Jimah Energy: Upfront equity

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Malaysia has notched up another impressive debt capital markets financing for a major infrastructure project. The latest deal to close is a RM6.1 billion ($1.6 billion) financing for Jimah Energy Ventures (JEV), a company owned by the royal family of the Malaysian state of Negeri Sembilan.

Most of the funding is being raised via an Islamic bond issue, but a bank guarantee facility worth RM167.7 million and a RM72 million standby letter of credit are also included in the package. The deal also involves a structural financial overlay, to isolate the array of construction, operating and financing risks inherent in the project – a first for the Malaysian market.

JEV has been granted a license to construct, operate and own a 1400MW coal-fired power plant in Port Dickson, Negeri, Sembilan for 25 years. The power plant comprises two power-generating units, each with a nominal net capacity of 700MW.

Sumitomo Corp is leading the consortium of contractors building the plant, which also includes Ishikawajima-Harima Heavy Industries and Toshiba. AmMerchant Bank, RHB Sakura Merchant Bankers, Malaysian International Merchant Bankers (MIMB) and Bank Muamalat Malaysia arranged the financing and underwrote the bonds.

The project's debt-equity structure – which stands at 96:4 compared to the more conventional 80:20 ratio of most independent power producers (IPPs) in the country – mirrors the financial engineering in the deal, with both debt and the majority of equity financed in the bond markets upfront.

According to Mohd Razlan Mohamed, a director at MIMB, "The Malaysian debt capital and bank markets have over 10 years of experience in funding domestic IPPs and the track record has been pretty good. So we thought it was about time to push the envelope and securitise the equity upfront."

In order to fund the equity, the arrangers established Special Power Vehicle, an SPV which is issuing subordinated bonds under the Bai' Inah principle in Islamic law. These bonds are divided between a RM800 million Class A note and a RM215 million Class B note. The notes are rated A1 by Rating Agency Malaysia (RAM). The Class B note is the real equity piece and is being subscribed to by the sponsor.

The senior debt financing is an Islamic Medium-Term Note (MTN) facility of up to RM4.85 billion issued under the Shariah principle of Istisna. RAM has assigned a long-term rating of AA3(s) to the bonds. The bonds are being issued on a staggered basis during the construction period to minimize the negative carry.

The first MTN issuance took place in May when JEV issued RM930 million of senior Islamic bonds with tenors ranging from eight to 12.5 years. The notes were priced from 6.3% for the eight-year notes to 7.2% for the 12.5-year notes. The next issue is due in November.

A RM405 million issuance of junior debt was sold by Special Power Vehicle shortly after, with maturities ranging between six years and 16.5 years. The junior bonds are priced at between 60bp and 160bp over the senior debt. The 16.5-year tenor represents the longest deferred issuance Islamic debt instrument done to date in the domestic capital market.

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The deal is remarkable because the last two tranches of note, to be issued in 2008, will be floating rate notes, pegged against Libor. "Previously, bond programs of this nature in Malaysia have featured only fixed rate notes. The sponsors felt comfortable with this arrangement because the notes will have a very short tenor and, in the recent past, the interest rate in Malaysia has been quite stable anyway," says Razlan.

Malaysia's project finance market has long been dominated by bond transactions. Project finance bankers say that bonds have become even more competitive compared with bank debt since the government removed restrictions on foreign purchases. Thanks partly to offshore interest, the initial round of bonds were well received, with the buyer list including fund managers, insurance firms, foreign investors and government-linked companies.

JEV is considered by investors to be a project with strong economics, underpinned by favourable tariff rates thanks to a power purchase agreement (PPA) with Tenaga Nasional Berhad (TNB). Fuel-supply risk for the project is low given the provisions of its coal supply and transportation agreement. Construction risk is also low, thanks to the reasonably generous construction timetable, favourable provisions of the EPC contract relating to liquidated damages and the performance guarantee.

The bondholders are given additional protection by a cost-overrun liquidity facility of RM285 million equivalent. Inclusive of the existing contingency sum of RM101.83 million, the cost-overrun buffer totals RM386.83 million, representing, about 10% of the EPC contract price.

As a third-generation independent power producer in Malaysia, the government requires that JEV bears some demand risk under its PPA. The PPA stipulates that only 80% to 85% of tariff will be guaranteed; the remaining 15% to 20% will be paid according to despatch.

Despite this risk and various sensitivity tests, JEV is projected to generate an annual net operating cashflow of about RM800 million, with an annual debt service coverage (ADSCR) ratio (without cash balance) of 1.26x to 4.98x throughout the life of the senior MTN program. The ADSCR is comparable to most other rated IPPs in Malaysia.

Jimah Energy Ventures Financing
Status: Closed
Size: RM6.1 billion ($1.6 billion)
Location: Malaysia
Description: Structured Islamic financing to fund the construction of a 1400MW greenfield IPP
Debt: RM4.85 billion in senior Islamic bonds, RM1.015 billion in subordinated Islamic bonds.
Arrangers: AmMerchant Bank, RHB Sakura Merchant Bankers, Malaysian International Merchant Bankers, Bank Muamalat Malaysia
EPC: Sumitomo Corp
Legal counsel to sponsor: Zaid Ibrahim
Legal counsel to lenders: Adnan Sundra & Low

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