Middle East Islamic Deal of the Year 2006

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Al Waha Petrochemical Company: Swept away

Al Waha Petrochemicals was a groundbreaking $631 million debt financing for the construction of a polypropylene project. It is also the largest standalone Islamic financing for a project anywhere in the world. It also includes and innovative approach to procurement that, as much as the Islamic element, is likely to be emulated across the region.

Al Waha is a petrochemicals complex with a projected production of 455,000 tonnes per year of propylene and 450,000 tonnes of polypropylene. It is located in the Jubail industrial zone in Saudi Arabia – part of the Saudi government's ambitious development plans for value-added petrochemical products.

The lead sponsor of the project is Sahara Petrochemicals, a specialist producer established by the Al Zamil group and traded on the Saudi Stock Exchange in Riyadh, which holds 75% of the project's equity. The owner of the remainder is Basell, the Dutch-based specialist polyolefins producer.

The two shareholders have interlinked interests in other projects at the site. Sahara and Basell are also among the main shareholders of the Tasnee (now SEPC) ethylene and polyethylene complex located nearby. Another Zamil company, Sipchem, is an established sponsor in its own right. The financing process for the plant is also closely tied up with those of its neighbours. Tasnee raised $2 billion from ECAs commercial banks and regional banks in June 2006.

Financial adviser on Tasnee was HSBC, with its affiliate Saudi British Bank. HSBC is also advising Sipchem on both its acetyls project and a forthcoming $8 billion olefins complex, which will probably smash records in the Saudi petrochemicals market. HSBC was, therefore, in a good position to perform a similar role for Al Waha.

The overarching financial adviser role, which recalls a similar part that RBS played in the early Qatari petrochemicals deals, requires the adviser to space out transactions and stagger approaches to different markets. But Al Waha, the middle of the three transactions, did not have to be quite as delicate, since the lead sponsor had decided early on, in part through the pressure of its lead shareholders, to tap the Islamic market.

The main task of the adviser and the ultimate lenders was to achieve this goal in the least expensive fashion possible, and adapt the financing structure to the exigencies of the petrochemicals market. The sponsors drew up a list of shortlisted banks in April 2006, and these institutions all ended up on the final list of arrangers – ABC Islamic Bank, Bank Aljazira, Banque Saudi Fransi, GIB, SABB and Saudi Hollandi Bank.

The deal features an innovative co-purchase agreement, which builds upon the typical sale and leaseback model that has typified Islamic financing in the region. The Islamic institutions delegate the procurement of the asset to the project company, while also holding a titular ownership interest in the project company. The contractual relationship is between contractor and project company, and between project company and Islamic financier.

The procurement is then combined with a forward lease arrangement, or ijara fil thimma, which is common for assets that do not yet exist. The main twist on the typical forward lease is that the Islamic institutions receive lease payments from a project company that they co-own, which in turn owns the assets. The lease payments also transfer incremental interests in the assets back to the sponsors. Cash swept to protect against volatile petrochemicals markets simply accelerates the transfer of interests. The precedent for this arrangement is the diminishing musharaka, common in Shariah-compliant real estate deals.

The 14-year $525 million in financing from the Islamic banks is offered under the same umbrella agreement as a SR400 million ($106 million) loan from the Saudi Industrial Development Fund. The lenders however, will be scaled back through the participation of the Saudi government-run Public Investment Fund, which agreed before the banks were mandated to provide a $250 million facility. Such financing goes some of the way to furthering the Saudi government's plans for Jubail even as projects have to contend with new structures and soaring construction costs.

Al Waha was not immune to the widespread construction price inflation in the Gulf. The price of the project increased from roughly $940 million at the time of shortlisting to just over $1 billion now, although the rise is manageable. Moreover, the project still benefits from a lump-sun turnkey construction contract with Technimont and Daelim, which protects the sponsor and lenders from further increases. The contract signed on 16 September.

Moreover, the financing also features pricing a little higher than conventional banks would offer on Saudi petrochemicals deals. This stands at 205bp over Libor equivalent precompletion, 195bp post-completion, 210bp from year seven, and 225bp from year ten. The providers would view this as part of the premium for the deal being subject to the jurisdiction of the Shariah courts, although the co-ownership structure, while untested, might lessen a risk that a court would treat the arrangement as a disguised loan.

But Al Waha demonstrates that the Islamic market is a viable standalone option for projects, particularly if sources of ECA, international or local debt are capacity constrained. The booming market for Saudi projects means that this situation is at present unlikely, but the Al Waha deal stands as a well-executed and useful experiment, and the $350 billion Islamic market will be called upon for similat feats in the future.

Al Waha Petrochemicals
Status: Signed 2 October 2006
Size: $1 billion
Location: Jubail, Saudi Arabia
Description:455,000 tonne propylene and 450,000 polypropylene project
Sponsors: Sahara Petrochemical (75%), Basell Polyolefins (25%)
Lead arrangers: ABC Islamic Bank, Bank Aljazira, Banque Saudi Fransi, GIB, SABB and Saudi Hollandi Bank
Financial advisers: HSBC/SABB
Lender legal counsel: Norton Rose (international) The Alliance of Abbas F Ghazzawi & Co and Hammad & Al-Mehdar (local)
Sponsor legal counsel: Clifford Chance (international) Al-Jadaan Law Firm (local)
Market and technical consultant: Jacobs
Lender insurance adviser: Willis
Sponsor insurance adviser: Marsh