CSX and the City

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CSX World Terminals (CSXWT), which recently concluded a $480 million deal to finance the construction of a new facility at the South Korean port of Pusan, is one of the few port developers in the project debt markets - and it plans to stay in.

In a somewhat prosaic industry, CSXWT is a relatively new creation. Previously the terminal operating arm of container shipping giant Sea-Land, it was formed after parent-company CSX sold its maritime transport business to Danish conglomerate AP Moller.

Similarly, the Pusan deal is something of a milestone. It represents CSXWT's first foray into the Korean market and makes CSXWT only the second foreign port investor - the first being PSA Corp of Singapore.

Despite the downturn in the world's container markets, given that Pusan is currently ranked as world's third largest container port, Ron Sforza, Senior Vice President and Chief Financial Officer, CSXWT, had little doubt that they would acquire the funds.

"We have a history of using project finance structures. When we were part of Sea-Land we completed deals on Salalah in Oman, and Asia Combined Terminals in Hong Kong, as well as more recently on Caucedo in the Domincan Republic, so we have track record. Secondly the local market is very strong and the high level of involvement by the Korean government was important, and thirdly the lenders knew the sponsors and thought that we and our partners were very bankable."

Indeed, such was the level of confidence in securing the necessary financing, and in the project's potential value, that there were some late alterations to the structure of the deal, which lessened the level of government contribution. "We felt that the risk we were taking was not as high as all that, and we didn't want to be limited on the upside, the potential was much greater than we had first envisaged. So we got approval from the government and this should allow us to generate higher returns," says Sforza.

Sforza admits that the fact that Samsung is providing part of the domestic debt under its Samsung Life Insurance subsidiary, while its construction arm is building the terminal, was important to lenders. But Mathew Leech, Global Business Development Manager, who put together most of the Pusan deal, says that it was not critical. "The linkage between the sponsor and constructor was very important, but not everything. It made it easier to get the deal done, especially given Samsung's close relationship with the government and the fact that there is such a high commitment to build from the sponsor, but it could have been done without it."

However there is still a limit to cash held, now the deal is completed, with release based on coverage tests, which Sforza agrees is fairly typical in project finance deals, "As we achieve certain returns we have to service debt levels, and if we didn't have this there would be some other guarantees that we would have to make." Nonetheless, finding lenders proved to be easier than first expected in the difficult financial climate of early 2002, and over the course of the negotiations a second raft of lenders emerged such as KBC, KfW and WestLB, who have all participated in the financing.

"When we first went to lenders in February 2002 there was quite a lot of interest, altogether 24 different banks, both onshore and offshore, bid for it. What happened was that we mandated the arrangers and a couple of the other banks that had been in the next best bidding level approached them. We didn't object to their participation, but we wanted to limit the number of arrangers that we dealt with, and especially the number of offshore banks to five."

CSX wants more banking relationships

CSX already had a long standing relationship with Bank of Tokyo-Mitsubishi, one of the lead arrangers, but Sforza stresses that the company is open to talking to other lenders. "We want to develop new relationships with the financial community because we see project finance as the right way to fund a lot of projects, especially greenfield ones."

Scotiabank is another lender that the operator has been involved with, most noticeably as its role as lead arranger in last year's $280 million deal for the construction of the Caucedo container terminal in the Dominican Republic. It also talked to the operator about Pusan: "We've got a good relationship with Scotiabank but they are not really as strong in Korea as they are in Latin America, which they know very well. Various banks are interested in various geographic areas where they know the risks better, and they didn't fit Korea." Leech adds: "One of the key requirements for Pusan was the very high constraints to secure financing, we were going to favour controllables. We didn't want to take on political risk insurance (PRI) because we were very confident in Korean sovereign risk, and securing PRI tends to extend the financing. Basically those institutions which were more comfortable with Korea offered more competitive deals."

But CSX does not exclusively use project finance. In Germany for instance, where it recently completed a Euro10 million expansion of its Germershiem facility - an inland terminal serving freight trains and barges - financing was done through existing cash-flows. There were additional governmental funds injected into the project as it fulfilled the political criteria of diverting cargo off the autobahns and onto more environmentally-friendly transport modes, but it is also further proof that there is little for lenders in the European markets.

Meanwhile a recent deal concluded in China, to take a 50% stake in the container terminal in Yantai, may see further action. "We're still waiting for Chinese governmental approval for the deal, but once that happens then some project financing may come of it," says Sforza.

Reasons for using project debt

However, of the major global container terminal operators, CSXWT is almost alone in plying the project finance market. "Three reasons I favour it," says Sforza, "Firstly it allows the project itself to expand and stand on its own financial merits. Secondly, unlike quite a lot of other operators we are usually involved in joint-venture operations with local partners. And thirdly, we usually generate higher returns under these structures and this is a good way of maximising better returns to our shareholders."

And what type of products are preferred? "We prefer non-recourse, but in reality there's always some limited recourse along with certain contingent liabilities. But basically we want to create a win-win situation for both us and lenders, and in something like Pusan, involves a lot of time and a lot of negotiations," Sforza says. Leech embellishes the point: "Project finance is preferable to pure debt because when you get into bonds or mezzanine facilities the structures tend to become more complicated. Ultimately it depends on the project itself, and as for why our competitors don't use it, in some cases they have. PSA did a project finance deal with Samsung, using onshore banks for its terminal at Inchon, and we've seen P&O Ports use it in some of their joint-venture operations as well. It's not just about how the operator decides to fund the development, you've got to realise what's best for your partners."

Sforza adds that the issue of flexibility is also critical, "We don't want to restrict the flexibility. It's critical to limit the amount of outside influence. We are the experts at making the money in the container terminal business, the lenders provide the means for us to do that."

But things do come unstuck sometimes. Parent company CSX is currently facing a $180 million claim filed by Hutchison-owned Europe Combined Terminals (ECT) over claims that Sea-Land broke its contract with ECT by withdrawing from a joint-venture terminal in Rotterdam when it was acquired by Maersk. CSX has responded in turn by taking preliminary steps to issue an arbitration against Maersk under the sales and purchase terms of the agreement. It says its in the right, the damage was done by Maersk, but it could nevertheless be facing a hefty payout this year.

Future deals

However, there is little doubt that CSXWT will again be tapping into the project finance market in the future. "We are constantly looking for investments both in brownfield and greenfield opportunities and in these cases we will usually look for project finance. But there isn't a project that we are about to go to the market with, and I can safely say that nothing will happen for the remainder of this year. There are a lot of investment opportunities about, but the industry is very competitive."

It is currently bidding for two major projects in India. It is up against Maersk to take control of the Vallarpadam transhipment terminal, and is set to submit a firm proposal after a board meeting on 8 July. It also part of a pack of 11 operators vying to take win a $200 million, 30-year build-operate-transfer scheme to develop a second container terminal in Mumbai's Jawaharlal Nehru Port. The project is a brownfield, involving the redevelopment of an old bulk cargo terminal, and it is highly probable that CSXWT will turn to project finance lenders if it wins the concession. P&O Ports, which operates the existing container terminal - and has been barred from bidding in this because of competitive issues - successfully tapped the market to develop its facility. Another factor is the increasingly good sovereign risk perception of India, which was upgraded by Moody's in February.

However, there are concerns that the spate of projects being built in India could lead to overcapacity in the terminal market, and of the eight to ten different criteria that CSXWT uses to judge a project's viability Sforza says this is one of the most important: "Terminal overcapacity gives us particular consternation and during all the privatisations in the last few years this has been a real problem. Buenos Aries, for example, was very successful for the government but not for the operators who took over the terminals, and I wouldn't want to invest in a project where its was unclear how things would develop in this area."

Nevertheless, these concerns do not crop up in Pusan where strong volume growth has put pressure on capacity. "The supply-demand situation there is such that there's no space left, and the developments are absolutely necessary, and that was one of things that interested us," Leech says.

So what sort of return on investment does make a project viable? "That is a very difficult question to answer, it depends on the market situation, the competitive situation, the risk situation. There is no one reply, each project is different, each geographic area is different, though I would say that we probably look for higher returns than our competitors," Sforza says, and Leech adds: "It's not only about returns for us. If you are looking at a deal that has been difficult to finance, the project has to stand by itself in terms of generated cash-flows for the first 10-12 years. So you have to look at returns on a long term basis."

Despite the structural economic uncertainty surrounding the container shipping industry, Sforza has confidence in the future of the terminal market: "The economics that we have been faced with over the last couple of years have hit the market, there's no question. On the other hand, in the conversations that I have had with lenders I've been told that they are always willing to finance good projects. Project finance in our industry is here to stay, the funds are out there for the right projects, and the right operators - our reputation helps us secure the finance, because the lending community has confidence in us."

And Leech concludes that the drop in confidence of some banks has actually had a positive effect. "What we have seen is that project finance banks have been whittled down. There are fewer participating, but those that are, are making the clear distinction between the container terminal industry and other projects such as power or water. It's a different competitive environment with different needs and different risks. The banks that can see this distinction are the ones that are willing to finance the projects, and in many ways that makes it easier for us."