Latin American Midstream Oil & Gas Deal of the Year 2012: Tarahumara Pipeline

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Financial equity providers have made little progress in Mexicos midstream oil and gas sector. With the exception of oil services, upstream remains the preserve of state oil company Pemex. But in toll roads, airports, conventional power and renewables, listed and unlisted infrastructure funds have made considerable progress.

The financing for the 549km Chihuahua pipeline features a financial equity provider, and suggests that with careful structuring such sponsors can compete with deep-pocketed strategic sponsors even on greenfield assets. It also reinforces the position of the Comision Federal de Eletricidad, Mexicos state power company, as the best source of oil and gas financings in Mexico.

The pipeline developer is Fermaca, a domestic oil and gas operator, and one of the few local sponsors with a pipeline presence. The biggest non-Pemex players in Mexican midstream are TransCanada, a long-standing player, and Sempra, which bought El Paso Corporations Mexican midstream assets in 2010. French, Spanish, Japanese and Korean sponsors make more fleeting appearances.

Gasoducto de Chihuahua, a Sempra acquisition from El Paso, was originally set to be the vehicle for the construction of a pipeline. Fermaca, which began acquiring rights-of-way options for a pipeline in 2007, persuaded the CFE to put the pipeline up for bid.

The bidding documents specified a start and finish point, and contractual capacities, but left the route to bidders. Fermacas bid benefited from the early-stage work in acquiring rights of way, a level of preparedness that the countrys toll road developers would be wise to copy.

The pipeline has a planned capacity, without any compression, of 850 million cubic feet per day, and will account for a big proportion of Mexicos 5 billion cubic feet per day national consumption. The line will bring gas from the US border at Ciudad Juarez/El Paso to Encino, Chihuahua, where it joins the Chihuahua-Torreón pipeline.

In El Paso, the pipeline will connect with existing infrastructure owned by El Paso Natural Gas company (now part of Kinder Morgan), which is also building a 450km Norte Crossing pipeline to serve Tarahumara. MGI Supply, a subsidiary of Pemex, is the sole customer for the new crossing section.

Fermaca had explored a joint venture with Samsung for the Chihuahua pipeline, which would have given the developer access to long-dated Korean export financing. But Fermacas engineering, procurement and construction contract for the pipeline, with a joint venture of Italys SICIM and Mexican firm GDI, was much cheaper than the Samsung equivalent. Samsungs enthusiasm for an equity stake faded along with its chances of the EPC business.

The developer turned to Ospraie Management, a New York-based hedge fund manager, to meet its equity requirement. Ospraie had helped fund Fermacas buy-out of Occidental from the Toluca pipeline in 2007. The subsidiary that Fermaca setup to operate the Toluca pipeline, Tejas Gas de Toluca, will operate the Chihuahua pipeline. The Ospraie Special Opportunities Fund owns portfolio company Fermaca Global, which in turn owns project company Tarahumara Pipeline.

Fermaca and Ospraie lack the large balance sheets of strategic pipeline operators, and the eventual financing for the pipeline had to include enhancements that would mimic the contingent equity support of a large strategic developer. Fermaca put up its development fee as contingent equity, with debt proceeds paying this out over time as the project meets construction, operational and financial milestones. The financial also benefits from commitments from outside equity funds structured as letters of credit.

The sponsors assembled a club of lenders behind the project incrementally, with ING, and then Crédit Agricole, among the earliest supporters. Banamex, Banobras, BTMU, Nafinsa and Scotiabank, joined the two initial banks as lead arrangers on the $378 million loan, with the two state-owned lenders highlighting the projects domestic support.

The debt has a seven-year loan, a 20-year amortisation profile, and interest rate hedging that also goes out beyond the term of the debt. Despite the long-dated swaps, the debt, which features starting pricing of 350bp over Libor, is likely to be a solid candidate for a capital markets refinancing if it enters operations as planned.

The CFE will eventually require all of the capacity on the pipeline to meet the needs of both its own fleet and independent power projects, which run on CFE-supplied gas, such as the Norte II plant. The sponsors will be encouraged to market the gas that CFE does not require in the early years of its 25-year transportation services contract to third parties such as industrial users. But the Chihuahua pipeline will be crucial to CFEs plans to bulk up its midstream network. One of the four new pipelines that it recently bid out (Sempra won two, and TransCanada the other two) will connect to it.

Fermacas early work developing the pipeline paid off. One of the most important conditions precedent to funding on the deal was the pipeline gaining control of 80% of its required rights of way. After signing in April, the deal closed on 25 May 2012. The deal is structured to allow for an exit by the sponsors, though banks will also be concerned to see that the project remains in the hands of a competent and committed sponsor. A listed infrastructure equity fund, or CCD, may be an obvious exit route for the two sponsors.

Tarahumara Pipeline S de RL de CV
Status
Closed 25 May 2012
Size
$472 million
Description
540km, 850 million cubic feet per day pipeline running through the Mexican state of Chihuahua
Offtaker
Comision Federal de Electricidad
Sponsors
Fermaca Global, Ospraie Management
Debt
$378 million
Lead arrangers
Banamex, Banobras, BTMU, Crédit Agricole, ING, Nafinsa and Scotiabank
Sponsors legal counsel
Latham & Watkins (international), Haynes and Boone (Mexican)
Lenders legal counsel
Milbank Tweed (international), Galicia Abogados (local)
Independent engineer
Shaw Group
Insurance adviser
Moore-McNeil