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Lotos Gdansk: No SPV required

01/07/2008

Polish state petroleum company, Grupa Lotos, has closed a Eu1.75 billion ($2.74 billion) 12.5-year project financing to support its Gdansk refinery upgrade. The project is structured as partially non-recourse, but it does not feature a special purpose vehicle (SPV). The debt is secured against land and a list of assets (storage tanks, transport pipelines, CHP plants, production installations etc) associated with the operations of the refinery and required ringfencing the holding company from its subsidiaries.

The deal has been three years in the making, and when financial adviser BNP Paribas first tested lender market appetite in October 2007 it was clear the financing would be a club to avoid margin and fee inflation in syndication.

Fourteen initial lead arrangers signed up, committing to share the Eu1.75 billion equally with tickets of Eu125 million apiece. The lead initial mandated lead arrangers are BBVA, Bank Polska Kasa Opieki, BTM (bookrunner and documentation), BNP Paribas, Caja Madrid, Calyon (bookrunner and documentation), DnB NOR, Fortis Bank, ING, KBC (bookrunner), Nordea Bank, RBS, SG (bookrunner and security agent) and SMBC.

Bank takes were later pared down to below Eu80 million, with the addition of three more lenders at lead arranger level – Bank Zachodni WBK, Rabobank and SMBC – and the inclusion of a $425 million Sace-guaranteed tranche.

The 12.5-year Eu1.75 billion facilities comprise a $975 million term loan, a working capital loan of $200 million, a Sace OECD-compliant $425 million facility (funded by BNP Paribas, BBVA and Fortis) and a contingency loan of $150 million.

Margins on the term loan are 115bp over Euribor during construction (due for completion in 2011) followed by 100bp, stepping up to 135bp over term. The upfront fee is around 110bp.

Although the banks were committed to funding the entire amount, the participation of Sace was welcome because the lead arrangers wanted the deal done without syndication. Discussions have yet to be concluded about whether to launch a general syndication, but the feeling among lenders is that there is now no need for this.

The funding completes Grupa Lotos's financing requirements for its ambitious '10+ programme'. Lotos signed a related $400 million inventory facility agreement in December 2007 with a consortium of four Polish banks. The Eu1.75 billion loan agreement represents roughly 10% of the equity of Grupa Lotos.

The debt is secured on the refinery's existing assets and cashflows, and incorporates a cash-sweep mechanism, which under the base case scenario will amortise a 20% balloon. The maximum security amount under project financing is $2.625 billion, which equates to a generous debt to security ratio of 50:50. Lotos's equity is funded with the cash flows from the operating part of the refinery, which, according to a participant on the deal, will provide overall leverage of roughly 60/40. There is also a typical 6-month debt service reserve account.

There is a limited amount of currency and commodity hedging, with the initial lead arrangers arranging the currency swaps and Lotos using its relationship investment banks to arrange commodity hedging.

The expansion involves the construction of a new 45,000 barrels-per-day mild hydrocracking unit based on Shell technology which will increase capacity by 75% to over 10.5 million tonnes per year, a new tank farm and LPG unit, and a hydrogen plant. Lotos awarded three key EPC contracts in late 2007, and paid for the work itself until drawdown.

In August 2007 Fluor was awarded a Eu200 million EPC contract to build utilities and other offsite equipment such as a new tank farm, LPG washing unit and the upgrade of the high-voltage power distribution system and water system and other outside battery limits units. In October, Lurgi was awarded a Eu103 million EPC contract to build two distillation units and a hydrogen plant. Technip was awarded the cracker contract worth Eu472 million in December.

The rationale for the expansion is to allow the sponsor to sell higher-value petrochemical derivatives such as bitumen and other refined products in the domestic market and across Europe. The hydrogen plant, for instance, will enable Lotos to produce an array of products, including natural gas, naphtha and liquid petroleum gas (LPG).

Lenders are comfortable with the refinery margin risk, since the capex requirement is not as large as a greenfield project and the state-owned sponsor has extensive experience. Given the dearth of project finance deals in the region, banks had to look to the Middle East for benchmarks, with the Greater Equate deal in Kuwait cited as a comparator.

Despite the absence of an SPV, due to the Polish security regime, the deal has all the hallmarks of a project financing, because there is no completion/construction guarantee, the banks are taking full refinery margin risk and the deal would be impossible to replicate on a corporate basis. A corporate financing would be limited to a debt/ebitda multiple and have a maximum tenor of around five years.

It will not be repeated soon, because majors prefer to finance European refineries on-balance sheet. But Austria's OMV could feasibly fund downstream expansion via project financing in the future, and, as Lotos has shown, raising debt this way allows sponsors to pursue more aggressive expansion policies beyond what a corporate facility would allow.

Gdansk refinery expansion
Status: Financial documentation signing 2 July, financial close imminent
Description: Eu1.75 billion loan for refinery upgrade in Poland
Sponsor: Grupa Lotos
Financial advisers: BNP Paribas
Initial mandated lead arrangers: BBVA, Bank Polska Kasa Opieki, BTM, BNP Paribas, Caja Madrid, Calyon, DnB NorBank, Fortis Bank, ING, KBC, Nordea Bank, RBS, SG
Lead arrangers: Bank Zachodni WBK, Rabobank, SMBC
ECA: Sace
Sponsor legal counsel: CMS Cameron McKenna
Lender legal counsel: Linklaters
EPC contractors: Technip (cracker), Fluor (tank farm) and Lurgi (hydrogen plant)