Saudi Kayan: Success in a liquidity crunch

01/06/2008

Despite a global project finance market devoid of liquidity SABIC has successfully secured the $6 billion debt for its largest vertically-integrated, grass roots, petrochemical project to date – Saudi Kayan Petrochemical Company (Saudi Kayan) – and at highly competitive sub-80bp pricing.

The transaction also achieved a number of significant milestones including the largest integrated greenfield petrochemical project in the world and, of particular significance to SABIC, the largest Islamic tranche in a greenfield multi-sourced project financing, surpassing even the success of SABIC's earlier Yansab project. In addition, the transaction features one of the largest ECA participations in project financing in the Middle East.

The deal demonstrates that for the right sponsor, in the right market, with the right structure, the current constraints on global project lending do not apply.

Deal background

The $10 billion project will be built in the Al-Jubail Industrial City in the Eastern Province of Saudi Arabia. It comprises an olefins cracker and major derivatives plants to produce polyethylene, polypropylene, ethylene glycol, polycarbonates and other derivatives.

Saudi Kayan and its financial advisors (Arab Banking Corporation, BNP Paribas and Samba) signed the deal on 30 May 2008. The bank group includes 20 local, regional, and international financial institutions along with four export credit agencies (ECAs) – ECGD, Kexim, KEIC and Sace1 – and the Saudi Arabian Public Investment Fund (PIF): A Saudi Industrial Development Fund (SIDF) tranche is also expected to be concluded during 2008.
SABIC owns 35% of Saudi Kayan and maintains effective management control. Of the remaining equity, 20% is owned by Al-Kayan Petrochemical Company (AKPC)2 and 45% by the public following a 5.6 times oversubscribed IPO in May 2007.

Saudi Kayan represents a strategic fit with the SABIC group, forming a cornerstone in the latter's expansion strategy to be among the world's top petrochemical companies by 2020. With production expected to come on stream by 2010, Saudi Kayan will produce a diversified product slate comprising 17 marketable petrochemicals largely intended for export to the Asian and European markets.

Saudi Kayan's key products

Products	**Design Capacity (MTPA)**
HDPE	400,000
LDPE	300,000
MEG	700,000
Polypropylene (various grades)	350,000
Polycarbonates	260,000
DEG	58,000
TEG	3,000
Ethoxylates (various grades)	40,000
MEA	45,000

DEA	45,000
TEA	45,000
Acetene	70,000
Choline Chloride	20,000
DMF	50,000

While Saudi Kayan will be producing similar products to those currently produced by the SABIC group including PE, PP and EG, it will also produce other highly specialized and value added downstream petrochemicals.

The production of polycarbonate will be a first for SABIC and a first in the Middle East. The key characteristics of polycarbonate are strength, thermal resistance, and lightweight and it is extensively used in the automotive, electronics, construction, and health care sectors. The production of polycarbonates from Saudi Kayan make it a perfect fit with SABIC's recent acquisition of GE Plastics, now known as SABIC Innovative Plastics, one of the top four producers and marketers of polycarbonate globally.

For Saudi Kayan, SABIC chose to adopt a predominantly lump sum services approach to the engineering, procurement, and construction (EPC) management of the complex, rather than the more traditional lump sum turn-key (LSTK) approach.

In the context of the current inflationary EPC market, Saudi Kayan's contracting strategy has a number of advantages over the traditional LSTK concept. The strategy allows Saudi Kayan to complete a significant portion of the project engineering and order of long-lead items in a timely manner, while retaining an option to convert into a LSTK at a later stage. It also gives Saudi Kayan maximum flexibility in terms of optimizing the procurement of services and capital equipment, allowing it to closely manage this process and thus to control costs more directly. The lenders to the project however accepted this risk given SABIC's successful track record in completing projects on time and on budget and the further financial support discussed later.

One of the project's major advantages is the supply of competitively priced feedstock, namely ethane and mixed butanes, made available by Saudi Aramco. The project also benefits from a marketing agreement with SABIC for all its production. The diverse product slate also gives Saudi Kayan some protection against cyclical price downturns in the different markets especially with respect to the more specialty products. The combination of low cost of production, complex integration (i.e. starting from the cracker and all the way down to specialized products), diverse product range, world scale production capacity, proximity to end markets, use of proven technologies and the engagement of reputable and experienced contractors (referenced in the table below) puts Saudi Kayan amongst the best projects in the world of its type with a sustainable competitive advantage.

EPCs

Contractors	**Plant**
KBR	Cracker/Benzene Extract
CTCI	Ethylene Oxide/Ethylene Glycol
Daelim	Polycarbonates
HQCEC	HDPE
Samsung	PP
Technicas Reunidas	Cumene/Phenol/Acetone/Bisphenol
Samsung	Methylamines/DMF/Choline Chloride/Ethanolamines/Ethoxylates
Fluor	Utilities and Offsites
Fluor	PMC

Project cornerstones

Saudi Kayan benefits from various advantages making the project cost effective and a formidable competitor globally.

The primary feedstock for the project is comprised of ethane and mixed butanes, which will be supplied by Saudi Aramco – the operator of one of the world's largest natural gas liquids systems. The price for the butanes is determined in accordance with the Resolution of the Supreme Council for Petroleum and Minerals providing a competitive price structure. The current pricing formula is based on an international pricing benchmark less a percentage discount (fixed at approximately 30% until 2011). The ethane is also priced competitively, currently at $ 0.75 per MMBTU.

Saudi Kayan has an exclusive marketing agreement with SABIC. Consequently, Saudi Kayan's production has access to the well established global marketing network of the SABIC group. In particular, while polycarbonate is a new product to SABIC and Saudi Arabia, Saudi Kayan will benefit significantly from the SABIC Innovative Plastics (top 4 marketer of polycarbonates in the world) worldwide network.

Saudi Kayan is, above all, central to SABIC's 2020 growth strategy. Hence, it is no surprise that it has SABIC's full commitment, demonstrated in an "uncapped" completion support.

Project highlights

• First producer of polycarbonates in Saudi Arabia and the Gulf region.
• Largest fully integrated greenfield petrochemical complex to be built in the middle east to date, providing Saudi Kayan with significant costs advantages.
• The financing structure includes the largest ever Islamic project financing facilities for a multi-sourced project financing.
• Complex multi-sourced financing involving conventional and Islamic institutions, four ECAs, SIDF and PIF. Notably the Sace facility is not a traditional export credit facility but has been extended on an un-tied basis. Further Kexim provided its facility on a direct funding basis (as opposed to a guarantee).
• Largest IPO for a greenfied project in Saudi Arabia.
• Diversified product portfolio that reduces exposure to cyclical price downturns
• Optimum project financing expressed in excellent terms and pricing despite the financial markets' unfavorable conditions

Financing structure

With a total cost of $10 billion, Saudi Kayan's financing structure is based on a 60:40 debt to equity ratio. As outlined earlier, the equity has been contributed by SABIC (35%), the general public (45%), and AKPC (20%). The debt components are summarized in the table below:

Debt component summary

Debt Component	**Amount**	**Percentage**	**Tenor**	**Margin**
Commercial Term Facility	727	12.20%	15 years	Pre Comp. 50bps Post: 70-75bps
Islamic Facility	1,030	17.20%	15 years	Pre Comp. 50bps Post: 70-75bps
Islamic Working Capital Facility	644	10.70%	15 years	Pre Comp. 50bps Post: 70-75bps
KEXIM	500	8.30%	15 years	Direct
KEIC	500	8.30%	15 years	25bps
SACE	500	8.30%	15 years	14bps
ECGD	500	8.30%	15 years	12bps
PIF	1,066	17.80%	15 years	–
SIDF*	533	8.90%	–	–
Total	6,000	100%	–	–

* Envisaged to be concluded second half of 2008

All the term facilities commence repayment after a 3-year grace period with the commercial, Islamic, ECAs, and PIF facilities repaid over 12 years. Except for the PIF facility which is payable in equal installments, the repayment profiles of the other facilities are sculpted to accommodate the project's projected cash flow.

Overall, SABIC looked to realise certain efficiencies by following closely the successful template it had established in the Yansab financing closed in June 2006. One of the key features is the completion support provided solely by SABIC; a clear indication of its confidence in the project and SABIC's ability to deliver the project on budget and on schedule. SABIC will provide an un-capped cost overrun support facility as well as cover any debt service that falls due if there is a delay in the scheduled completion date, for a period of up to 24 months (6 months longer than Yansab reflecting the increased complexity of the project).

One of SABIC's key objectives is to maximize the size of the Islamic financing. As a result, the financing structure comprises two Islamic tranches. This strategy enabled the project to take full advantage of the available financing capacity both locally, and internationally.

The "global Islamic tranche" was made available to all invited institutions. It is based on the widely accepted and used forward lease structure (Ijara Mowsoufa Fil Thimma). Under this structure, Saudi Kayan is appointed "by the participants" to procure the construction and development of the assets. Once constructed, the assets will be delivered to the "assets custodian" on behalf of the Islamic investors, who will lease it back to Saudi Kayan. The repayment terms under the lease agreement are the same as the commercial term facility.

The Islamic Working Capital facility is provided by Al-Rajhi Bank on a sharia'a complaint basis (Murabaha). During construction, the facility may be applied towards project costs. Subsequent to construction, it may be used for working capital. The facility is based on a revolving structure and the tenor matches that of the commercial term facility.

The four ECAs provided facilities each in the amount of $500 million. It is noted that Sace provided its facility on an untied basis while Kexim provided a direct lending facility.

Underwriting and syndication

SABIC's main objective throughout the development phase has been to maintain the schedule of the project. Given the project's complex and large EPC contracting packages, significant thought and financial engineering has been required to ensure that the EPC packages are in line with the eligibility criteria set by the various ECAs.

However, to continue the momentum while optimizing the financing structure, early on SABIC sought an underwriting for the entire $6 billion of debt from the initial mandated lead arrangers comprising ABN Amro, Arab Banking Corporation, BNP Paribas, HSBC and Samba. This certainty of financing provided Saudi Kayan with the ability to proceed with the IPO, to place key project contracts as well as to take further carefully calculated steps towards reaching the ultimate financing package.

The syndication process was subsequently launched in the 4th quarter of 2007 approaching local, regional, and international financial institutions. Roadshows were carried out in Dubai, London and Hong Kong taking into account the geographically diversified entities involved in the project. The commercial tranche was well oversubscribed reflecting the local and international appetite for the project despite the challenging environment prevailing in the financial markets at the time. Given the overall subscription, it was decided that there would not be general syndication, and SABIC opted instead to close the deal as a club.

Once completed, Saudi Kayan was successful in forming a well-diversified group of lenders including 20 financial institutions, PIF and 4 ECAs.

Lenders

Bank	Role
ABN Amro Bank N.V.	Initial MLA, bookrunner
Arab Banking Corporation (B.S.C.)	Initial MLA, financial advisor, bookrunner
BNP Paribas	Initial MLA, financial advisor, bookrunner, ECGD facility agent, SACE facility agent & KEIC facility agent
HSBC	Initial MLA, bookrunner
Samba Financial Group	Initial MLA, financial advisor, bookrunner
Al Rajhi Banking & Investment Corporation (Saudi)	IMLA-Islamic Working Capital Facility
Arab Petroleum Investments Corporation (APICORP) (Saudi)	MLA, on-shore security agent
Bank Al Jazira (Islamic) (Saudi)	MLA
Banque Saudi Fransi (Saudi)	MLA, on-shore account bank
The Bank of Tokyo-Mitsubishi UFJ, Ltd. (International)	MLA, inter-creditor agent; commercial facility agent
Citibank N.A., Bahrain (International)	MLA, off-shore account bank and off-shore security and trustee agent
Fortis Bank S.A./N.V.	MLA
ING Bank N.V. (International)	MLA
JPMorgan Chase Bank, N.A, London branch (International)	MLA
KfW (International)	MLA

The National Commercial Bank (Saudi)	MLA, Islamic facility agent
The Saudi British Bank (SABB)	MLA
Sumitomo Mitsui Banking Corporation (International)	MLA
Riyad Bank (Saudi)	Senior lead arranger
Emirates Bank International PJSC	Senior lead arranger

Footnotes

1 ECGD: the Export Credit Guarantee Department (UK), K-EXIM: The Export-Import Bank of Korea, KEIC: Korea Export Insurance Corporation, SACE (Italy).

2 AKPC is a Saudi closed joint stock company.