EMEA Petrochemicals Deal of the Year 2005

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Qatofin and Q-Chem II: Shared assets

The first time two major project financings sponsored by different shareholder groups have been raised simultaneously to finance large common production assets, the combined Qatofin and Q-Chem II financings will be the benchmark deal for future shared petrochemical asset financings in the Middle East and GCC.

Sponsored by Qatar Petroleum (51%) and Chevron Phillips (49%), the Q-Chem II project, which is an expansion of the existing Q-Chem I plant in Messaieed, comprises a 345,000 metric tonnes per annum (mtpa) normal alpha olefins plant and a 350,000 mtpa high density polyethylene plant (HDPE).
The Qatofin project, also in Messaieed, is a 450,000 mtpa linear low density polyethylene plant (LDPE) and is sponsored by Total Petrochemical (36%), Qapco (63%) and Qatar Petroleum (1% – although QP owns 56% of Qapco).

Both projects will share a 1.3 million mtpa upstream ethane cracker and related pipeline – the world's largest ethane cracker to date. Consequently, the principal challenge for banks was to negotiate the intercreditor agreements based on the commercial arrangements for sharing the cracker/pipeline – in effect to limit the impact of each project's lender group on each other in any given stress scenario – as part of two distinct financings with different sponsors and to some extent different lenders (although the projects share most lenders there are exceptions).

Despite the complexities posed by the shared cracker, both the $1.45 billion (including a $260 million US Exim tranche) Q-Chem II facility and the $760 million Qatofin commercial bank debt came in oversubscribed by a combined $830 million with 24 lenders committing to Qatofin and 30 to Q-Chem II.

Furthermore, at time of close, the deals achieved the best all-in bank pricing for a Qatari petrochemicals project to that date: 50bp over Libor pre-completion (with completion guarantees), 80bp for the next three years, 85bp for the following four years, then 95bp through to maturity at year 14. Fees were 75bp over the final hold amount.

Both financings include a principal repayment deferral option to provide greater operational flexibility and the flexibility to tie repayments to cash flow, with principal repayments determined by two schedules – the Target Repayment Schedule (TRS) and the Mandatory Repayment Schedule (MRS).

The MRS is relatively back-ended compared with the TRS and comprises a balloon feature. The ability to defer payment/extend loan tenor provides both projects with more ability to weather potential downturns in a highly cyclical petrochemical industry.

The financing structure also mitigates the impact of low and cyclical price scenarios by incorporating an option to defer the ethane gas feedstock payments during periods of low product pricing: the ethane feedstock to the cracker will be supplied from the nearby EGU and Dolphin projects' on-shore facilities.

Although clearly popular with lenders, the Qatofin project comes with no long-term offtake agreements. QAPCO and Total have long-term marketing arrangements to sell the Qatofin product, but the deal is still the first petrochemicals project to have been project financed without long-term volume offtake support for its key production.

Conversely, Q-Chem II has almost identical offtake arrangements to Q-Chem I, with the price risk taken wholly by the project and a total volumetric offtake agreement with Chevron Phillips and an agency agreement with Qatar Petroleum.

Both projects were a long time in coming to market – they began as a JV agreement between Qatar Petroleum and Chevron Phillips Chemical in June 2001 for a cracker and ethylene derivatives plants to be located in Ras Laffan Industrial City – and have benefited in the interim from the hike in oil prices.

The projects are buoyed by oil prices because there is a fixed gas supply agreement in place with Qatar Petroleum on a take-or-pay basis with an inbuilt escalation factor, which is considerably lower than the market price. So as oil prices rise, the margins these petrochemical plants make increases because the feedstock inflation is likely to be less than the inflation of their polyethylene products.

Polyethylene petrochemical plants based on ethane feedstock are also at a competitive advantage to naphtha-fed plants (of the type seen in the US) at times of high oil prices because the cost of naphtha is more closely correlated to crude than ethane: the Middle East has a virtual monopoly on high volume ethane feeds.

The one drawback of the prolonged lead-time for both deals was capital cost inflation, principally due to the booming demand for EPCs in the Middle East, which put an extra 15% on the costs originally envisaged – for example the Qatofin plant was originally slated for $670 million and came in at $760 million. Conversely, with the Qatar Petroleum escalation factor in place, both projects will be more profitable than originally forecast at conception.

Qatofin
Status: Signed 24 October 2005
Size: $760 million commercial bank debt
Sponsors: Total Petrochemical (36%); Qapco (63%); QP (1%)
Financial adviser: HSBC
Lead arrangers: ABN Amro, Arab Bank, ABC, Apicorp, Bayerische, BTM, Calyon, Citibank, CBQ, Commerzbank, Fortis, GIB, HSBC, HVB, ING, MashreqBank, Mizuho, Natexis, QNB, RBS, SG, Standard Chartered, SMBC, WestLB
Sponsor legal counsel: Milbank Tweed
Lender counsel: Linklaters
Technical adviser: Jacobs

Q-Chem II
Status: Signed 24 October 2005
Size: $1.45 billion ($260 million ECA and $1.19 billion commercial bank debt)
Sponsors: Qatar Petroleum; Chevron Phillips
Financial adviser: RBS
Lead arrangers: ABN Amro, Ahli United Bank, Arab Bank, ABC, Apicorp, Banca Intesa, BBVA, Banco San Paulo, Bayerische, BTM, Calyon, CSFB, CBQ, Commerzbank, DnB NOR, EDC, Fortis, GIB, HSBC, ING, KfW, MashreqBank, Mizuho, QNB, RBC, RBS, SG, SMBE, WestLB
ECA: US Exim
Sponsor legal counsel: Latham & Watkins
Lender legal counsel: Skadden Arps
ECA counsel: White & Case
Technical adviser: Jacobs