Tiger feats

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The Asian project finance market is gathering pace. According to David Gore, managing director, project finance and advisory at SG CIB, Hong Kong, "In the past couple of years there has been a real pick-up in the level of asset acquisition activity by Chinese, Japanese and other Asian corporates." More importantly, these hitherto risk-averse sponsors are no longer just sticking to their domestic markets but have begun to pursue projects outside the region, particularly in the Middle East, Latin America and even Africa. Given this current trend, Asian export credit agencies (ECAs) will have their work cut out.

There is, however, one ECA that stands out from the rest in the region: the Japan Bank for International Co-operation (JBIC). With total assets of ¥9,779.5 billion ($86 billion) and ¥1,727.5 billion in total capital and reserves in its International Financial Account, there is no other ECA in Asia-Pacific that can match it in terms of capacity or innovation. "The other ECAs are now doing what JBIC was doing twenty years ago," says a Singapore-based banker.

Even so, JBIC has impressed bankers and sponsors alike with the audacious move of creating a subordinated debt facility in its transaction for the Caliraya, Botocan and Kalayaan (CBK) power complex in Laguna, Philippines. "Although it's easier to use this structure for power projects, because PPAs will always guarantee revenue, I never thought that JBIC would do it," muses a Tokyo-based project financier. Nevertheless, the deal marks a first for any export credit agency in taking on a role in an acquisition where the facility effectively consists of subordinated debt.

The establishment of the facility, however, comes as a direct response to the requirements of Japanese corporates. According to Ryuchi Kaga, director general of JBIC's project finance department, Japanese companies, especially utility companies and trading houses, are looking to purchase foreign IPPs. Moreover, utility companies, which are facing stiff competition at home, have been forced to seek more lucrative markets elsewhere.

With a number of power assets, especially brownfield opportunities, coming on stream, JBIC needed a product that would assist Japanese utilities and trading houses on the acquisition trail. As one Tokyo-based project financier puts it, "JBIC's unofficial strategy is intended to support power projects in Asia Pacific." Nevertheless, with the majority of brownfield assets already subject to senior loans, the problem was getting the senior lenders on existing deals comfortable with a new debt facility.

Another consideration for JBIC was pricing, especially in a market where senior debt margins are notoriously tight. "We do not require high pricing to provide profit," says Kaga. With the seven-year debt for the deal rumoured to be below 300bp over Libor, these represent very competitive terms for Japanese corporates looking to expand into Asia's emerging power markets.

Under this new mezzanine facility, which replaces equity on single asset purchases, future project revenues will repay the senior lenders, while the new lenders will be paid out of dividends passed by the project sponsors.

CBK

In April, J-Power and Sumitomo signed a $100 million subordinated loan agreement with JBIC for the Caliraya, Botocan and Kalayaan (CBK) power complex in Laguna, Philippines. The subordinated loan backs the purchase of the CBK project's equity. JBIC has put up $60 million, with the balance being shared between ING and Mizuho (acting as agent bank).

Under the terms of the new facility, JBIC, Mizuho and ING rank pari passu, though all three are subordinated to the senior lenders on the existing project, which was signed in early 2001. BNP Paribas, Dai-Ichi Kangyo Bank, Industrial Bank of Japan and SG Asia were coordinating lead arrangers on the $383 million financing. The deal was heralded as the largest-ever PRI-backed term loan, a massive $351 million.

The Japanese ECA is also providing political risk insurance, which covers the long-term offtake agreement between CBK and the Philippines' National Power Corporation (NPC), for the commercial lenders. The power purchase agreement (PPA) has a 25-year term, and any non-payment default is covered by the ECA.

The original sponsors of the 792MW pump storage hydro power facility, Edison Mission Energy (EME) and Industrias Metalurgicas Pescarmona SA (IMPSA), were casualties of the Californian power crisis in 2000 and Argentina's 2001 financial crisis respectively. The project – which was originally developed in 1994 – continued to perform well and at a higher capacity. When, early last year, EME decided to auction its stakes in all 10 of its international projects, IMPSA invoked the right-of-first-offer for its partner's stake.

The entire equity was then flipped to the Japanese sponsors, without the need for a bridge financing, even though EME had agreed terms with IPM Eagle, a consortium of Mitsui and International Power (IP). In the end EME had no choice but to take the deal off the table. None the less, the majority of the remainder of the EME portfolio went to the IP/Mitsui vehicle Normanglade 4.

Mezzanine or not?

Although the subordinated facility may be a first for the ECA, it has not come without its detractors.
In certain quarters, it is rumoured that some 50% of the subordinated debt is actually being guaranteed by the sponsors. If this were to be true, then JBIC is not as fully exposed to project as it might otherwise be.

When asked whether this was indeed the case, JBIC issued a denial. "There is no guarantee from the sponsors, the loan is non recourse," says Kaga.

Others have also been quick to point out that the loan documentation contains certain covenants which protect the lenders from true mezzanine status. In addition, there is some uncertainty as to whether an inter-creditor agreement, to which the senior project lenders would need to be party, has been signed in accordance with traditional mezzanine financings.

With some $300 million of the original debt outstanding, coupled with the fact that the project is now 100% Japanese-owned, it is expected that CBK will be refinanced. Moreover, with pricing set at a margin over Libor and interest rates so low, a refinancing is expected to take place before year-end. It was rumoured that JBIC's participation as a subordinated lender was contingent on an exit refinancing. As yet, there is no evidence for this.

CBK is not the first time that JBIC has offered the subordinated facility. In 2004, J-Power contemplated using the structure when it tried to acquire a stake in the Titan II petrochemicals project in Indonesia. According to a regional source, "They tried to structure a similar facility, but, in the end, the deal was gazumped by the Malaysians and Indonesia exercised its pre-emption rights."

Given the success of the current debt financing, it is unlikely that JBIC will not continue to offer the product. According to JBIC, there are a couple of deals currently in the pipeline: one in the Middle East and the other in Asia Pacific. In future, however, the Japanese ECA will focus on Saudi Arabia and the United Arab Emirates, especially in relation to independent water and power projects (IWPPs). In the next few years, the Middle East is expected to take up some 30% of the ECA's project share, in comparison with 40% in Asia Pacific.

In April, the $3 billion acquisition and expansion of the Taweelah B independent power and desalination plant (IWPP) in Abu Dhabi reached financial close. The transaction comprised the sale of Taweelah B by Taweelah United Power Company to Asia Gulf Power Holding, a consortium including Marubeni and the Japan Gas Corporation. JBIC provided a

20-year $1.24 billion overseas investment loan – its largest loan yet – while local, regional, and international commercial banks provided a $940m commercial loan tranche.

Further support mechanisms

According to Kaga, the two main support mechanisms are single asset structures, such as CBK, and project portfolio lending (PPL). PPL can cover more than one project if the Japanese company in question purchases the bulk of the assets. The structure looks at the primary cashflow of the holding company, thus shortening the due diligence procedure, whereas traditionally diligence would have to be carried out for each project. Given the diversified risk, pricing tends to be lower.

There is much talk of Mitsui being a prime candidate for the PPL facility, given its acquisition, together with International Power (IP), of Edison Mission Energy's international IPP portfolio. However, it is unclear whether the energy giant has been talks with the Japanese ECA. In late May, Mitsui and IP agreed the purchase of Calpine's Saltend power station £500 million ($912 million). The purchase price is made up of £225 million of equity, 70% provided by IP and 30% by Mitsui, together with a £275 million non-recourse loan.

As part of its commitment to environmental conservation and improvement, JBIC is also looking to provide senior loans for renewable energy projects with favourable terms and conditions such as reduced fees and cost-sharing of due diligence.

"These greenfield projects eligible to this new scheme should be less than $50 million in size and can include all renewables except hydropower. For many sponsors, this special treatment will reduce the cost of burden and allow projects to be eligible for project finance," says Kaga. The move follows the agreement between OECD countries for a trial set of special lending terms to be offered by member ECAs to renewable projects.

JBIC is currently looking at the recovery of geothermal heat in an existing geothermal power plant. None the less, the ECA is expecting that the bulk of applications for renewable energy loans to come from Central and Eastern Europe.

Last year, JBIC provided a $126 million direct loan, under its overseas investment credit programme, for the Mexican Electricidad Sol de Tuxpan project. Tuxpan's sponsors, Mitsubishi Corporation (70%) and Kyushu Electric (30%), mandated Mizuho Corporate Bank as lead arranger, joined by Bank of Tokyo-Mitsubishi and Standard Chartered. The three were to provide an $86 million commercial bank facility, covered by a 97.5% guarantee from JBIC.

The speed at which the deal was done was unprecedented. Those close to deal were particularly impressed with the Japanese ECA's transaction speed, which was much faster than had been previously thought possible.

China

With about $1 billion earmarked for subordinated facilities, and a per project limit of $200 to $300 million, it is as yet unclear as to whether JBIC is doing enough to keep Japanese corporates competitive. Time will tell if the ECA has the right products to quell the aggression of China's emergent banking sector.

"You must remember that the Japanese are very wary of the growth of China. The country will become the manufacturing base of choice, with unlimited funds on the back of foreign direct investment. Therefore, Japanese and other Asian corporates and institutions will have to adapt to compete with China. And anyone operating from a non-China base will need to be innovative in order to compete," says one regional expert.

Recent high-profile acquisitions range from the energy to the IT sectors. In May, Lenovo Group Limited acquired IBM's Personal Computing Division for $1.25 billion, comprised of approximately $650 million in cash and $600 million in the Chinese group. In June, Fu Chengyu, chairman of CNOOC Limited stated that Unocal had indicated that it would begin talks in relation to the Hong Kong incorporated public company's cash offer. With a stake in Unocal, CNOOC would add to its other interests in Australia and Indonesia.

While many agree that recently JBIC has been aggressive in supporting Japanese acquisition activity, it will need to develop its product base further in order to give Japanese corporates the edge they will need.