DEAL ANALYSIS: SULB

08/05/2012

On 28 March, United Steel Company (SULB) closed a $1.08 billion financing for the construction of a steel production complex in the Hidd industrial region in Bahrain. SULB is a joint venture between Foulath, the holding company for several sovereign investors including the Gulf Investment Corporation (GIC) and the Japanese steelmaker Yamato Koygo.

The 1.3 million square metre steel plant will comprise a direct reduction iron ore (DRI) plant with a nameplate capacity of 1.5 million tonnes per year (mtpy) and design capacity of 1.8 mtpy, a melt shop with nameplate capacity of 800,000 tpy and design capacity of 1.2 million tpy, and a heavy section rolling mill with nameplate capacity of 600,000 tpy and design capacity of 1 million tpy that will produce medium to large H-beams. Construction on the new facility has already started and is expected to be completed by 2014.

The deal is significant because it will complement several other steel production facilities in the Hidd region, which will mean that once constructed, it will form a part of the Middle Easts first ever fully integrated steel production facility, with manufacturing capability extending from iron ore pelletising through to final production. It is also the first ECA-based financing to close in Bahrain since the $1.55 billion financing backing Aluminium Bahrains expansion in 2003, and closed despite significant political turmoil in the country.

The deal is the culmination of an investment process that started in 1984, when the GIC commissioned one of the first ever pelletising plants in the region, Gulf Industrial Investment Co (GIIC). Over the years various associated industries have been established in the region as offshoots of GIIC, including most recently in 2005 United Stainless Steel Company (USCO), a producer of flat stainless steel products.

But, GIIC has typically exported most of the 11 million of direct reduction grade iron oxide pellets that it produces annually to neighbouring Arab states, including Saudi Arabia and Qatar and as far afield as Malaysia and Indonesia, to be used in direct production to produce steel. SULB, once constructed, will use the feedstock from the neighbouring GIIC plant.

This was a large part of Yamatos decision-making when it was searching for its next offshore joint venture. Although steel prices have remained flat globally since the middle of last year, rebar consumption remains high in GCC states because of a persistent construction boom. The Middle East is currently a net importer, and the new plant will replace roughly 20% of the 4 million tonnes of annual imports into the region.

The sponsors formally approached banks to assess their interest in lending to the project in 2010. At the beginning, the sponsors were said to be prefer a project finance deal and held talks with Mizuho and SMBC about lending long-term, without any ECA cover. However, the absence of any long-term offtake contracts and the volatility in international steel prices meant that a pure project finance route was always going to be difficult.

The sponsors settled in the end on a hybrid between a project financing and a corporate export financing because the structure offered advantages in tenor and pricing. The bank facilities benefit from a standard security package for a project finance transaction, but also from sponsor guarantees, not only until completion but also a full guarantee until the final repayment of the four separate bank facilities.

The deal closed on 28 March through $373 million in long-term debt, split equally between the two mandated lead arrangers, BNP Paribas and Societe Generale, as four separate tranches. The two banks are providing $104 million in debt with a tenor of 10 years plus construction, guaranteed by Hermes and then $159 million and $70 million, both of which also have a legal maturity of 12 years and are guaranteed by K-Sure and SERV respectively.

The appearance of SERV, the Swiss export risk insurer, was facilitated by SMS Concasts role as equipment supplier but is still unusual for Middle Eastern deals. The sponsors held preliminary discussions with both JBIC and Nexi because Kobe Steel is supplying equipment to the project, but are understood to have preferred the terms on offer from the two European and Korean ECAs instead.

The three ECAs are providing banks with 95% political risk and 95% commercial risk insurance. The debt is then rounded off with a $40 million 7-year uncovered term

loan, the proceeds of which will be used to cover some project costs that are not eligible for ECA cover, such as fees. The debt is fully amortising and will be repaid every six months after construction is completed. The financing is also understood to feature cash sweeps that kick in two years after completion.

Both the uncovered and covered facilities rank pari passu in the cash flow waterfall. The sponsors are also providing around $705 million in equity, which was designed to give the project sufficiently low leverage to attract international bank support and fund the first phase of construction before a project facility could be agreed.

The main facility documents were signed on 30 September, but it took an additional 6 months before the deal finally closed. The banks executed the deal through their Paris offices and needed the additional time to get comfortable with the local laws and regulations governing the security arrangement. The structure of the documentation is becoming more unusual on ECA-backed deals, because it features separate facility agreements for each of the four tranches along with an umbrella common terms agreement.

SULB
STATUS: Signed 30 September 2011, financial close 28 March 2012
SIZE: $1.08 billion
DESCRIPTION: Financing for the construction of a steel plant in the Hidd industrial region of Bahrain
SPONSORS: Foulath (51%), Yamato Kogyo (49%)
MLAS: BNP Paribas, Societe Generale
ECAS: Hermes, K-Sure, SERV
SPONSORS LEGAL ADVISER: Baker & McKenzie
LENDERS LEGAL ADVISER: Clifford Chance
SPONSORS LOCAL COUNSEL: Hassan Radhi & Associates
LENDERS LOCAL COUNSEL: Qays H. Zubi
EPC CONTRACTOR: Samsung Engineering Corp