

Asia-Pacific Mining & Metals Deal of the Year 2012: POSCO Krakatau

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A joint venture between state-run Indonesian metals company Krakatau Steel and South Korean developer POSCO closed a \$1.729 billion steel mill financing in February 2012. The debt supports the construction of the largest fully integrated steel plant in Southeast Asia. The financing consists of long-term commercial bank debt backed by export credit guarantees, and benefits from heavy sponsor support. The plant will be vital to Indonesias infrastructure plans over the next decade.

Indonesia has a significant steel supply deficit. The country needs 8-9 million tonnes of steel each year to meet its infrastructure demands but local producers supply only around five million tonnes. The Krakatau POSCO joint venture, with the South Korean sponsor holding 70% equity and the local developer controlling the remaining 30%, was formed to help plug this gap. POSCO and Krakatau Steel had initially pledged to invest \$6 billion to construct a number of steel mills in the country, and have recently suggested that this might eventually rise to \$11 billion.

POSCO is the worlds sixth-largest steelmaker in terms of crude production capacity of steel, and currently operates two integrated steel mills in South Korea. Krakatau Steel is majority owned by the Indonesian state, with the remaining 20% of its share capital listed on the Indonesian stock exchange.

The first phase of the joint venture will involve building a plant with a capacity of three million metric tonnes per year of steel slabs, which can be processed into 1.5 million tonnes of steel plate per year, and other products such as hot rolled coil. The plant is located in Cilegon, a major coastal city in Banten province, close to an existing Krakatau Steel factory and blast furnace. The sponsors intend for the plant to eventually produce shipbuilding plates of different grades and specifications, marine construction plates and other products that are not currently manufactured in the country.

Indonesia has the largest economy in the region but saw its growth slow to 6.2% in 2012 due to a fall in exports. Last year also saw the country post its first-ever trade deficit as domestic consumption grew. Investment in manufacturing is part of the governments long-term economic policy, with Krakatau POSCO a big component of its strategy. The government has also put in place compulsory purchase regulations, which should remove one of the bigger obstacles facing projects in the country.

The sponsors retained Standard Chartered as financial adviser for the Krakatau POSCO project in January 2011. At first, the sponsors considered a multi-sourced export credit agency (ECA) financing structure, but decided that it would be undesirable to source significant amounts of equipment from Europe. They were assembling the deal during the height of the Eurozone crisis, leading the project company to turn away from European ECAs and towards an Asian ECA-covered debt structure.

ANZ, BTMU, Credit Suisse, HSBC, Mizuho and Standard Chartered were lead arrangers on the deal, which covered around 65% of the total project costs. The financing comprises \$931 million of equity, a \$529 million K-Sure covered tranche, a \$500 million Kexim-covered facility and a \$700 million Kexim direct loan. The tenor on all the debt is 13 years

and 10 months. At the time the deal closed, it was the largest single overseas commitment by Kexim.

Krakatau Steel will buy about 1 million metric tonnes of steel slabs from the unit each year. POSCO will take some of the remaining output and the project will sell any surplus to other end users such as shipbuilders, though no formal offtake agreements have been confirmed. POSCO is supplying the feedstock for the plant from its mining operations.

POSCO has recently expressed concern over a rival joint venture signed by Krakatau Steel with Japanese companies Nippon Steel and Sumitomo Metal Corporation (NSSMC). The NSSMC plant will also be based in Cilegon, near Krakatau Steels existing units. The new joint venture will look to produce items such as cold rolled coil and galvanised CRC, high-grade products that can generate greater profit margins than the Krakatau POSCO products. POSCO received news of the rival venture before it signed, and is understood to have protested the proposed \$378 million NSSMC development.

Japan and South Korea have a long-established rivalry in business, which explains POSCOs objections; POSCO probably is concerned that the NSSMC deal will eat into the projected profits of its own venture. But the high demand for steel in Indonesia may mean this risk is minimal. Moreover, the Indonesian government views Krakatau POSCO as a vital project. The sponsors are also providing some guarantees of the debt, though these are several, and in proportion to their equity stakes, rather than joint.

POSCO Krakatau

STATUS

Financial close

14 February 2012

SIZE

\$2.66 billion

DESCRIPTION

Construction of Southeast Asias largest integrated steel mill located in Cilegon, Indonesia.

SPONSORS

POSCO, Krakatau Steel

DEBT

\$1.729 billion

EQUITY

\$931 million

LENDERS

Standard Chartered, ANZ, BTMU, Credit Suisse, HSBC, Mizuho, SMBC

ECAs

KEXIM, K-Sure

SPONSORS FINANCIAL ADVISER

Standard Chartered

LENDERS LEGAL COUNSEL

Allen & Overy

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