

Saudi Arabia's liquidity bounce

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Saudi Arabia is one of the largest project finance markets in the world, and probably the largest energy project finance market globally. And no other market comes close to the steady stream of consistently large projects. Saudi Arabia wants to increase its gross domestic product (GDP) and diversify its economy. It plans to do this by leveraging its vast oil and gas reserves in developing the so-called three pillars: oil and gas, petrochemicals and mining and minerals. State and quasi-state incumbents Aramco, Sabic and Ma'aden dominate their respective industries.

Up the value chain

The unlisted national oil company Aramco is a relatively rare user of project finance, restricting its use to projects where it co-sponsors with a foreign partner. Though infrequent, its projects are huge. But Aramco can squeeze banks both on structuring and pricing. When the \$8.5 billion Jubail refinery project financing was first pitched to banks in the summer of 2009, banks argued that the deal should be priced at a level higher than the Dolphin gas pipeline, which closed with debt margins of above 300bp over Libor.

However, given the pull of Aramco and co-sponsor Total almost all active international project banks, with some additions, and all local banks took part in the 16-year financing. The pricing for the international bank tranche starts at 150bp in construction, then rises to 170bp through to 190bp in operation. The long term riyal funding priced at 95bp pre-completion, and 130bp to 150bp in operation. The upfront fees were 170bp.

The low debt pricing should not disguise how challenging the risk profile was for bank credit committees. The sponsors have put up completion guarantees but there are no fixed-price contracts on either the feedstock or output, resulting in refining margin risk and volatility risk. Most banks grudgingly stumped up the cash in the hope of securing future Aramco business, such as accounts and trust work or arranging a rare corporate loan. The deal highlights the disparity between the cost of long-term riyal funding versus dollar funding and the liquidity of local banks. And although local banks are far less able to source long-term dollars cheaply, such is the pull of Aramco that at least one international bank was able to flip its participation entirely to a local bank days after financial close.

Barclays, Deutsche, JP Morgan and RBS were notable for their participation, given the lack of project lending activity in their kingdom. And conspicuous by its absence in the deal, particularly given the added pressure from the presence of French oil major Total, was BNP Paribas.

The Jubail deal is some way ahead of project finance market capabilities for Saudi Arabia. However, what Aramco can achieve on debt margins and structures may not be possible for other sponsors, even quasi-state players such as Sabic and Ma'aden. This may be particularly relevant with regard to the delayed \$995 billion Jubail project sukuk, which Deutsche Bank and Samba are set to launch soon. It is questionable whether the sukuk structure is repeatable and genuinely taps a new source of liquidity. The sukuk, the first for a greenfield project in Saudi Arabia, will refinance a \$1 billion sponsor loan. It had been delayed about concerns over Shar'iah compliance, given that it will be linked to a non-operating asset, but the delay for most of 2011 has come from the need to obtain Capital Markets Association clearance before the launch of the request for proposals.

Project Pipeline

Project name	Sector	Sponsors	Financial adviser (s)	Estimated project cost	Next milestone
Arabian Chlorovinyl (ACVC)	petrochemicals	Ma’aden, Sahara Petrochemicals	HSBC/SABB	\$750 million	Lead banks appointed, close by July
Madinah Airport PPP	transport	n/a	IFC (to grantor GACA)	\$500 million	RFP deadline 5 June
Ma’aden mine and refinery	mining/metals	Ma’aden, Alcoa	Standard Chartered, Riyadh Bank	\$3.5 billion	Bank RFP submission by 7 June
Jubail polymer compounding plant	petrochemicals	Sipchem, Hanwha Chemical	HSBC/SABB	\$800 million	Launch to banks June/July
Qurayyah IPP	power	Likely to be Acwa/Samsung/MENAC Infrastructure Fund plus SEC	Citi (to grantor SEC)	\$2.1 billion	Award due end of June. Bank club and ECAs in place. FC by end of July.
Saudi Acrylic Monomer Company	petrochemicals	Tasnee, Dow Chemicals, Sahara Petrochemical, Evonik	HSBC/SABB	\$1.5 billion	\$500m bridge in place. Long term deal to launch in Q3 or Q4 2011.
King Abdullah Economic City heavy steel	metals	Rajhi Steel	HSBC/SABB	\$4 billion	Approaching banks before 2012.
Jubail Integrated Petrochemical Complex	petrochemicals	Aramco, Dow Chemicals	RBS, Riyadh Bank	\$20 billion	ECAs approached by 2012. Bank launch in 2012.
PetroRabigh 2	petrochemicals	Aramco, Sumitomo Chemicals	SMBC, SABB	\$8-\$10 billion	Revised FEED study due. Financing launch around Q4 2012

Sukuks and shifting sands

Most of the Saudi banks are likely to take a portion of the sukuk, given that many of them had their bank debt commitments scaled back (\$13.5 billion commitments were received for an \$8.5 billion financing). Alongside the Saudi banks the General Organization of Social Insurance (GOSI) pension fund is likely to be a large participant in the sukuk, and GOSI could be a useful source of additional liquidity for future mega projects in the Kingdom.

Some market observers blame the Capital Markets Association for the lack of capital markets activity in the project sukuk space and in the wider capital markets. Like other Islamic instruments, sukuks suffer from shifting scholarly interpretations of Shar’iah compliance, and an active secondary market seems as far away as ever. Islamic finance enthusiasts often point to Malaysia as an example of a buoyant sukuk market. Its detractors suggest that the pool of private capital in that market is still shallow. “I think you have to be a little circumspect when you say that Malaysia has the deepest sukuk market going,” says one banker. “The process is to get a rated bond from the local rating agency. With a rating the state pension funds can purchase the bonds – it’s a bit of a merry-go-round.”

The developers of Saudi mega projects will need to uncover additional pools of private capital. Most believe, if the country wishes to avoid a closed loop of capital and the increasing use of state funds such as the Public Investment Fund and Saudi Industrial Development Fund or annexed local banks, the international capital markets will be a necessity.

Before ConocoPhillips’ withdrawal from the Yanbu refinery project, the Aramco/ConocoPhillips joint venture, together with their financial adviser Citi, looked at a multi-sourced financing including a 144A bond component. Both the US 144A and Eurodollar markets are very liquid but untested in the Saudi project space and their use would probably require more conservative structures to obtain the necessary credit rating to hit the right liquidity sweet spots.

But it has always been hard to persuade sponsors to stretch themselves to close a bond deal when banks are so cheap and accommodating. A sukuk might open up a new source of funding, but only if Saudi banks are able to commit more to a notionally tradable source of such as a sukuk than to a take-and-hold bank debt tranche, and they may have to mark a

sukuk holding to market. This will be difficult to judge with the market at such an embryonic stage and appetite for Aramco-backed deals is unlikely to be quantifiably different in the local market. Incremental development will likely only come from a hit to the appetite of bank lenders, whether a local-lender specific shock or the unfolding impact of the Basel 3 regulations on international banks.

Petrochemicals and mega-projects

These questions of liquidity will be brought into sharper focus with the mega-projects ahead. Dwarfing even the Jubail refinery deal will be the Aramco/Dow integrated petrochemicals plant, which has been moved from Ras Tanura to Jubail. The deal, with a project cost of around \$20 billion, will need to tap every available source of local and international financing.

Like the Jubail refinery, the petrochemical complex will lean heavily on ECAs. Jubail refinery had \$500 million in direct ECA facilities and \$2.2 billion in covered facilities from eight agencies: JBIC, NEXI, Kexim, K-Sure, Coface, Hermes, Cesce, and EDC. The ECAs were the cheapest source of funding, with upfront fees of 130bp, and a flat margin of 125bp. The financial advisers RBS and Riyadh Bank are hoping to solicit direct lending and raise a combined \$8 to \$10 billion in coverage from the major ECAs for the Aramco/Dow joint venture.

On the smaller petrochemical deals, of which there are a large number, as the kingdom seeks to move downstream to longer polymer products, the majority of the financing is expected to be closed as a mix of local bank debt, ECA debt and a smattering of international bank debt. The combined HSBC and SABB franchise has the advisory market sewn up.

First to close will probably be the Ma'aden/Sahara Petrochemical joint venture ACVC. The project will be located at a complex in Jubail owned by Sahara, in turn a 90% subsidiary of the Zamil Group. The plant will produce 250,000 tons per year (tpy) of caustic soda and 300,000 tpy of ethylene dichloride (EDC). The feedstock, ethylene, will be supplied by Saudi Ethylene and Polyethylene Co (SEPC). The caustic soda will be used in Ma'aden and Alcoa's alumina refinery in Ras Al Zour, another project in the market. The Saudi Industrial Development Fund (SIDF) has agreed to provide \$240 million to the project.

Sipchem, the second-largest petrochemical company in the kingdom behind the world's largest, Sabic, is also close to the market in a JV with Korea's Hanwha Chemical. The plant, also located in Jubail, will produce 200,000 tons of low-density polyethylene and ethylene vinyl acetate and 125,000 tons of other products. HSBC/ SABB is financial adviser and Norton Rose legal adviser to the sponsors. The deal could be launched to the market in late June.

Third up will probably be a deal for a joint venture of Tasnee, Dow Chemical, Sahara and Evonik. The group has obtained a \$500 million bridge loan to mobilise construction for its \$1.5 billion downstream acrylates complex, also at Jubail. Samba, SABB and BSF are providing the \$500 million one-year bridge loan with a long-term project financing set to launch in the third or fourth quarter of 2011. The long-term deal is still in the structuring phase but is likely to have a debt-equity split of 65:35. Two export credit agencies, Hermes and Kexim, are looking at the deal. The project company, Saudi Acrylic Monomer Company (SAMCO), has awarded its EPC contract to a consortium of Germany's Linde and Samsung Engineering for a 160,000 tpy acrylic plant and a 160,000 tpy butyl acrylate plant.

The complex will produce acrylic acid and acrylics used in the manufacture of dyes and resins, as well as a super absorbent polymer used in nappies. The complex will, like the ACVC project, receive its feedstock from the next-door SEPC plant, which is owned by Tasnee, Sahara and Basell Polyolefins. The acrylates project is scheduled to be complete by the end of 2012.

Mining creates the next resource behemoth

The buoyancy of the petrochemicals market is a reflection of Saudi Arabia's large competitive advantage over the rest of the global market: the combination of the world's lowest feedstock prices and the ability to build, finance, and expand capacity quickly. These strengths allow it to meet increasing demand from Asia and China.

Similarly, Saudi Arabia's mining and metals sector benefits from very low input costs and strong government support. It

is estimated that the Arabian Shield resource may be comparable to those available in Australia. Capitalising on these strengths is listed mining incumbent Ma'aden, which has entered into two new businesses – which will both be the source of large project financings – phosphates and aluminium.

Banks have until 7 June to submit responses to the request for proposals for the \$3.5 billion bauxite mine and alumina refinery sponsored by Ma'aden and Alcoa. However, one bank has already requested an extension, and if another bank joins it the deadline will be put back.

Although the asset differs markedly, the risk profile is very similar to the earlier \$5 billion smelter financing that closed in November 2010. Banks are likely to compete mostly on price, with few mark-ups to the term sheet. Pricing is expected to be 10-20bp tighter than on the smelter, given demand from local banks.

The debt-equity ratio is roughly 60:40, the tenor is 16 years and there is a balloon payment at maturity of around 20%, with a 30% cash sweep starting at around year eight. Ticket sizes start at \$50 million but preference will be given to those of over \$100 million.

Feedstock for the refinery will be transported by rail from a mine at Al Ba'itha, near Quiba, in the north of the country. First commercial production from smelter and mill is scheduled for early 2013 and late 2013, respectively. First production from the mine and refinery is set for early 2014.

The two projects comprise phases 2a and 2b of a \$11 billion vertically integrated aluminium complex in Saudi Arabia. But the advisers, Riyadh Bank and Standard Chartered, are bundling the projects together in a single project financing. BNP Paribas is advising Alcoa.

Elsewhere in the country's metals sector, Rajhi Steel has named HSBC financial adviser for its SR15 billion (\$4 billion) heavy steel complex in King Abdullah Economic City. The project financing should be in the bank market by the end of 2011, and after the project is complete 50% of its equity will be floated on the Saudi stock exchange. The Saudi Ministry of Petroleum and Mineral Resources has agreed that the complex will receive 70 million cubic feet per day of dry gas from Saudi Aramco.

The complex will produce 1.8 million tpy of direct reduced iron and 650,000 tpy of hot briquetted iron. There will also be a 2 million tpy melt shop which will produce 200,000 tpy of steel/stainless steel ingots and 600,000 tonnes of billet to be used in the construction of seamless pipe. The total output of the complex is scheduled to reach 2.65 million tonnes in 2016, which will include 1 million tonnes of rolling capacity to produce railway lines – the first of its kind in the kingdom.

Beyond the three pillars

Outside of the industrial sectors of oil & gas, petrochemicals and mining and metals, the power sector continues to be a source of regular project financings, with Saudi Electricity Company (SEC) arguably now the leading grantor in the region. Next up is the Qurayyah 1 independent power project (IPP). A consortium of Acwa Power International, Samsung and MENA Infrastructure Fund using Siemens turbines came out with the lowest tariff in SEC's public reading of bids for the 1,963MW project, with a bid of \$0.193 per kWh.

The consortium was recently named first-ranked bidder on the project, and is set to sign a PPA shortly. The bid is a record benchmark for the GCC region and 45% cheaper than the \$0.28 per kWh achieved by GDF Suez on Riyadh PP11, the last similarly sized gas-fired IPP in the kingdom, from December 2009.

Acwa already has bank and ECA commitments in place, although the debt amount has yet to be finalised. Standard Chartered is documentation bank, HSBC is Kexim/K-Sure co-ordinator and KfW is Hermes co-ordinator. The commercial debt is set to price at a new post-crunch low of around 150bp over Libor. The Korean ECA debt will be in the form of both direct loans and 100% covered guarantees, while Hermes is offering 95% cover. NCB and Bank Saudi Fransi are leading the Riyal-denominated facilities. Allen & Overy is providing lender counsel and Chadbourne & Parke is sponsor counsel.

The cost of long-term riyal funding compared with dollar funding has, according to bank sources, been as much as 100bp lower over the last 18 months. So perhaps the biggest financing issue for IPPs is to what extent sponsors can keep

international bank participation to a minimum, or whether they are required at all. Access to dollar funding and the inability to hedge interest rates on riyals beyond 10 years will mean that an all-local bank deal is unlikely any time soon. These shortcomings, more than due diligence skills, probably explain the persistent presence of international banks best.

After Qurayyah 1 has reached financial close, SEC will immediately tender the 1,800MW Qurayyah 2 and then the 1,600MW Dheba IPP on the north-west Red Sea coast.

Outside of SEC's pipeline, Aramco is exploring build-operate-and-transfer (BOT) concessions for its power and steam projects, and will make for a highly desirable project offtaker. Aramco currently generates 2GW of generating power internally, plans to reach 4GW by 2015, 8GW by 2020, and has retained HSBC/SABB to advise on the pipeline. Aramco has cogeneration plants in Abqaiq, Berri, Uthmaniyah, Qatif, Riyadh, Yanbu, Jeddah, Shaybah, Juaymah, Shedgum and Ras Tanura. It plans to set up a separate company, Powerco, to run its power assets with the aim of being the most efficient operator in the world. It wants to reach a 75% efficiency saving on gas and oil, against an OECD average of 39%.

Beyond power, local banks can look forward to the financing of Madinah airport, though the traffic risk is too difficult for international banks to absorb. The deadline for submissions under the airport's request for proposals is 5 June. Eight bidders are short-listed for the project, but between three and five are expected to submit bids. The bidders comprise: Airports Company South Africa, a YDA-led group, BADR consortium, a Saudi Binladin-led group, the Saudi Airplex consortium, a Limak Investment-led group, the TIBAH consortium and a Saudi-Malaysian consortium.

The project is a brownfield expansion that will involve the building of a new terminal and possibly upgrading the runway. The expansion will be phased, with a first phase capable of handling eight million passengers per year, and a second phase 14 million passengers per year. Given that the Jeddah airport Hajj terminal had a cost of \$325 million for a 9 million-passengers-per-year terminal the cost of the first phase of the Madinah Airport terminal is likely to be around \$500 million.

Beyond the above projects, there are a number of residual pickings for project sponsors and local banks. There are likely to be a number of smaller project financings of around \$100 million in the wastewater sector, following the privatisation of water, sewerage and associated network services around the major industrial cities to National Water Company. The wastewater model could provide a template for further use of project financing in the social infrastructure and transport sector, with a privatisation first then a series of concessions. However, at least one active adviser questions the time it takes to deliver new infrastructure using such a method because it involves a protracted path to an IPO.

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