# Balancing act

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On the face of it, the turnaround in Egypt's project finance fortunes as the decade has progressed has been remarkable. Whereas the $130 million of uncovered international debt that went into the 1999 Sidi Krir financing exhausted all the syndication market's available lines for the country, bankers now say there is a tremendous appetite for Egyptian risk, while the country is also benefiting from a new liquidity in the domestic bank market.

Gas has played a central role in this transformation. LNG plants at Idku, site of ELNG, and Damietta have finally brought Egypt the hard currency resources it needs to effect a long-term economic revival. But a slow-down in the rate at which Egypt's estimated 120 trillion cubic feet (tcf) potential gas reserves are being proven casts a shadow over this revival in project finance fortunes. The price of gas is heavily subsidised for domestic use. Industry analysts say it is too low to provide enough incentive for adequate exploration.

The reason behind this problem is the government's national strategy for husbanding Egypt's gas resources, whereby a third of gas discoveries are earmarked for domestic use, another third left aside as a strategic reserve and only the remaining third allowed to be exported. Whatever the merits of this policy, operators say they are feeling the squeeze on profit margins and are putting pressure on Egas, the state-owned gas company to raise the domestic gas price.

This is the backdrop against which Egypt's first two petrochemical projects – the $880 million EMethanex project and the larger EAgrium project – prepare for launch on the international syndications market. As Project Finance went to press, EMethanex was awaiting final fulfilment of the CPs before signing, while EAgrium could end up taking a little longer.

Monetising gas reserves through the development of a fertiliser industry is a central plank of Egypt's economic strategy. As one banker notes, "The petrochemicals industry provides more cash and value added in terms of employment than just shipping out the gas, so the government is very keen to develop the sector for both economic and political reasons."

But the strains caused by such high domestic demand on the country's gas cast some doubt on the viability of the government's long-term plans for the petrochemicals sector, which are to build a total of 14 new plants by 2020, with a total investment of $10 billion. Both EMethanex and EAgrium, the first of these, rely on gas supply agreements with Egas, the state gas company, which has equity stakes in both projects and would find itself overextended were it to enter into similar agreements on new projects without enough extra gas reserves being proven first.

"The Egyptian government and Egas are quite open about the problem and say they won't sanction another project until they know they have the gas," says one banker. "Egas has a lot invested in these petrochemical projects and knows what kind of trouble it will land itself in if it can't deliver."

**EPC costs**

Of more immediate concern for EMethanex and EAgrium is the inflation in the EPC sector. Most observers say EMethanex, which followed the ELNG 2 template by appointing five pathfinder banks, is the better structured of the two deals, and the cost issue seems to have been resolved more smoothly, with the sponsor's bearing the brunt of the increase through additional equity.

But there is a strong feeling among some bankers involved in Egyptian petrochemicals that Agrium – EAgrium's Canadian sponsor – has tried to railroad the project past the banks using a heavy-handed approach. Agrium, which is advised by RBC, appointed 10 banks in February, each committed to underwriting $125 million. The were SG, BNP Paribas, Intesa Sanpaolo, EDC, Arab Bank, Apicorp and local banks CIB, Banque Misr, NSGB and National Bank of Egypt. The appointment was delayed by a few weeks after the EPC bids from Uhde and Snamprogetti came in high, and the total amount to be borrowed increasing from $750 million to $1 billion.

"The sponsors were quite confident that they would get an attractive EPC price and were quite surprised at the one they got," says one banker involved in the deal. "They then thought the banks would find it palatable to raise $1 billion and they could push for a new base case. But nobody has yet committed to anything and ultimately the project could still be dropped."

The banker also accuses Agrium of being "quite careless" in refusing to bring an ECA on board, despite the fact the shortlisted EPC bidders were German and Italian, making it relatively straightforward to involve Hermes or SACE. While EMethanex does not have an ECA on the deal, approximately half of the $530 million debt is provided by the EIB, though bankers involved insist there was sufficient commercial bank interest to proceed without the EIB.

But another banker, heavily involved in structuring the deal, says the objective was to achieve the best possible deal for a sponsor whose track record as a leading producer in the fertiliser industry should give sufficient comfort to the banks. He insists the deal is sufficiently flexible to withstand one or two banks dropping out and dismisses the point about ECAs arguing they bring nothing to the table except political risk insurance.

"We will not allow the lowest common denominator to drive the deal and we will not allow banks to come inside with all sorts of promises then try to force different terms once there," he says, pointing out that the information memorandum went out in November the deal was three times oversubscribed.
While EPC prices have gone up, fertiliser prices have also done so and industry analysts believe that whether the economics for Egyptian fertiliser projects make sense boils down to how sustainable higher commodity prices are.

"It's a question of whether the current prices are the result of everyone rushing in at the same time creating a hothouse or whether higher prices reflect longer-term trends," says one banker. "In general consultants are saying that fertiliser prices will continue to be higher over the next few years."

**Domestic liquidity**

But tussles between bankers and sponsors over trying to get the best deal out of a financing should not obscure one of the most remarkable features of EAgrium, which is the strength of local bank lending to the project. The debt is split between a local and an international tranche, with the four local banks providing at least 40% of the financing and possibly more one of the international banks drops out. Moreover, the banks have been able to price the debt very competitively at 90-150bp with a 15-year tenor, lower at the front-end than the international tranche, which as things stand prices at 100-130bp.

Egypt is reaping the rewards of reforms to the banking sector begun over a decade ago, which have resulted in an influx of foreign capital international banks buy up Egyptian ones. In one of the latest takeovers, Sanpaolo Intesa bought Bank of Alexandria from the government for $1.6 billion, the proceeds of which were to be used to capitalise other state-owned banks.

Another big reason for this newfound liquidity is the transformative effect gas has had on Egypt's economy. Not so long ago Egypt was stagnating with inflation in double digits for five out of the first six years of the 1990s and the Luxor massacre dealing a severe blow to tourism in the country. Now, barring any unforeseen shocks, the economy looks set to grow by over 5% for the third year running in 2007.

"The Egyptian economy went through some pretty tough times in the 1990s with weak import substitution policies," recalls one banker, who was involved in the liberalisation of the country's financial sector during that decade. "But after ELNG export earnings really took off on a large scale and brought in the hard currency reserves that have made the Egyptian pound stronger and made the local bank market much more solvent."

In project finance terms, this means both that sponsors have to rely exclusively on international appetite for Egyptian risks for larger projects like the fertiliser plant deals, but also that the country is able to finance many smaller infrastructure projects without having to turn to the international syndications market at all.

A recent example of this came when the Egyptian Natural Gas Holding Company (EGAS) raised $153 million seven-year debt from nine local and regional banks to finance the Taba Sharm Elsheikh pipeline along Egypt's Gulf of Arabia coast. Several more gas pipeline projects on the horizon make this potentially a lucrative sector for Egyptian, as well as regional, banks.

Egypt benefits not only from the liquidity of its own domestic bank market but also from its proximity to the Gulf states which are themselves flush thanks to their own gas bonanzas. In particular, it is not just bank capital that is flowing into the country but also Gulf equity investors looking to put their funds into high yielding assets rather than keeping them in New York and London bank deposits. The tourism sector is currently one of the biggest beneficiaries of this investment, though most projects in this sector are likely to be financed on a recourse basis.

**Refinancings and refineries**

EMethanex and EAgrium are the only two large greenfield projects currently out in the market. There are however two large refinancings that will launch soon: the $750 million refinancing of the Port Said and Suez power stations, Egypt's second IPP financing after Sidi Krir, and a $600 million refinancing of the Union Fenosa/Eni LNG train at Damietta. The latter latter deal, known as Segas, will refinance a six-year corporate loan in the project market with a 15-year tenor. Royal Bank of Scotland is advising on the deal and the information memorandum is set to go out in May.

Sidi Krir was already refinanced last summer, pricing at 90bp during construction and between 115bp and 150bp during operation. Tanjong purchased Part Said and Suez from EDF and the refinancing is now being arranged by Calyon, with BNP and SMBC also on board. These two deals were the only power deals in Egypt financed on a non-recourse basis, and although more power deals should be on the way in, these are now getting financed through soft loans, leaving no room for the project finance market.

In terms of future deal flow, the two main areas for large deals would seem to be refineries and further LNG facilities. SG and BNP are just two international banks that are looking at refinery projects in around Egypt, with the expectation that there might be one large project upward of $1 billion, and maybe one or two smaller ones. These would be upgrades of existing refineries rather than greenfield construction, and it would seem there's currently something of a race on to see who can gets a refinery project approved first.

"Most of the existing refineries, apart from one new one, were built with Soviet era technology that produce a lot of fuel oil but not gasoline and diesel," says one banker. "So the economics look good provided the capital costs remain under control."

**Where's the gas?**

Despite the slow-down in gas discoveries, it is still a question of when, rather than if, there will be more LNG deals; there is a general consensus in the market that the gas is there – it is simply a question of when it will be found. In 1998 and 2005, Egypt's proven gas reserves grew from 36 tcf to 67 tcf, but the level has not increased by much since then. However, a major 1 tcf offshore discovery by BP at the end of January helped reinforce the consensus view.

There is a general expectation that a new LNG train will be financed next year, with Segas and ELNG both in competing for it. The current view is that the train is more likely to be at Segas. While in the petrochemical industry some bankers are looking to places like Algeria as a likelier source of future deal flow, as far as LNG bankers are concerned, Egypt remains a "no-brainer". Egypt is where the gas is, and banks need to go where the gas is.