By Michael D. Tusiani

“SHELL AND BG: WILL THEIR STRENGTHS BE MERGED?”

Competitors had better watch out if the strengths of both companies are combined and preserved.

The primary driver for Shell’s acquisition of BG was to consolidate its position as a global leader in the LNG business. Each company has an impressive portfolio of assets with little geographic overlap. While both manage their risks very carefully, they have different cultures, strengths and operating styles. Shell is rather measured and methodical, while BG is more entrepreneurial, seizing opportunities ahead of the pack. Will the sum of the parts be greater than the whole?

Shell benefits from BG’s reserve position. Its proven oil and gas reserves and production will increase by 25% and 20%, respectively. BG was successful in finding gas — particularly in deep water, such as offshore Tanzania. In Queensland, Australia, BG has put the world’s first LNG project based on unconventional gas into production. The addition of Shell’s Queensland reserve position is a good fit.

Shell may be eager to apply its Prelude floating liquefaction technology to BG’s deepwater assets in Brazil and Tanzania where an onshore plant may be costly. BG, in contrast, decided not to develop in-house technology, preferring to rely on a third-party contractor to deliver its projects quickly and reliably.

Unlike oil, a highly liquid commodity, a firm developing an LNG liquefaction project costing tens of billions of dollars must secure long-term purchase contracts with creditworthy buyers. The financial risks are too great for companies to rely on sales into a relatively small short-term market where trades are constrained by limited flexibility in shipping and the need to place large parcels into modestly sized outlets.

Shell, a conservative LNG player, sells most of its LNG on a long-term basis prior to taking its final investment decisions (FID) on projects. Still, it could gain from BG’s nimble LNG marketing expertise. BG was among the first to exploit the emerging LNG short and medium-term markets. It used these trades not only to generate arbitrage profits but also to establish downstream market positions, adroitly shifting short-term sales to longer-term deals ahead of market swings. Contrary to perception, neither company is currently heavily exposed to the LNG spot market. BG, an early mover in the North American gas export scene purchasing from Cheniere's initial trains, has resold these volumes ahead of later projects.

On the shipping side, Shell operates its own LNG fleet mostly under long-term charter arrangements. Based on years of experience, BG uses the expertise of others to operate their vessels and its chartering policy smartly uses optionality as a hedge to market and technology changes.

An operation that combines the best of BG and the best of Shell represents a strong threat to its LNG rivals. The challenge, as for all acquisitions, is the integration of their individual strengths and business cultures. BG's entrepreneurial marketing skills contrast with Shell's more consensual and structured approach. Shell has developed solid relationships with the established buyers, particularly in Japan and South Korea. Will these buyers be able to accommodate the BG style? In the upstream space, will BG's exploration team still find the inspiration to locate new gas fields within the Shell system? Given its size and history, the Shell culture may prevail but, hopefully, for the sake of the shareholders, the strengths of both companies will be combined and preserved. The next few years will provide the answers.