Stendal does its paperwork

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The pulp industry is cyclical by nature, and by the accounts of insiders, conditions are unfavourable at the moment. With this in mind, the lenders to Mercer International's Eu828 million ($812.7 million) pulp mill project structured the financing to accommodate cyclical prices. They say the result is a secure, robust financing with strong guarantees in place because it is predictable over the long-term. The two sponsors are also German-based ? RWE Industrie-Losungen (RWE IN) and FAHR Beteiligungen. The project reached financial close on 20 August 2002 and construction has already begun.

Mercer has a 63.6% stake in Stendal, RWE 29.4% and FAHR 7% in the project which is led by lender Hypovereinsbank and executed by project company Zellstoff Stendal. Hypo has fully underwritten the entire Eu828 million of project facilities, the debt slice of the total project costs of just over Eu1 million. Equity was Eu100 million, with a stand-by facility of Eu30 million and start-up cash flow of Eu26.1 million. Other costs within the EPC contract amount to Eu321.5 million.

The mill will produce around 552,000 tonnes of northern bleached softwood kraft pulp per year. This is the first greenfield mill producing pulp of this kind to be developed in Germany for decades, and represents the largest and most significant project financing to close in the German market to date.

?With a number of banks evidently underweight in German and Central European project finance assets and against the backdrop of struggling power and telecoms portfolios, this deal is attracting significant interest from the international and domestic banking markets,? says Marc Thuemecke, head of the industries group at Hypo. General syndication is expected to be complete by the end of October.

The Stendal mill will be based in the state of Sachsen-Anhalt in Germany, and as such qualifies for a combination of state aid through various EU-approved grants, and subsidies. Part of this financing is a five-year, Eu160 million, bridge facility, which makes up 19% of the total debt.

Of the remaining 81%, 70% will be covered fully by the government and a federal state deficiency guarantee ? a grant brought in to boost economic growth in Eastern Germany, with the aim of supporting the manufacturing industry and reducing unemployment levels. The deficiency guarantee subsidies are provided to establish, expand or reorganize business enterprises.

This sort of guarantee is a commonly used instrument in Germany. They are granted to secure large investment loans, generally up to about Eu10 million if it is useful to the national economy.

The debt breaks down into six tranches ? Eu587 million splits two ways. Tranche A has a tenor of eight years and tranche B has a tenor of 15 years. Both are state-guaranteed with margin ranging from 60-75bp. The following three tranches are uncovered loans amounting to Eu82 million with tenors of 5.5, eight and 15 years with a margin of 150-155bp. The final tranche is the Eu160 million bridge for quasi-state receivables ? this tenor is five years with a margin of 125bp. These will be repaid very quickly following a grace period for construction in six-monthly unitary payments. Weighted average loan is 8 years ? being repaid early in short tranches so after 5.5 years only 65.5% of debt will be outstanding.

The Stendal project benefits from the aforementioned government guarantee for up to 80% of any losses. Over and above the normal project security the government is guaranteeing 57% of the total debt facilities in year one and 77% in year 5.5. Also, the bridge facility is backed by quasi-state receivables (ie, state aid and VAT repayment) and carries a one-year debt service reserve account (DRSA).

This DRSA is designed to structure the financing around a cyclical market. In addition to it, lenders felt comfortable with a

payment deferral mechanism and an average debt service coverage ratio (ADSCR)-linked distribution lock-up test. The project has strong economics with an ADSCR of 1.70x.

Mechanisms aside, however, it is clear that timing is critical for any pulp mill coming online, and Stendal is forecast to be in a positive position for pulp prices and has conservative break even prices for pulp and wood costs, according to market adviser NLK Associates and Jaakko Poyry. ?Downside scenarios proved the project to be robust even in unfavourable pulp market conditions,? says von Moltke of Hypo.

The Stendal pulp mill will be constructed by RWE IN under an EPC contract. In terms of manufacturing costs, it will lead the market competition-free. This is the second pulp mill to be sponsored by Mercer in Germany. The first was the conversion and expansion of the Rosenthal mill in 1999 in the state of Thuringen. Experience from this first mill shows sufficient demand for larger pulp production capacity, since European buyers welcome a local source of pulp.

The pulp that is produced from the Stendal mill will be sold through short to mid-term contracts, that is, one to five years with varying market prices. Germany benefits from a good supply of wood that will help ensure that prices do break even, once the mill is in operation.

The construction of Stendal pulp mill is scheduled for completion in 2004.