Sohar Aluminium: No clubbing

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The $2.4 billion aluminium smelter project in Sohar, Oman, is significant for a number of reasons. It is the first greenfield smelter in the Middle East for 25 years; it comprises the largest greenfield generation plant in Oman to date; the project uses the first project finance Islamic facility in Oman; and the financing was pulled together using a small number of lead arrangers rather than using a club of banks, as has been typical of Middle East deals of this size in the recent past.

The project is symptomatic of the growing trend in the region towards diversification from oil and gas related activities into manufacturing fuelled by low-cost energy. When the plant is up and running in June 2008, it is expected to contribute over 2% of Oman's GDP.

Sponsored by Oman Oil Company (40%), ADWEA (40%) and Alcan (20%), Sohar Aluminium consists of an AP35 pot-line smelter that will manufacture 350,000 metric tonnes of aluminium per year, and a 1,000MW combined cycle gas turbine power plant. Bechtel has been awarded the EPC contract on the smelter and Alstom has been awarded the contract on the power plant.

The total project costs are met through $1.545 billion in debt and a $900 million equity contribution. The debt breaks down into a $1.2 billion 16-year commercial tranche, a $260 million 16-year Islamic portion and an $85 million letter of credit facility.

The financing followed the traditional route of appointing a small number of mandated lead arrangers, which then approached a wider group of sub-lenders. Committing to underwrite up to $1.5 billion as lead arrangers were ABN Amro, Citigroup, SMBC and EDC. The strategy allowed the sponsors – with mediation from their financial adviser Citigroup – to obtain a quick close by negotiating with a smaller number of parties.

Given the size of the deal, adopting this approach has considerable underwriting risks. Nevertheless, and despite the tight pricing, the debt was successfully taken up at sub-underwriting level. The debt is priced at 45bp over Libor pre-completion and steps up to 60bp until year 10, 75bp to year 13, and 95bp to year 16.

The initial bank group went out to the market with a participation fee of 75bp for tickets of $175 million, but after feedback from the market this was fattened to 80bp. Most of the usual Gulf project lenders came in on the commercial tranche before the syndication was signed on 11 December, with HSBC the only notable exception. Joining with $175 million commitments that were subsequently scaled back were Abu Dhabi Commercial Bank; BNP Paribas; Standard Chartered; GIB; Calyon; WestLB; BankMuscat; Mizuho; Arab Bank and Oman Arab Bank jointly; RBS; SG and ING. ABC committed $50 million. Eleven institutions came in on the Islamic facility (see box). The first drawdown occurred on 23 December.

One criticism of not using a club is that smaller local and regional banks are precluded from taking part. However they will be given the chance (albeit with smaller fees) when the bookrunners, Citi and ABN, launch an anticipated general syndication of some of their allotment. The sponsors will be keen to appease would-be local participants because Oman Oil Company is likely to require their input to roll out future projects.

Although the debt features a lean average coverage ratio of 1.5x, the key metric is the breakeven point of the project that is aligned with a $1,100 per tonne price of aluminium on the London Metal Exchange. Given that aluminium is now at a 17-year high of $2,368 per tonne – more than double the breakeven point – the lenders, which are exposed 100% to market price risk, have a large buffer for comfort.

The project relies significantly on the credit of Canadian aluminium manufacturer Alcan. Alcan is taking 100% of the offtake at market price and is also supplying the alumina feedstock through a medium-term supply contract, the price of which is linked to aluminium market price. The project company has the option of obtaining another source of feedstock when the Alcan contract expires, or has the option of extending the contract.

During construction a debt service undertaking (DSU) is in place that falls away when the independent technical consultant, Hatch, is satisfied that the various prongs of the completion test relating to production and operation of the smelter and power plant are met. The $85 million letter of credit facility is in place to fund the reserve account.

The strength of the fundamentals is reflected in the low ADSCRs and pricing, particularly given that it differs from other recent smelter transactions in Bahrain in that it is greenfield and not an extension. The project also signals Citi's intention to put its balance sheet behind important sponsors in the region.

The return to the traditional 'pyramid' shape of MLA commitment, with the sell down to sub-lenders, has risks, and it may irk some market participants, but this project shows it can expedite closings with tight pricing. Perhaps the next to follow this model is the QP-Norsk Hydro smelter in Qatar, expected mid-2006.

Sohar Aluminium Company
Status: Financial close 28 October 2005; syndication closed 11 December 2005
Description: $1.545 billion financing for Aluminium smelter and power project – ($1.2 billion commercial tranche; $260 million Islamic facility; $85 million letter of credit)
Sponsors: Oman Oil Company (40%); ADWEA (40%); Alcan (20%)
Lenders to commercial tranche: ABN Amro; Citigroup; SMBC; EDC; Abu Dhabi Commercial Bank; BNP Paribas: Standard Chartered; GIB; Calyon; West LB; BankMuscat; Mizuho; Arab Bank And Oman Arab Bank; RBS; SG; ING; ABC
Lenders to Islamic facility: ABN Amro; Citigroup; Abu Dhabi Commercial Bank; BNP Paribas; Standard Chartered; GIB; Arab Bank; RBS; SG; Calyon; WestLB
Financial adviser: Citigroup
Sponsor legal counsel: White & Case
Lender legal counsel: Allen & Overy
EPC: Bechtel (smelter); Alstom (power plant)
Technical consultant: Hatch