Company Background

BG Group

The UK's third-largest oil and gas group after BP and Shell, BG Group Plc ("BG") has a broad portfolio of interests covering Exploration and Production, Liquefied Natural Gas, Transmission & Distribution and Power.

History

BG was formed in 1997 following its demerger from British Gas Plc where it formed its international division.

Operations

While their headquarters are in the United Kingdom, 60% of the BG workforce are located overseas. BG Group manages its business on an integrated regional basis across 27 countries on 5 continents. The high performing upstream Exploration and Production business remains the core of the group's activities. The Liquefied Natural Gas, Transmission & Distribution and Power businesses form the downstream activities, providing stable revenues to the group.

1) Exploration and Production

Although known primarily as a major gas player, BG also has vast oil exploration activities. Compared with the likes of BP and Shell, which struggle to grow production by 3% a year, BG's production is forecast to grow by 6-8% a year as far out as 2020.

Brazil – Santos Basin

BG's most exciting prospects lie in the Santos Basin, an area covering 352,000sq km - slightly larger than the land mass of Italy - and lying 300km off the south-east coast of Sao Paulo, Brazil. The fields are among the largest discovered anywhere in the world since the 1960s, though they are difficult to access. This is due to the location and the fact that the oil is locked in reservoirs beneath 2,000m of water and a further 5,000m of rock, sand and salt - requiring cutting edge robots and other technology to recover.

Brazilian officials have estimated that the Santos Basin contains at least 50 billion barrels of oil and if developed would make the country the world's fourth-largest oil producer after Saudi Arabia, Russia and the US.

The fields are economically viable at oil prices of $40 not just in terms of day-to-day operating costs, but also in terms of full capital investment return. One reason for this is that the fields have so far revealed greater pressure support for oil extraction than first presumed. High flow rates mean that the costs of extracting the hydrocarbons from the deep offshore area are lower, requiring fewer wells and lower capital expenditure. It may also indicate significantly larger volumes of recoverable oil than previously modelled.

Guara

Results from the test well on the Guara field, discovered in June 2008, have shown that it holds between 1.1 and 2 billion barrels of recoverable oil, dwarfing the "giant" discovery announced by BP in the Gulf of Mexico of 500 million barrels.

BG has a 30% interest in the field, alongside Petrobas, Brazil's national oil company, and Repsol of Spain, who own 45% and 25% respectively.

Commercial quantities will be produced from 2012, initially producing 50,000 barrels per day ("bpd") with the oil being piped into giant floating tankers before being shipped ashore. From 2013, the field will be producing 120,000bpd.

Tupi

Tupi is thought to contain 33 billion barrels of oil making it the world's third largest known reserve. This field should produce 120,000 bpd from 2013.

Iracema

Flow rates on the Iracema site have set a new record for the already-prolific discoveries in the Santos basin, joint-ventured by BG and Brazilian state oil company Petrobras.

Abare West

Oil and gas have been successfully hit on this field, though it is too early for any indication of recoverable assets.

BG are also exploring the possibility of a floating liquefied natural gas unit to monetise gas from the Santos Basin fields. BG has always said that in addition to the valuable oil, the quantity of associated natural gas is also very significant. BG envisages 3 million tonnes per year of LNG output, much of which should find its way onto the profitable global LNG market.

2) Liquefied Natural Gas

The heightened awareness of environmental degradation throughout the world now favours natural gas as the fossil fuel of choice being both green and abundant. Consequently future demand is projected to outstrip supply, increasing the value of the Group's existing LNG portfolio, which consists of:

Australia

Before its acquisition of the Queensland Gas Company in 2008, BG had no interest in the Australian LNG market, which some analysts predict will become the "Middle East of gas" and the largest exporter of LNG by 2020. Following this acquisition BG is an integral part of Australia's energy plans and it expects a significant amount of production to come online by 2014. The relative low cost of the operation means that BG makes money with the benchmark US gas price as low as $2-3 per million British thermal units (mmBtu).

Worldwide

BG has won bids to construct new LNG import terminals in Chile, Brazil and Hong Kong. Not only will these increase its spread of contracted deliveries beyond the softening US market, but the involvement with Chile will raise the group's deliveries to the southern hemisphere. That's useful - it helps smooth revenues because demand for gas there peaks when demand in the northern hemisphere is lowest.

LNG Shipping

BG has a core fleet of ships that deliver LNG cargoes worldwide. BG is in fact the largest international oil company operator of LNG ships and has supplied 21 of the 22 LNG importing countries and sourced LNG from 10 different supplier countries.

US Shale

The group made a strategic move into the US shale gas market following the $1.3bn purchase of a 50% interest in the Exco Resources project in Texas/Louisiana. The outlook for US gas prices is presently downbeat due to a glut of supply, but over the long term it is predicted to rise from the current distressed level. Shale gas has become increasingly important, as the many deposits could turn out to be the largest single source of gas in the US.

3) Transmission and Distribution

BG has focused its T&D activities on the high-growth markets of Brazil and India. In Brazil it owns 60.1% of Comgas, Brazil's largest gas distribution company, serving around 630,000 connected customers in the Sao Paulo area. In India it owns 65.12% of Gujarat Gas Company Limited, which is India's largest private sector gas distribution company.

4) Power Generation

BG Group owns 4.4GW of power capacity providing power to the UK, Italian, US and Australian national electricity markets.

Management

The company's management is exemplary and has time and again displayed a knack for spotting the next big thing.

That reputation was established with BG's acquisition of liquefied natural gas facilities on the US east coast in the early 2000s, when no one else could see their value. BG used these terminals as the anchor for an LNG supply and trading business that subsequently boomed as the rest of the world latched onto the value of LNG.

Brazil is another place where BG moved ahead of the pack, hitting upon a string of world-class oil discoveries. The Brazilian government now thinks that the Santos Basin is so prolific it has tightened the tax regime for oil companies seeking entry - but not for the first movers such as BG, which enjoy the original terms.

Another example is where the group has acquired exposure to the US shale gas industry, which aims to exploit hard-to-drill deposits. ExxonMobil, a famously canny enterprise, recently bought US shale-gas company XTO for $41bn, illustrating how significant shale gas is likely to become.

Management is also adept at coping with changing market conditions. For years, BG exploited arbitrage opportunities between the price for LNG in the US and Europe and in the Far East. When the opportunity was there, it switched cargoes from its Atlantic routes to East Asia. It executed this arbitrage so well that its LNG operation continually exceeded expectations. Despite the softening of the global economy in 2008, BG had seen this coming and locked in favourable prices for existing supplies.

Takeover Target

Conventional wisdom is that integrated behemoths such as BP and Shell are essentially ex-growth, running just to stand still with new production barely enough to replace declining output at older assets. The quick-fix answer to this is acquisition, and BG Group is clearly the most attractive oil and gas asset on the planet worthy of super-major oil company attention.

American giant ExxonMobil announced its first significant acquisition for years in December 2009, targeting the US shale gas company XTO. Now its appetite is whetted, we believe ExxonMobil could potentially make a bid for BG.

Such a move was hard to justify in recent years, with hydrocarbon prices swinging wildly and Brazilian upside less obvious. But now oil looks convincingly underpinned by a $60 to $70 floor even if the global economic recovery is slow, while in the next couple of years BG will benefit from both lucrative production in Brazil and a whole new southern hemisphere LNG business to add to its existing footprint. A canny predator will believe holding fire now will probably mean paying lots more later.

23rd February 2010

Research Disclaimer

Gibraltar Asset Management is the trading name of Gibraltar Asset Management Limited. Gibraltar Asset Management Limited is a member firm of the London Stock Exchange and is authorised and regulated by the Gibraltar Financial Services Commission. Research: Neither the information nor the expressed opinions in this document constitute or intend to be an offer, or a solicitation of an offer, to buy or sell relevant securities (i.e. securities mentioned herein and options, warrants, or rights to or interests in any such securities). The information and opinions contained in this document have been compiled from, and based upon generally available information and independent research undertaken by ourselves or by our team of London based institutional analysts, which has been qualified and reviewed by our portfolio managers for suitability. However, the accuracy or completeness of the analysis cannot be guaranteed. Confidentiality: The information in this document and any attachments may contain proprietary information some or all of which may be legally privileged. It must not be disclosed to or used by persons other than the intended recipient. If received in error, please notify us immediately and then delete this document. Content: Please note that the content of this document may be e-mailed and may be intercepted, monitored or recorded for compliance purposes. Copyright: Copyright in this document and any attachments created by Gibraltar Asset Management Limited belongs to Gibraltar Asset Management Limited unless otherwise stated. Care: Gibraltar Asset Management Limited shall not be liable to the recipient or any third party for any loss or damage howsoever arising from this document and / or its content, including if e-mailed, loss or damage caused by virus. It is the responsibility of the recipient to ensure that the opening or use of this document and any attachments shall not adversely affect systems or data.

Contact: Telephone (+350) 20075181 Mail: gam@gam.gi Website: www.gam.gi