Hynix: China takes a lead

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Winning project finance mandates in China's tricky regulatory environment has long been a challenge for international banks. Unable to compete with Chinese banks and their outsize balance sheets, traditional project finance houses have been turning to international sponsors, looking to add value through intricate structuring.

The recent Hynix deal, however, suggests that even this source of business may be drying up. When a wholly foreign joint venture decided to build a $2 billion manufacturing plant on China's east coast, it selected China's largest banks to arrange the financing, giving domestic lenders one of their first opportunities to lead a project sponsored entirely by overseas investors.

Hynix-ST Semiconductor, a joint venture between Korea's Hynix Semiconductor and Geneva-based STMicroelectronics, is developing a semiconductor chip manufacturing plant in Wuxi, in China's Jiangsu Province with a $1 billion limited recourse financing.

Rather than relying on their own relationship lenders, which are understood to have insisted on guarantees from the two equity partners in order to bank the project, Hynix and ST approached Chinese banks with a request for funding.

Industrial & Commercial Bank of China (ICBC), China's largest bank, won the arranger mandate, with China Development Bank (CDB) and Agricultural Bank of China joining as MLAs shortly after.

The $1 billion debt package consists of around $750 million in senior term loans, and $250 million of junior debt. The senior loan is further split between renminbi and US dollar tranches, with the majority of the debt denominated in dollars.

After launching the deal in October 2005, syndication was finally completed and documentation signed on 11 August this year. Financial close was held on 26 October.

Joining ICBC, CDB and Agricultural Bank on the $750 million facility were a total of 17 financial institutions. The list of lenders includes both Chinese and international banks, and the need to translate each and every document presented a significant challenge to the legal teams involved.

"Although the deal has been completed under Chinese law, there was really no precedent in terms of Chinese documentation," says Young Joon Kim, a partner at Milbank, which advised the borrower. "As far as possible we have tried to use international standards that the foreign banks understand and draft documents in an international style."

The security agreement was a particular sticking point. Under the terms of the deal, lenders will have no recourse to the two sponsors. "This was an absolute requirement for the borrower," says Kim. There is some limited recourse, however, as Hynix and ST have agreed to purchase certain products from the joint venture, but these offtake agreements are not included in the security arrangement. Instead, the lenders had to become comfortable with the market for memory devices that will use the joint venture's products.

The Wuxi facility will manufacture both NAND Flash and DRAM memory chips, which are used in digital consumer electronics from computers to mobile phones. Hynix is already the biggest supplier of DRAM memory to the expanding Chinese market, with an estimated market share of 47%. Lenders will have security over all the assets of the joint venture, including the borrower's plant and equipment.

South Korea's Hynix has a 67% stake in the project company, while STMicroelectronics owns the remaining third. The borrower's plant is located in the Wuxi Export Processing Zone, a special administrative area established by the Jiangsu government to stimulate foreign investment.

When ICBC announced the deal a year ago, the senior debt was split between a $660 million tranche priced at 150bp over Libor and a Rmb830 million ($100 million) tranche priced at the prevailing rate set by the People's Bank of China (PBOC).

In an effort to control the rate of lending by its asset-rich banks, China's banking regulator dictates that loans denominated in renminbi, the Chinese domestic currency, must be priced according to the rate set by the PBOC. Banks are allowed to offer discounts of no more than 10% to the PBOC rate to creditworthy clients, and China has been increasing the benchmark rate this year to cool investment in its growing economy.

With the five-year rate now over 6%, international banks – which have a much lower cost of capital – are increasingly looking to bank Chinese assets, and it is little surprise that banks with strong ambitions in China have also committed to the deal. These same restrictions, however, limit the ability of foreign lenders to compete on price, further hampering efforts to lead project financings in China.

Despite China's clear demand for new infrastructure, international lenders have found it difficult to win project financing business in the country. Strategically important projects, such as the $22 billion Three Gorges Dam on the river Yangtze, have been bankrolled by huge policy loans from the state-owned China Development Bank, limiting international lenders to pursuing business with foreign investors.

One of the largest project deals involving foreign lenders is the $2.7 billion financing of the Nanhai petrochemicals complex sponsored by CNOOC, Guangdong Investment and international oil major Shell, completed in 2003. ANZ, Bank of Tokyo-Mitsubishi and HSBC led the $1.1 billion international tranche of that deal, which included guarantees from six export credit agencies.

Hynix-ST's financing route suggests that even this source of business is becoming scarce. "Chinese banks leading project financings will be a growing trend," says Kim. "Just as the Japanese banks began leading deals 10 to 15 years ago, Chinese banks are educating themselves in international structures. There is so much liquidity in the domestic banking system that foreign lenders are finding they cannot compete."

Hynix-ST Semiconductor
Status: Financial close 26 October 2006
Description: Limited-recourse financing for the construction of a $2.03 billion memory wafer fabrication plant in Wuxi, China
Size: $2 billion
Debt: $1 billion ($750 million senior and $250 million junior facilities)
Sponsors: Hynix Semiconductor (67%); STMicroelectronics (33%)
Lead arrangers: ICBC, China Development Bank, Agricultural Bank of China
Participants: ABN Amro, Banca Nazionale del Lavoro, Bank of China, China Construction Bank, China Minsheng Banking Corp, China Merchants Bank, China Everbright Bank, Chinese Mercantile Bank, Citic Industrial Bank, Citigroup, Credit Suisse, Deutsche Bank, Hana Bank, Industrial Bank, Korea Exchange Bank, Merrill Lynch, Shenzhen Development Bank
Junior debt: DBS Bank
Legal counsel: Milbank (Hynix and Hynix-ST); Gide Loyrette Nouel (ST and junior lender); LLinks Law Offices; Jiangsu FD Yongheng (senior lenders)
Accountant to borrower: Ernst & Young