support the increase to the aggregate fee pool.

## **Item 8 – Issue of Performance Rights to Dr Julian Fowles**

We currently intend to vote AGAINST Item 8 for the same reasons we currently intend to vote AGAINST Item 6, the Adoption of the Remuneration Report.

## **Item 9 – Refresh of Placement Capacity**

As enunciated above, we believe KAR should be returning cash to shareholders, not asking shareholders to potentially provide more capital. For this simple reason, we are currently intending to vote AGAINST Item 9.

## **Shareholder Vote on the Sustainability Report**

Now that Karoon has graduated from being an explorer to a producer, we believe shareholders should be offered the opportunity to vote, albeit on a non-binding basis, on its Sustainability Report. Like many other shareholders, we would consider this best practice. Failing to offer shareholders this opportunity is another more general reason why we currently intend to vote AGAINST most of the resolutions at the upcoming AGM.

If you have any questions or would like to discuss this further, please do not hesitate to contact me via email at [Gabriel@sandoncapital.com.au](mailto:Gabriel@sandoncapital.com.au) or via mobile on 0408 936 357.

Yours sincerely,



Gabriel Radzynski  
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Sandon Capital Pty Ltd