

Singapore: The Price of Power

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With the majority of Asian project finance markets still in tatters, bankers have been doing what they do best - banking on Singapore (Asia's safest credit) for some major new business.

But deal flow - even in such a small market - has yet to match expectations and more importantly, "it's a place where the funding rule book tends to get thrown out," says one local financier. "You've got very aggressive pricing and credit structures not seen elsewhere in Asia and possibly the world," he explains.

The tendency for aggressive pricing was most recently displayed in the StarHub deal, providing funding for the new telco's fixed and mobile telecommunications services. According to syndication sources at ABN Amro, the S\$825 million (\$490 million) deal closed in mid-November and was oversubscribed to nearly 20 banks. ABN Amro was overall arranger. Co-arrangers were BNP, Commerzbank and Overseas Union Bank (OUB). The date for signing is early December. Pricing was tiered between 115bp and a tight 60bp.

The tight pricing reflects a stable political system and booming economy (forecast to grow 6% next year) - Singapore is Asia's safest credit. At the same time most project finance deals have traditionally included sponsors that are either government entities or companies with substantial government shareholdings. The StarHub deal, for example, includes state sponsors Singapore Power and Singapore Technologies Telemedia as well as the very bankable credits of Nippon Telegraph & Telephone and British Telecom.

So, although individual bankers have expressed concern over StarHub's significant market risks, principally related to the fact that mobile telephony penetration rates were high before StarHub even appeared on scene, the deal was snapped up by the finance community. "Less sophisticated banks were happy to leap in just on the basis of shareholder's credit," complains one European banker.

The market's eagerness is also explained by a third factor influencing pricing; the rarity of Singapore project financings. The first US dollar project financing for a Singapore company (Tech Semiconductors) was done only six years ago (in 1993). The first Singapore dollar-based deal was done even more recently, in November 1998 for Sembawang Utilities and Terminals (SUT), a deal arranged by Citicorp, Sumitomo Bank, DBS Bank and Bank of Tokyo-Mitsubishi (BTM). Other banks involved were DNIB, Credit Agricole Indosuez, OUB, and KBC Bank.

SUT is currently raising an additional S\$70 million on a limited recourse basis for an expansion of the SUT facilities. The new deal tops up the original S\$244 million project financing. Citibank is believed to be the transaction arranger. The funding will be within the same group of banks who participated first time around.

Low margins were similarly in evidence for the SUT deal, which funds the first phase of a multi-utility project at Pulau Sakra, Jurong Island. Spreads, which were tiered like the StarHub transaction, fell from approximately 110bp to under 90bp.

According to Citibank project financier, Peter Ho, who handles much of the Asian power business from Hong Kong, the SUT deal has a longer tenor, but because the project's revenue contracts are already lined up, market risks are lower. Ominously, for those hoping for higher pricing on the up-coming project finance deals in Singapore, both the SUT and StarHub deals began to be structured during the backend of the Asia crisis when pricing on all financing transactions had escalated sharply.

The largest source of project deals in Singapore over the next year will be the power sector. Trying to estimate the risks involved is proving to be a headache for bankers since Singapore's power market is deregulating in a peculiar and perhaps unique fashion.

"Power trading is already open to competition through the pool pricing system but, unlike in the Australian experience, the generation and distribution assets have not yet been sold off," comments a banking source at one of Singapore's indigenous banks. As a possible precursor to privatization, the transmission and distribution networks have been corporatized, and are now owned by PowerGrid and Power Supply respectively. The question arises: will the untested risks in Singapore's power sector push margins higher than those enjoyed by the StarHub and SUT sponsors?

The reverse (further pricing contraction) looks like being the case in the second phase funding for one of Singapore's three generating companies, Tuas Power. Funding will cover the construction and equipping of Tuas's 720MW gas-fired power station. The key pricing issue centres on the project's backer, Temasek Holdings, the 100% Singapore government-owned corporate. "The deal is being looked at as a government financing rather than as a limited recourse loan," says Alexandra Tracy in ABN Amro's Singapore project finance team. Some very experienced project finance names, ABN Amro is one of them, are steering clear of the deal because of the low, sub-90 basis points, pricing that is likely to result.

Meanwhile, phase three of Tuas's development plans, the construction of a 1,200MW power station is on hold. For this more ambitious phase Tuas has been advised by a number of different parties to wait until the pool pricing pool mechanism has proved itself and the planned West Natuna (Indonesian) gas pipeline project has started to pump gas into the Singapore market. As more of Singapore's power stations start running on gas, the availability of cheap gas supplies is now a key issue.

Indeed, in the SembCogen financing (see below) arrangers have crafted a S\$35 million facility in case gas supplies are delayed. Indonesia's Pertamina and SembCorp Gas have signed an agreement to boost supply by 325 million cubic feet of natural gas a day delivered via a sub-sea pipeline system to Singapore from Indonesia. According to a financier close to SembCorp, gas should start flowing from the pipeline in the third quarter of 2001. But because Indonesia with all its instabilities is the source of the gas supplies financiers are taking a, 'I'll believe it when I see it' attitude. The project's sponsors did consider project finance for the pipeline but are now providing the capital themselves.

With StarHub out of the way, the most eagerly anticipated mandate is for the SembCogen power project. Bids for the S\$400 million financing, being split between four tranches, a S\$300 million term loan, a \$90 million guaranteed facility and two contingency facilities, were due by the end of November. According to ABN Amro, the guaranteed facility has been put in place to support an original Economic Development Board loan which is part-funding construction. The deal will eventually provide the bulk of capital required for the SembCogen's 815MW merchant power plant construction which is already underway and due to be completed in 2001. The gas-fired plant is the second phase of the Jurong island development following the SUT project and is backed by the same sponsors - Tractebel, SembCorp Engineering, JTC International and EDB Investment. Financing for the development, say banking sources, is scheduled to close by the end of the second quarter next year, if not before. Sources say Citicorp, Sumitomo Bank, DBS Bank and BTM, arrangers of the SUT deal, have the right to match offers on up to 50% of the loan amount.

If fine margins are a given in the upcoming Tuas deal, the pricing picture for SembCogen is less clear. Although not a

power deal, some bankers believe the SUT financing provides a pricing template for the SembCogen financing since the major sponsors behind SUT are also the backers of SembCogen.

However, there are several key differences between SembCogen and SUT. Bankers not only have to contend with the fact that SembCogen will be the first greenfield power project involving a non-government company, and a level of revenue risk greater than for SUT, but also with an uncertain operating environment in the power sector. As the banking community gears up for the financing, analysts point out that the Singapore Electricity Pool (SEP), set up in April 1998, is currently monopolized by Temasek Holdings.

"It is not clear how the monopoly is distorting the pricing market," says one analyst. "SEP's pool pricing data is in the public domain. But it will still be difficult to draw conclusions on future pricing trends because Temasek's subsidiary Singapore Power (SP) will still have a dominant position in the market even when SembCogen comes on stream," he adds.

A second major market uncertainty stems from the unusual nature of demand for electricity in Singapore. Together the manufacturing and non-manufacturing sectors accounted for about 80% of total demand during 1997 to 1998. Residential sector demand, on the other hand, was fractionally less than 20%, a lower percentage than in other developed economies. "The Singapore power market's dependence on business means that the sector is very vulnerable to the economic cycle," says the analyst.

Moreover, in the short term, the outlook for electricity demand growth is not promising. At a time when SP alone has enough generating capacity to supply 50% more than Singapore's current power requirements, demand is expected to remain stagnant or decelerate. SP projects demand growth to slow to between 4% and 6% over the next two to three years.

As SembCogen will only be dispatched in to the pool on a lowest price basis, financiers have to be comfortable that SembCogen can compete effectively with dominant SP's own generators. The SembCogen facility needs to run at operating costs below those of the existing power stations. Much of the hefty due diligence now being done by financiers is to estimate the operating costs of the three up and running power plants, Power Senaka, Power Senoko and Tuas, included in which will be a calculation of the generators' debt funding costs. The incumbent players are eager to protect their operating secrets and concrete cost data is hard to come by, but what financiers do know for sure is that SP's assets largely run on fuel-oil, less efficient than SembCogen's gas-fired alternative.

SembCogen's backers are understood to have sent out tenders to their many relationship banks. For that reason financial institutions are bracing themselves for yet another aggressive tender process with proposals likely to be based on a typical IPP project finance structure. "We will see a traditional IPP funding put in place. A limited recourse, highly leveraged deal with between 20% and 25% equity," says Gerald Massenet at Credit Lyonnais.

International project finance banks were originally attracted to the nascent finance market for Singapore power by the Tuas plant divestment, which was in the market a year ago. The sell-off of up to 60% (about S\$500 million) in Tuas Power, the first real move to privatization in the power industry, never saw the light of day. The disposal was shelved because of the slowdown in demand for power during the Asian economic crisis. Rumours have also circulated alleging that the sale was handled badly. "The privatization arrangers [CS First Boston was adviser during the transaction] couldn't realize the full value of the plant," says one banker.

The important point to note is that Tuas succeeded in drawing in all the major and some lesser project finance players and therefore in making the market more competitive. "Financiers are still hoping to put the market research built up for the Tuas transaction to good use before it becomes obsolete," comments one observer.

In the meantime, the Tuas divestment program is not likely to be relaunched in the near future says Charles Ong at DBS

Bank. "The government wants to hold back and fully review what the structure of the power industry should be before reactivating the Tuas sell-off. The government has announced that Singapore Power's co-generation assets will be divested by 2001," says Ho. At least two more large-scale power project deals should therefore be expected in the next two years. A power project finance market in Singapore has emerged principally because of government deregulation efforts. But with a population of only 3.5 million, and therefore a power sector that is tiny by international standards, the sector is unlikely to be a source of significant deal volume unless privatization kicks in - and then it may be shortlived.

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