CASE STUDY:

HYBRID CAPITAL SECURITIES

BG GROUP RECENTLY ISSUED $2BN OF HYBRID BONDS TO INVESTORS ACROSS THE UK, EUROPE AND ASIA. CHARLES STEWART EXPLAINS HOW

In June, BG Group issued subordinated hybrid capital securities totalling $2bn, in sterling, euro and dollar tranches. All tranches were well received by investors. Here, we review the history and rationale behind the transaction, the structure of the securities and their marketing and distribution.

Rationale

BG Group is a global oil and gas company that has a significant programme of capital investment, focused particularly on our major growth projects in Brazil and Australia.

Oil and gas is a long-term and capital-intensive industry, and a strong balance sheet and credit rating are an important part of our business model. By issuing hybrid bonds, in conjunction with our portfolio rationalisation programme targeting $5bn of capital release over the next two years, we are further strengthening our balance sheet during this period of major capital investment. This will drive our continued growth.

Bond structure

The structure of hybrid bonds has steadily evolved as rating agencies continue to develop their own individual policies towards the product. A key objective for BG Group was to achieve 50% equity credit from each of our three rating agencies. This required careful balancing of the requirements of each agency's hybrid criteria (each agency has its own focus and, in certain aspects, differing views as to what constitutes hybrid equity).

Key features for the agencies include subordination, coupon deferral and permanence. In relation to permanence, the securities include a non-binding statement of intent around replacing the hybrid equity with instruments of similar equity credit if redeemed early in certain scenarios. This statement helps reinforce the permanence of the rating agency equity component and is important in relation to the equity content afforded by the agencies.

Additional issuer flexibility is provided by special event call options, which allow the bonds to be called if, for example, tax deductibility or (as a result of a change in rating agency methodology) equity credit is lost.

Marketing

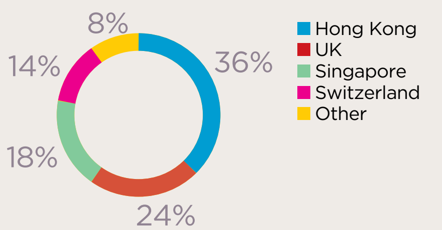
We wanted to have as much flexibility as possible in the tranching of the transactions, so we dedicated two roadshow teams to cover all the major centres in the UK, Europe and Asia. The roadshow was announced on 7 June and started on 11 June, with London, Edinburgh, Frankfurt, Amsterdam, Paris, Zürich, Hong Kong and Singapore all targeted for investor meetings. We were keen to complete the roadshow in four days and have the option to price on Friday 15 June, ahead of the Greek election that weekend.

Our proposition met with a very strong response. Unusually for a UK roadshow, we held a day of London meetings in one location, with investors coming to us, in order to maximise the number of investors we met.

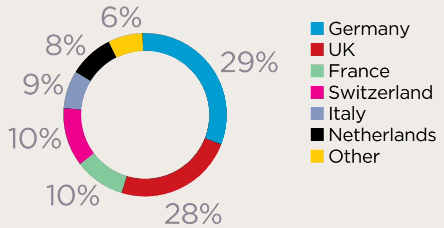
By the Thursday, it was clear that there was strong appetite for a deal, but feedback from investors revealed that a launch would be more constructively received if delayed until after the Greek elections.

We also decided that the dollar leg of the transaction would benefit from more time to enable us to gather feedback from the private banks in Asia.

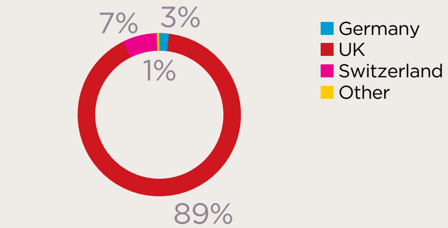
INVESTOR ALLOCATIONS BY GEOGRAPHY – $



INVESTOR ALLOCATIONS BY GEOGRAPHY – €



INVESTOR ALLOCATIONS BY GEOGRAPHY – £



Execution and pricing

Initial price talk for the euro and sterling issues commenced on the morning of Monday 18 June in the region of 6.500% for both tranches. The euro order book grew to over €1.25bn and sterling to over £1bn. Feedback was sufficiently strong to enable us to meet our tranche size targets of £600m and €500m, pricing at the initial price talk level of 6.500% (equivalent to mid-swaps +517.6 bps in euros and +533.6 bps in sterling).

A couple of days later, we announced a US dollar tranche with price guidance of 6.750% to 7.000%. The order book quickly grew overnight in Asia, with strong demand from private banks driving the momentum. By the time Europe opened, the order book was in excess of $1.5bn, enabling us to revise price guidance to around 6.625%. This tranche also met with strong demand and allowed pricing of a $500m tranche inside guidance at 6.500% – in line with the earlier euro and sterling tranche pricing.

Distribution

Across the three tranches, more than 230 orders were received prior to allocation, with the largest order being equivalent to $300m and the smallest £100,000. By geography, investor appetite was strongest in the UK and Germany, with significant interest in the US dollar tranche from Hong Kong and Singapore. As expected, the main investors by type were fund managers, insurance and private banks as well as 'long-only' hedge funds and pension funds.

Market response and secondary trading

Press response to the transaction was uniformly positive, reflecting a clear endorsement of BG Group's strategy and growth plans. The trades tightened slightly on the break and, at the time of writing, they have continued to perform in the secondary market.

All in all, from BG Group's perspective, the deal was a clear success, with sterling and euro pricing in line with guidance and dollar pricing following suit. We were happy with the book size, we met our target issue size in all tranches, and performance in the secondary markets has been good.

STRUCTURE OF BG HYBRID CAPITAL BOND

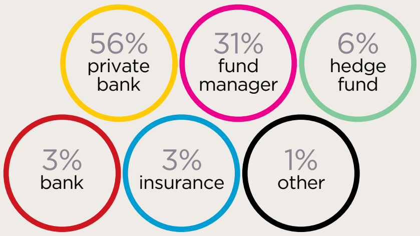
ISSUER	BG ENERGY CAPITAL PLC
GUARANTOR	BG ENERGY HOLDINGS LIMITED
RANKING OF NOTES	SUBORDINATED, SENIOR ONLY TO ORDINARY SHARE CAPITAL
MATURITY	30 NOVEMBER 2072
INTEREST RATE STRUCTURE	FIXED FOR 10.5 YEARS (RESET AT YEAR 5.5); FRN THEREAFTER WITH 25 BPS STEP-UP AT YEAR 10.5; AND A FURTHER 75 BPS STEP-UP AT YEAR 25.5
INTEREST DEFERRAL	OPTIONAL, CASH CUMULATIVE AND COMPOUNDING. DIVIDEND PUSHER ON ARREARS
ISSUER CALL OPTIONS	AFTER 5.5 AND 10.5 YEARS AND EACH INTEREST PAYMENT DATE THEREAFTER
SPECIAL EVENT CALLS	TAX DEDUCTIBILITY; LOSS OF EQUITY CREDIT (FROM RATING AGENCY METHODOLOGY CHANGE) AT 101% GROSS-UP, SQUEEZE OUT AT PAR
REPLACEMENT LANGUAGE	INTENTION-BASED, SUBJECT TO CARVE-OUTS (FOR EXAMPLE, IF RATING IS MAINTAINED)
GUARANTOR RATINGS	A2/A/A (ALL STABLE)
INSTRUMENT RATINGS	BAA1/BBB+/BBB+
EQUITY CREDIT	MOODY'S – 50%, S&P – 50%, FITCH – 50%

The hybrid capital issuer was BG Group's financing company BG Energy Capital plc, guaranteed by BG Energy Holdings Limited. Structuring banks were BNP Paribas and The Royal Bank of Scotland. Joint lead managers were Barclays, BNP Paribas, Deutsche Bank and The Royal Bank of Scotland. For more information on the deal, please contact Charles Stewart at BG Group: charles.stewart@bg-group.com

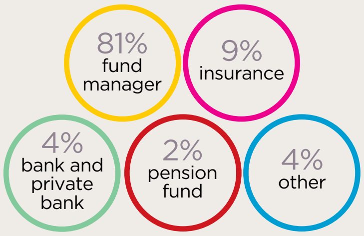
Charles Stewart is head of funding and investment at BG Group

BG GROUP

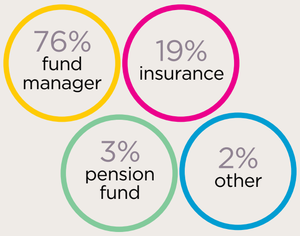
INVESTOR ALLOCATIONS BY TYPE – $



INVESTOR ALLOCATIONS BY TYPE – €



INVESTOR ALLOCATIONS BY TYPE – £



SOURCE: RBS