Nanhai: ECA to love

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Project finance players are used to long lead times before deal completion and true to form, the CSPC Nanhai Petrochemicals project financing, Asia's largest and one of its most complex project finance transactions, was several years in the making before its eventual signing in August.

In that time frame the financing plan went through a number of incarnations before the final template was settled on. This template comprises: an equity component equal to 40% of the total project cost and a debt financing comprising $1.977 billion (equivalent) from PRC banks (including senior secured RMB and US$ base and standby debt facilities) and $700 million in offshore financing from eight international commercial banks. $400 million of the offshore debt is sourced from five export credit agencies: US EXIM, GERLING NCM, Hermes, Japan Bank for International Cooperation (JBIC) and Nippon Export and Investment Insurance (NEXI).

Given that Chinese banks are now highly competitive in the domestic project finance arena, it is questionable why any debt came from offshore sources. As one foreign banker suggests: "the Chinese banks could quite easily have sourced the debt by themselves," she says.

The participation of the foreign banks (ANZ, Banca Intesa, BTM, Credit Agricole Indosuez, HSBC, Mizuho Corporate Bank, SMBC and WestLB) as lenders has much to do with the history of the deal. Bill Pearson, a project finance expert within Shell, says it started working on the financing plan soon after the joint venture agreement with CNOOC was signed, back in October 2000. "At the time the project finance market for large scale projects in China was not as well defined as it is today. There was considerable uncertainty about the amount of liquidity available in the Chinese bank sector and we were also potentially competing for liquidity with the other petrochemicals projects underway." Arranger Credit Lyonnais, co-arrangers Fortis Bank and KBC Bank and manager Hang Seng Bank joined in general syndication.

The mandated leads of the domestic loan include Bank of China, China Development Bank and Industrial & Commercial Bank of China. Agricultural Bank of China and China Construction Bank came in as co-arrangers, while Everbright Bank of China signed up as manager.

The original financing plan therefore included a larger debt component from the offshore banks and ECAs (closer to $1 billion). As the extent of Chinese bank appetite and price competitiveness became clear, the offshore tranche was scaled back, but not reduced to zero, partly for relationship reasons.

Given the amount of competition in the bank market for this deal, the sponsors were clearly in the driving seat, pushing commercial banks into early allocation commitments and agreement on a financing proposal that was relatively light on sponsor commitment, says a banker. Halfway through the negotiations on the financing, the plan was then presented to the ECAs in the hope that the agencies would not demand substantial changes.

"To get a proposal where the term sheet has already been accepted by the commercial banks is not normal, but we have seen the practice before," says Fred Binkhuysen, senior project finance manager at GERLING NCM. One source suspects that the international banks were quite aware that the ECAs would tighten up the deal in the lenders' favour and were happy to sign the initial term sheet partly for that reason.

The ECAs in particular were keen to ensure security of supply given that there is no dedicated feedstock supplier. Standby feedstock supply arrangements (whereby Shell and CNOOC agree to procure supply if a shortfall arises) were therefore put in by the ECAs to alleviate feedstock supply risks.

Simon Black, partner at Allen & Overy notes the deal also included an innovative guarantee provided by the project sponsors, CNOOC and Shell, which steps-down in percentage terms and eventually falls away as the project is completed and meets certain financial and other tests. "This is the first time we have seen such a structure in a petrochemical project in Asia," says Black. The 100% sponsor guarantee during construction highlights lenders (again, particularly the ECAs') concerns about the unusual nature of the contractor arrangements. Rather than having one overall turnkey contractor, as banks prefer, the sponsors divided the contracts between the 12 different process units that make up the plant.

One can speculate that the sponsors also hoped for a level of competition amongst the ECAs when the financing proposal was presented to them. "In fact the deal is a good example of how the ECAs can come together and agree a common line," says Michael Schroeder, in the Project Finance Team at Hermes. None of the ECAs approached for the financing walked away from the deal.

The project financing was delayed in its closing stages by issues concerning land access. The issue arose because CNOOC has been granted approvals to build a refinery adjacent to the petrochemical plant. Originally the refinery was going to be built in a second phase by the petrochemical joint-venture. But, according to one source close to the project: "in the end it was decided that the facility would be developed by CNOOC only." Arrangements therefore needed to be put in place for the transfer of the refinery land to CNOOC. Agreements were also needed to cover the temporary use of part of the land earmarked for the refinery by the petrochemical joint venture for lay down of its construction materials.

With Shell having just inked an agreement with CNOOC to explore oil and gas deposits in the East China Sea its finance professionals will have to start contemplating another China deal. "But the banking market shouldn't draw too many conclusions about how we might finance future ventures in China from this transaction," says Michael McMurray, Global Treasurer at Shell Chemicals.

CNOOC and Shell

Petrochemicals Company

(CSPC)

Status: Signed

Location: Guangdong, China

Description: 40% equity, 60% onshore and offshore debt package to fund the Nanhai petrochemical project

Total cost: $4.3 billion

Project debt: $2.677 billion

Sponsors: CNOOC (45%), Royal Dutch/ Shell (50%) and Guangdong Investment and Development Company (5%)

Financial advisor: Banca Intesa

Lawyers: Freshfields Bruckhaus Deringer (advising the ECAs), Latham & Watkins (commercial lenders) Commerce & Finance Law Office (lenders and the ECAs), Allen & Overy and Jingtian & Gongcheng (advising the borrower), Linklaters & Alliance (acting for CNOOC)