Q-Chem 2 and Qatofin: 2 into 1

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The financing of Q-Chem 2 and Qatofin has applied project financing to what has long been practice between the oil majors on industrial sites across the world but financed on a corporate basis: sponsors of downstream petrochemical plants sharing the same upstream hydrocarbon polymer cracker.

The Q-Chem 2 project, which comprises normal alpha olefins and high density polyethylene plants (HDPE), and the Qatofin project, which comprises a linear low density polyethylene plant, also share equity in an upstream cracker. This deal is the first time two project financings have been combined in this way.

The principal challenges in putting together these financings were the intercreditor agreements based on the commercial arrangements for sharing the cracker – distinct, standalone financings were necessary because of the different sponsor groups and to limit the impact of one group of lenders on the other. Although the projects share most lenders there are a few exceptions (see box). The other main challenge was managing lending appetite to enable two very similar credits, namely Qatari petrochemical deals to tap the market at the same time.

Both the $1.45 billion Q-Chem 2 and $760 million Qatofin financings finished oversubscribed in the bank market despite very aggressive pricing for greenfield petrochemicals projects: 50bp over Libor pre-completion (with completion guarantees), 80bp for the next three years, 85bp for the following four years, then 95bp through to the 14-year maturity.

With an eye on possible saturation of the lending market, the Q-Chem 2 deal was structured defensively with export credit agency support – US Exim provided a $260 million tranche. It is widely accepted that given the voracious bank appetite in the region at the moment, and the success of Q-Chem 1 (one banker says that Q-Chem 1 'is really coining it at the moment'), all of the Q-Chem 2 debt could have been placed with banks. Still, the US Exim facility was provided at very competitive terms.

Both projects were a long time in gestation. Originally, a JV agreement was signed between Qatar Petroleum (QP) and Chevron Phillips Chemical in June 2001 for a cracker and ethylene derivatives plants to be located in Ras Laffan Industrial City. In a later decision by QP, Atofina and QAPCO were invited as participants in the cracker project and an MOU was signed with the TotalFinaElf affiliate in October 2001. Later, Total stepped in as 36% shareholder in Qatofin in place of Atofina – its petrochemical division that it spun-off as Arkema.

During this time the fundamentals underpinning these petrochemicals projects have improved considerably because of rising oil prices. Even since April the prices of derivative products have increased. These projects are buoyed by oil prices because there is a fixed gas supply agreement in place with QP 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 as the feedstock inflation is likely to be less than the inflation of their polyethylene products.
Polyethylene petrochemical plants based on ethane feedstock are at a competitive advantage to naphtha-fed plants of the sort found in the US at times of high oil prices, as the cost of naphtha is more closely correlated to crude than ethane. The Middle East has a virtual monopoly on high volume Ethane feeds, so is likely to see a wave of further petrochemicals plants.

Slightly offsetting the advantages of the rising price of oil during a prolonged lead was the capital cost inflation, principally due to the booming demand in EPCs in the Middle East. Capital cost inflation had put an extra 15% to the costs originally envisaged – for instance the Qatofin plant was slated for $670 million and came in at $760 million.

The ethane feedstock to the cracker will be supplied from the nearby EGU and Dolphin projects' on-shore facilities. A new ethylene pipeline from Ras Laffan to Mesaieed will supply ethylene to the derivative plants owned by Q-Chem 2 and Qatofin. The ethylene pipeline will be initially designed to transport 1,300,0000 metric tons of ethylene per annum, with a possibility for expansion to 1,600,000 metric tons per annum. All three complexes are scheduled to commence operations around late 2008.

Q-Chem 2's HDPE and normal alpha olefins plants in Mesaieed, adjacent to the Q-Chem 1 plant, will have a production capacity of 350,000 metric tons per year. Qatofin's LLDPE plant – next to QAPCO facilities – will produce 450,000 metric tons per annum of polyethylene.

For Qatofin there are no long-term offtake arrangements in place, but QAPCO and Total have long-term marketing arrangements to sell the Qatofin product. Q-Chem 2 has almost identical offtake arrangements to Q-Chem 1 with the price risk taken wholly by the project, with a total volumetric offtake agreement with Chevron Phillips and an agency agreement with QP. Both products will tap the global market.

The case for sharing a cracker is compelling given the economies of scale. Now that the difficulties of combining complex commercial arrangements with two project financings is complete, perhaps it can be done again with a shorter lead time – Saudi is tipped as the next most likely host.

Qatofin
Status: Signed 24 October 2005, financial close due 15-17 November, first drawdown shortly after
Size: $760 million commercial bank debt
Sponsors: Total Petrochemical (36%); Qapco (63%); QP (1%)
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
Financial adviser: HSBC
Sponsor legal counsel: Millbank
Lender counsel: Linklaters
Technical adviser: Jacobs

Q-Chem 2
Status: Signed 24 October 2005, financial close due 15-17 November, first drawdown shortly after
Size: $1.45 billion ($260 million ECA and $1.19 billion commercial bank)
Sponsors: QP (51%); Chevron Phillips (49%)
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
Financial adviser: RBS
Sponsor legal counsel: Latham & Watkins
Bank counsel: Skadden Arps
ECA counsel: White & Case
Technical adviser: Jacobs