Boldly global?

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Global appetite for gas is on the rise and international oil and gas companies are looking to cash in. In the period to 2010, annual growth in worldwide gas demand is expected exceed any other as its economic and environmental benefits are increasingly trumpeted. Moreover, new focal points are emerging in the energy landscape. Countries with fast developing economies, notably China and India, are hungry for energy but lack the infrastructure. In other areas, regulatory liberalisation may effect project development, breaking down traditional barriers. The LNG market is also entering a period of considerable growth and change.

Investment potential for international oil and gas companies is huge. But risks are high as well. Developing economies are precarious and many projects capital intensive. Energy prices are increasingly volatile and global economic slow down has investors and lenders alike adopting a very cautious approach. Flexibility is the name of the game in the face of an ever-changing energy landscape.

BG Group, for one, has high hopes. The company was born as a result of a restructuring of the ?old British Gas? in 1999. A second demerger was completed on 23 October 2000. Lattice Group, incorporating UK gas transmission network Transco, was launched to progress UK development. BG Group retained international operations, stating that ?its core business lies in the development, management and supply of existing and newly emerged gas markets around the world.?

Since the split, BG has pursued a policy of consolidation and expansion. Gas is the focus and it has interests in every link of the gas chain. 2001 saw the sale of Italian exploration subsidiary, BG Rimi. In other regions, growth is the focus. BG is currently finalising negotiations to purchase Enron's stake in Indian exploration interests. This is the company's first foray into upstream activities in India, where it currently owns downstream distribution assets and is planning a LNG project with Reliance.

LNG is increasing its presence in BG's portfolio. The £900 million Idku LNG project in Egypt, sponsored by BG, Edison and EGPC, is close to financial close. Offtakers are currently being sought. The terminal will be fed from the BG- and Edison-owned West Delta Deep Marine field, where successful drilling has already been reported. In Trinidad, construction is already underway on Atlantic LNG's two expansion trains.

Coming up is a programme of ambitious investment in both established and emerging gas markets. But where will the funds come from? BG's track record proves it is certainly not afraid of non-recourse lending but current leverage is fairly conservative. The company has a low A grade rating from Moody's and BBB+ with positive outlook from Standard and Poor's.

?BG's strategy of diversification minimises risk,? says a Moody's analyst. ?It has assets in all areas of the oil and gas industry in many different regions. Country risk is obviously an issue and there are risk concentrations, notably Kazakhstan, but BG compensates by pursuing diversity.?

Going forward, BG faces a balancing act of active investment and growth into new markets whilst maintaining its investment grade rating. Craig Cowley, head of structured finance and John O'Driscoll, group director of treasury and corporate finance, BG Group discuss upcoming investments, finding finances and minimising risks.

PF: What are the major areas of focus for new investment in the coming years?

JO'D: Gas is definitely our focus and where we see potential growth. Currently, about 75% of total production is gas, with oil and liquids providing a degree of balance to the portfolio. The broad strategy, then, is to develop gas chains.

PF: How does the sale of BG Rimi fit into the wider plans? Is BG minimising Italian activity?

JO'D: BG inherited a portfolio of assets. Like any company, we are constantly re-evaluating our portfolio and seeing what fits. Rimi was one that didn't. We do still have a significant presence in the Italian energy market and are developing opportunities, e.g. Brindisi LNG. The six regions where we are concentrating our major efforts are the UK, Latin America, Trinidad, Egypt, Kazakhstan and India.

PF: BG has outlined ambitious investment plans, up to £8 billion from 1999 to 2006. How are these funds likely to be raised?

JO'D: Most investments will be financed from operational cash flow. The remainder will be a mixture of equity funding, balance sheet debt and non-recourse debt. On balance sheet debt levels will rise somewhat.

PF: Do you expect to see gearing levels rise considerably?

JO'D: We have stated that BG's gearing should not exceed 25%. One of the drivers for this is that the company aims to retain a single A category rating.

PF: In what circumstances do you tend to favour the project finance route?

CC: Typically, we raise project debt against midstream assets. LNG terminals, as capital intensive, utility-type midstream assets, in particular. Atlantic LNG's first train was project financed and the upcoming Idku LNG project in Egypt will follow suit. We would actually have liked to fund Atlantic LNG's expansion trains with non-recourse debt but our partners did not agree. In the past we have done project financings in a number of areas, including power stations in the Philippines, Malaysia and Italy, pipelines and a distribution company in Egypt.

As far as project financing is concerned, we will use it where it doesn't delay or interfere with commercial development of projects. We like to retain a mix of corporate and project debt. We are open about our operations and off balance sheet figures. We had about £600 million at the end of last year.

PF: What is your policy for refinancing project debt?

CC: Typically, we review the project once it is in commercial operation and possibly refinance debt at this stage. Recently we have been frustrated by market conditions. We have been intending to refinance debt for Atlantic LNG's original train for a while, but felt the time is not right.

PF: Would you consider a capital market refinancing?

CC: To date we have not issued non-recourse bonds. We probably have a slight preference for bank debt but the capital markets could be possible. If a project was settled then the capital markets could be an option for refinancing. Because Atlantic LNG is currently under expansion, bonds would probably not be considered appropriate in this instance. On the corporate side, we have a very strong history of bond issues although this debt transferred with the Lattice demerger.

PF: BG is expanding significantly in India and other non-investment grade countries. How do you intend to raise finances for these projects?

CC: It is difficult but it can be done. The distribution companies we invest in raise debt themselves on the income generated from their own customer base. The proposed acquisition from Enron is not likely to be project financed, in line with our general policy on upstream assets. Also, we have a corporate view on how we want our portfolio to be balanced with regard to OECD and non-OECD countries. Developing country exposure is also a factor on our investment and disposal decisions.

PF: Do you have plans for growth in Latin America, even given current concerns over its economic health?

JO'D: Distribution in Brazil, where we own distribution company Comgas, is growing very rapidly. But it is organic growth rather than aggressive investment. This year we secured capacity rights on the Bolivia/Brazil pipeline, in which we have a stake. This is key to monetizing Latin American operations, allowing us to transport gas from our upstream asset in Bolivia. We also own distribution company MetroGAS in Argentina. With regard to the current crisis, I think we realise that from time to time, situations such as this will arise ? the key issue is that BG has the skills to deal with them.

PF: In many areas of Asia Pacific, there is huge potential growth in gas. Does BG plan to move in?

JO'D: It is not an area where we will be active for the foreseeable future. You must bear in mind that BG is actually a company with relatively limited resources, which we want to focus on those projects that we have said we will deliver. We do not want to get distracted from this.

PF: LNG projects figure highly on your itinerary. Is BG committed to continued expansion in this field?

CC: Definitely. We see ourselves as having significant expertise in this field of the industry. British Gas Corporation was the first company to ship LNG in the 1960s.

PF: The LNG market is expanding globally and becoming more flexible. Do you think that there is move away from reliance on long term purchase agreements and if so, do you think this will make financing harder to raise?

CC: The necessity for long-term contracts may diminish as spot markets develop and mature. We believe that it is well established in the US and that lenders would take this risk on. In Europe, on the other hand, it is less mature and accordingly there is a strong preference towards having a long-term buyer in place. There is no ability in Europe to just dump LNG into the market on a spot basis.

PF: How far progressed is the Idku project in Egypt?

CC: FEED contracts have been put in place with Bechtel and an EPC contract is being put together. The environmental impact assessment has commenced, SocGen has been appointed as the project's financial advisor with Shearman & Sterling as legal advisor

PF: Have you secured gas sales contracts?

CC: We are currently in negotiations over this. It is likely that the LNG will be sold to Europe in the first instance, although we are considering the US as an offtake as well. We will definitely have to secure sales agreements before going to the debt markets. I do not think it is possible yet to finance an LNG terminal on a purely merchant basis.

PF: Do Atlantic LNG's expansion trains have sales agreements?

CC: There are agreements in place with El Paso, who has an obligation to purchase a certain capacity. BG as a supplier will receive a netback based on US gas market prices. Train two is scheduled to come on line in September 2002 and train three in June 2003.

PF: Do you believe that the US will become an increasing focus for sale of BG's LNG?

CC: It is market access that is the issue in the US. There are not many importation facilities and the ones there are tend to be controlled by individual companies. BG has recently secured capacity at CMS' Lake Charles facility, but there is a limit to how much more is available.

PF: In summary, what do you feel are the key challenges for BG in the coming few years?

JO'D: The main challenge, which I believe is well known to shareholders, is the delivery of key projects. One of the major ones is the LNG export project in Egypt. Completion of the Caspian pipeline, which will connect the Karachaganak field in western Kazakhstan to the Black Sea, is also a priority. Further down the line, we believe that monetizing upstream assets in Latin America is an important component of our growth.