Gulf bridged?

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Over the last three months, Gulf oil ministers have become increasingly anxious as the oil price has drifted below the lower end of Opec's target band. But the prospect of sagging oil revenues and ever larger expenditures over the next year provide yet further impetus for diversification away from oil for most of the largely oil-driven Gulf economies. Indeed, for much of the Middle East, vast and ambitious gas initiatives have, for largely this reason, firmly set the new hydrocarbons trend.

Despite global economic uncertainties, the need for the continual, uninterrupted flow of oil and gas remains unchanged, even if supply currently outstrips demand. And this fact alone will ensure ever more investment. But in any event, the principal beneficiaries of new exploration and production deals will be the investors in major energy companies and their projects.

With a glut of opportunity throughout the region, privately sponsored projects have been trying to bite into the international and regional debt markets. And project financing for major hydrocarbon deals throughout the Middle East is growing up ? fast.

New fuel for kingdom

The familiar refrain ? that oil price volatility is, as it ought to be, encouraging non-oil economic expansion ? is playing itself out conspicuously well in Saudi Arabia, the region's most voluminous energy provider, where every effort is now being made to encourage private sector growth. Most exemplary of the kingdom's commitment to economic reform is its gas initiative. It involves setting up a privately financed gas system encompassing everything from upstream gas development to downstream petrochemicals and power generation. Beyond the $25 billion in up-front investment, the program will also inspire other associated projects, employment and further foreign investment over the next two decades.

And increased foreign investment, spearheaded by the gas initiative, will start creating work in the kingdom from the middle of next year, if it runs to schedule.

The initiative, and the momentum with which it has proceeded, has been much vaunted by the international business and financial community ? consortia for three core ventures were announced in May, and financial, legal and technical negotiations are now under way, due to be wrapped up in coming months. A December 16th deadline was set for the signing of implementation agreements on the core ventures.

For the first core venture, the exploration and development of gas fields in the South Ghawar area, a consortium of ExxonMobil (35%), Royal Dutch/Shell (25%), BP (25%), and Philips Petroleum (25%) have been lined up. Investment will be between $12 billion ? $16 billion. The project also calls for gas transmission, power, water and desalination schemes. More specifically, it includes up to 4,000MW of power generating capacity, with integrated desalination facilities, as well as petrochemical plants.

The second venture calls for exploration in the Red Sea area and the development of Midyan and Bargan fields. A consortium fronted by ExxonMobil (60%), in partnership with Marathon Oil Company (20%) and Occidental Petroleum (20%), was formed. The initiative will require between $5 billion ? $10 billion. The scheme will also require further investment and development in power and desalination projects, as well as related petrochemical projects.

A consortium of Shell (40%), TotalFinaElf (30%) and Conoco (30%) formed for the third core venture ? the exploration of blocks in Rub al-Khali, and the development of gas in the Kidan and Shaybah fields. Again, total investment will be between $5 billion ? $10 billion. As with the other two schemes, power, water and petrochemical facilities will be part of the package.

Saudi Arabia has also made bold advances in developing its petrochemical industry. Over the last two decades, Saudi Basic Industries Corporation (SABIC), majority owned by the government, has been at the forefront of this drive, propelling itself, with a 35 million t/y capacity, to the top ranks of global petrochemical producers. It has several more projects in the making, including the new Jubail United Petrochemical Company complex, for which four separate projects with foreign private partnerships will be carried out.

In addition, the gas initiatives undoubtedly will have a stirring effect on the domestic petrochemical industry and the private opportunities therein, particularly given SABIC's ever evolving relationship with the private sector.

United Arab Gas

Sitting on one tenth of the world's proven oil reserves and producing 1.8 million barrels a day, Abu Dhabi has also attracted a wealth of interest in its ever diversifying hydrocarbons sector, especially over the last few years.

More specifically, the UAE has embarked on a massive multi-billion dollar program of investment in its gas sector, vital for the introduction of gas-fired power plants and the transformation of the Taweelah commercial district into a gas-based industrial zone. Gas underlies the federation's economic diversification plans. Now, the most ambitious of its gas schemes, the Dolphin Project, is inching towards realization.

Dolphin, an agreement signed two years ago between United Arab Emirates Offsets Group (UOG) and Qatar General Petroleum Corporation (QGPC), aims to pump two billion cu.ft/d of natural gas from Qatar's offshore North Field undersea to Abu Dhabi and onward to Dubai and Oman, with a possible future link to the subcontinent.

UOG signed preliminary agreements with Mobil Oil Qatar for the supply of 300 million to 500 million cu ft/day, the upstream section of the project. A full development and production sharing agreement is also set to be signed shortly.

Earlier this year, Enron, which had signed agreements with UOG to work on the midstream part of the scheme, bowed out of the $3.5 billion project. The company apparently sold its stake in the project to UOG for an undisclosed sum. DEL has begun negotiations with other major international oil companies interested in taking over Enron's stake. In the meanwhile, UOG will own a 75.5% share in the project, with upstream strategic partner TotalFinaElf holding the remaining 24.5%.

The five prospective partners are Conoco, ExxonMobil, Occidental Petroleum, Royal Dutch/Shell, and BP. Midstream work on gas transportation will require building a 350-kilometer pipeline from a processing plant in Ras Laffan, Qatar, to the Taweelah terminal in Abu Dhabi and Jebel Ali terminal in Dubai.

As the plan stands, UOG and Abu Dhabi National Oil Company (ADNOC) have also issued a joint declaration dividing up gas distribution between them. Gas from the Dolphin project will be the exclusive supply for gas fired plants, except in the western region of Abu Dhabi, and will also supply gas for ADNOC contracts with Dubai.

The effort continues. Eleven banks were invited to bid for the financial advisory mandate, of which four are said to have been shortlisted. They are CSFB, BNP Paribas, Credit Agricole Indosuez and SG. Of these, CSFB is understood to be the frontrunner, although an official appointment is still pending ? and, some suggest, long overdue, raising concerns about whether DEL will try to move ahead without a financial adviser for the project. The company way simply wait to appoint one after settling on a new foreign partner.

The project is critical for the Emirates, let alone the rest of the region, since there's such a huge need for gas right now. In Dubai alone, the largest call on gas will come from industry, which is forecast to double its consumption in the next five years. Throughout the UAE, demand from the power sector is projected to surge some 60% in that time.

Major capital intensive projects are also currently under development in Abu Dhabi's upstream gas sector. The most important of these is the second phase of the $1.2 billion Asab gas development (AGD 2), the $1.3 billion third phase onshore development (OGD-3) and the $400 million Hail gas project.

The downstream sector in Abu Dhabi is also set to hit a new milestone with the commissioning of UAE's first petrochemical plant, a $1.2 billion polyethylene complex of Abu Dhabi Polymers Company (Borouge).

Industrial Omantra

Neighboring Oman is also following the Gulf-wide pattern ? it has already taken some bold steps towards stimulating foreign investment and diversifying away from oil. The result, so far, has been one of the most punctual and extensive privatizations of its kind in the Gulf, alongside some landmark project financings. In the wake of the original Oman LNG and Salalah port project successes ? both of which rake in massive foreign investment, provide long term revenue streams and employ local Omanis ? the lender community has ample proof of the potential for successfully pulling off big ticket projects in Oman.

But several of the country's major industrial schemes, crucial to its economic plans, so far exist only on paper. Their development requires the provision of one of Oman's most treasured resources ? gas.

The Omani government readily proclaims its commitment to diversification. The argument used to be that the slew of drawing-board industrial projects languished for many years because, without gas pipelines, there could be no industry. The infrastructure needed to serve the industrial schemes is now largely locked in place. And much work has been done to make these projects bankable. But issues persist, such as addressing government guarantees on gas and water supply, possibly in the form of direct agreements between the governments and the lenders.

Another scenario plaguing planners is the allocation of valuable and, by regional standards, scarce, gas reserves to industrial projects which, some claim, may never materialize. And there is the rub. With an expansion of Oman LNG under consideration, its as yet unclear what will prove more profitable.

Senior government officials pick out five or six schemes which they hope will emerge favorably. Among them are the Sohar industrial estate schemes, the Oman-India Fertilizer Scheme, and the Aluminium Smelter project. The latter is least likely to move. But despite frilly rhetoric, there is reason to be hopeful, yet.

Most advanced of the Sohar schemes, however, is the $870 million Sohar refinery project. ABB Lummus Global has been selected to act as the project management contractor on the project, sponsored by Oman Refinery Company.

Since gas delivery is essential to Oman's industrial development, the question is whether there will be enough gas to sustain all the projects. Indeed, the sultanate has more than doubled its reserves over the last decade. The government has also signed a memorandum of understanding with the vast Dolphin gas project, which aims to pipe gas from Qatar throughout the Gulf. In any event, future additions to current gas reserves are inevitable.

At the same time, Oman's gas export program, also vital to its economic plan, is picking up new momentum. Citibank was recently appointed financial adviser for the proposed expansion of the Sur liquefaction plant of Oman LNG. The expansion plan is based on the addition of a 3.3 million t/y train to the current facility.

The original Oman LNG project began commercial operations in April 2000, and marks the largest industrial project in Oman's history. It comprises, according to the government, the cornerstone of the diversification drive. The project, which reached financial close in late 1997, commanded a formidable $2.5 billion, and demonstrated to the lending community the country's aptness for such large scale project finance deals.

Recently signed, however, was the refinancing of the original Oman LNG facility. A group of banks have agreed to terms on a lead arranging group for the $1.3 billion refinancing package. They are Bank of Tokyo Mitsubishi, Credit Agricole Indosuez, Credit Lyonnais, Gulf International Bank, Arab Banking Corporation, Hypovereinsbank, ANZ Investment Bank, Apicorp, Sumitomo Mitsui Banking Corporation and Mizuho Financial Group, HSBC Investment Bank and Royal Bank of Scotland

It is possible that Bank Muscat may join the transaction, though possibly after the launch of general syndication, expected in January.

The deal is interesting in that several major international banks have failed to participate. ABN Amro, Barclays Capital and BNP Paribas have all pulled out of the deal. And Citibank, Oman LNG's financial adviser, also has not joined the lead arranging group.

The company's credit is very strong, already having successfully financed two trains. The new loan will repay the existing loans. The ultimate aim was to achieve cheaper margins while stretching the tenor to 18 years; instead, the tenor has only reached 16½ years, with pricing still fairly high, given current risk levels. The deal has a step-up pricing structure starting at 90bp for years one to five, rising to 110bp for years six to ten, and then to 140bp from year eleven to maturity.

The sultanate is also pursuing plans to expand upstream gas infrastructure in the central Oman gas fields. A $250 million project, being undertaken by Petroleum Development Oman (PDO), is underway, in part to meet Oman LNG's feedstock requirements.

Doha's fruitful reserves

Possibly the most encouraging signs of investment in the Gulf oil and gas sector are occurring in Qatar. The state, flaunting an extensive list of gas-based projects and rising government spending on infrastructure, has witnessed a rush of project activity over the last two years ? and looks set to maintain that trend in coming years.

Indeed, its level of activity is in marked contrast to much of the Gulf, and sponsors and contractors alike are fiercely vying for entry into what is quite feasibly the Gulf's most competitive market.

Qatar has taken center stage in the regional project finance market in 2001 and now, at year end, the country has successfully funded several key industrial projects on schedule, while having laid firm foundations for more deals next year. Qatar is assured to remain a target market for regional and international project developers for the foreseeable future. Indeed, Qatar Petrtoleum (QP) alone expects to spend around $10 billion over the next 2-3 years.

The challenge, of course, will be to raise such vast sums. But QP, for one, has already established itself in project financing and enjoys exceptional relations with the international and regional lending community. The company is also aiming to tap as many sources of finance as possible ? it is recently understood to have been considering the possibility of securing Samurai financing for the first time. And if the success of this year's financings is any measure, the liquidity and appetite certainly exists ? regionally, if not internationally.

But companies like QP and its kin also face the challenge of having to put into practice ambitious investment programs against the backdrop of lower energy prices. Post September 11 oil price forecasts have been revised downward, with some predictions as low as $17-18 a barrel by early 2002.

But, by all accounts, QP's investments are set to remain fairly robust. Its proposed LNG and petrochemicals projects are based on solid fundamentals, drawing on some of the lowest gas feedstock prices in the world, while being undertaken at existing installations ? with the result of massive savings, and profits.

Susceptible to an oil price slump, however, are the gas-to-liquid (GTL) projects. Some argue that GTL projects are not commercially viable at an oil price below $13 per barrel. Despite such concerns, QP's GTL venture appears assured, particularly in light of its drive to exploit and export its North field gas reserves.

Ultimately, even in the event of a sharper and more sustained oil price slump, Qatar's public finances still extremely strong, given the recent surge in oil and LNG production. The result is that the government is now in a far better position to balance its budget, without resorting to savage spending cuts, and thus thwarted projects.

The projects are aplenty, most of them expansionary. Ras Laffan LNG Company (RasGas) now has its sights set on achieving financial close on the $1.4 billion train 3 project. The debt facility is understood to be almost complete and is set to be released once market conditions settle

Four bank groups are prequalified to bid for the position of lead arranger. The 4.7 million-tonne-a-year (t/y) train, due to be completed in 2004, will supply gas to India's Petronet LNG, which has signed a 25-year sale and purchase agreement (SPA) with RasGas, sponsored by Qatar Petroleum and ExxonMobil.

Around 40 banks had been invited to bid by Goldman Sachs, the financial adviser for the project.

The total cost of the project is around $1.4 billion, with 70% debt and 30% equity. The commercial loan portion will be roughly $700 million with a probable 10-year tenor. ExxonMobil is providing a $285 million direct loan.

But it doesn't stop there. RasGas is also aiming to finalize a handful of condition precedents (CPs) contained in its SPA with Edison, which calls for the delivery of 3.5 million t/y of LNG starting in 2005. The gas producer will then push ahead with the EPC contract awards and financing for the 4.7 million-t/y train. The contract will be carried out by the train 3 contractor, a consortium of Chiyoda Corporation, Mitsui & Company and Snamprogetti ? its train 3 contract contained an option for train 4, which is due to be exercised in the first quarter of 2002. BNP Paribas is financial adviser for the fourth train, which is due to start up in mid-2005

Qatar LNG (Qatargas) is also now turning its attentions towards expansion ? with a fourth train. It recently signed a memorandum of understanding (MoU) with Repsol YPF and Enel for a joint feasibility study for a new train of 4.8 million t/y and to market its output. The cost will largely depend on whether Qatargas decides to install its own utilities or take electricity, water and seawater cooling from common facilities planned, and currently under development, in Ras Laffan.

As a result of both RasGas and Qatargas producing sizeable quantities of helium as a by-product of the LNG process, the two developers have opted to build a joint helium plant at the RasGas plant at an estimated cost of $50 million. The appointment of a FEED contractor is imminent

Many other gas-related developments are currently under consideration. They include an enhanced gas utilization (EGU) project, central to Qatar's industrial plans; major gas recycling projects; the infamous Dolphin project; and several GTL schemes.

The first of several planned GTL schemes is a QP joint venture with Sasol, at Ras Laffan. About six groups are expected to prequalify to bid for the EPC contract, to be awarded in September 2002. The estimated $1 billion project involves building a 34,000 barrel a day (b/d) plant to produce middle distillates. Royal Bank of Scotland is financial adviser and plant completion is set for 2005

In addition, several other potential GTL and petrochemical projects dot the future Qatari industrial landscape, making the country a source of ever more intense petroleum industry focus for years to come.