Full steam ahead on Saudi IWPPs

Luke McLeod-Roberts

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When Saudi Arabia's Water and Electricity Company (WEC) announced its intention to launch tenders for what would be the world's greatest IWPP, there were some who doubted whether the project would get off the ground

And the scepticism wasn't totally unwarranted given demanding legal issues and problems around enforceability which could have kept lenders away, while the price tag on the project - US$2.5bn - might have left some wondering whether there was sufficient liquidity in the market to absorb the cost.

But now that Shuaibah has closed - and in record time for a major project finance deal in the region, going from PB to FC in less than seven months - the participation of multiple types of lending institutions, innovation on the contractural aspects and the sheer scale of the deal have meant that it has come to be considered a blueprint for future projects, helped increase confidence among investors and convinced observers that Saudi mega-IWPPs are more than just a pipedream.

This case study explains why a pipeline of deals is guaranteed and shows what projects are on the books.

Background

WEC launched RFPs for Shuaibah, an IWPP with 900MW of generation capacity and the potential to process 880,000 cubic metres of water/day, on 31 July 2004. This is the third unit at the Shuaibah complex 120km south of Jeddah on the Red Sea coast.

The tender had been expected earlier, but the desire by the financial advisers to secure key credit support from the ministry of finance before proceeding caused a slight delay.

Three consortia were shortlisted bidders:

- one led by IP and including Saudi Oger, Mitsui, Sumitomo and Xenel
- another headed by Trachtebel with the Bugshan Group
- a third one of ACWA Power, Khazanah Nasional Berhad, Malakoff Berhad and Tenaga Nasional Berhad

But both IP and Trachtebel pulled out prior to the final submission date, leaving WEC with just one envelope to open in an elaborate ceremony - that of the Saudi/Malay venture.

Fortunately for the parties concerned that was considered to be a highly competitive bid and the significant Saudi component was attractive to the government.

The Malay firms were motivated in their bid by three issues: appetite for new opportunities outside of their domestic market, the desire to get in on projects with significant Islamic tranches (Adrian Creed at Trowers & Hamlins cites a 'battle' between London, Bahrain and Kuala Lumpur over the rightful home of Islamic finance), as well as the reduced problems which the Malays find sourcing staff to work in Saudi due to security considerations in comparison with their U.S. counterparts.

Although there had been precedents in the Saudi power project finance sector - the US$645m Tihama co-generation project developed by Aramco had secured US$510m in external financing - prior to Shuaibah there had never been anything of comparable size or with a sovereign guarantee.

Still, Tihama was important in its own right, given that all the lead arrangers were Saudi banks, showing that 'local banks could manage on their own without international banks looking over their shoulders,' according to John Dewar, partner at Milbank.

Legal hurdles

'Its quite a tough jurisdiction, not the most friendly one you could imagine, there are problems of enforceability, of interest payments and of documentation.'
A legal source involved in deals in Saudi.

The key problems facing foreign investors on this deal were those of enforceability of the project agreements - with all matters being dealt with under Sharia courts, in contrast to other GCC countries where special commercial courts operate - and that of security on the collateral. The latter was a particular headache for the ECAs, which act within the constraints of tight public policy frameworks.

Legal teams worked hard to devise ways in which these problems could be overcome as quickly as possible.

The parties agreed that certain aspects of the deal would be covered under offshore agreements, while a joint stock company was set up by WEC and then the shares were transferred to the foreign investors involved.

The financing

A strong Islamic financing tranche on Shuaibah was both the result of a preference of the sponsors for such a structure, as well as being a function of the project's magnitude - US$2.5bn total value, of which US$1.96bn is debt. Figures like that need a wide pool of financing.

The funds were split into three tranches - a US$947m international commercial facility, a US$210m Islamic facility and a US$855m ECA facility.

The commercial banks offered some pretty aggressive pricing, margins of 115bps rising to 170 over the tenor and the Islamic banks followed suit, effectively offering the same pricing as their commercial counterparts (officially it is a margin 22bps higher, but that it to take into consideration that they are not allow the same fees upfront because of local law).

The entry of the local banks in full force into the national project finance power market is an interesting development in itself - the reliance on different asset bases had meant that they had traditionally played more in the trade finance and short-term markets, so seeing them take on 20-year tenors was quite a radical step.

This was the first deal which united both ECAs and Islamic banks in a single transaction. And the presence of the traditionally cautious ECAs is likely to increase investor confidence in the market.

Implications for the Saudi power and water market

Since Shuaibah closed there has been much talk from the veritable army of advisers working on the deal about how it has been a landmark transaction in the sector and this is more than just mutual back-slapping, Shuaibah really has set a precedent for the Saudi water and power market.

Firstly, the elaboration of a set of legal documents which provide ample security for investor interests means that the 'dirty work' in this area has now been done. Future IWPPs in the country - and there will be at least two a year (either new-builds or upgrades and tenders of state plants) - will have a robust template in place, shortening the time which will need to be spent on this aspect of the paperwork and freeing up energy to work on the EPC and O & M contracts.

Secondly, in bringing in ECAs, Shuaibah has increased confidence in the market (which has always had a pretty low rate of default anyway) and shows that the appetite for investment is high, while cooperation between these agencies and Islamic banks has shown that multiple financing options are available for mega-projects in the country.

Four major IWPPs, two of which are around the 2,500MW mark, are due to be bid for this year. This makes quite a change from the situation before Shuaibah was tendered. One of the IWPPs which is expecting bids in May, the Marafiq US$3.5bn project at Jubail, had previously been up for tender at the same time as Shuaibah, but WEC suspended the project when bids were on the verge of being presented.

A source who was active in Saudi at the time has told *IJ News* that they think that was the right decision at the time: 'Shuabiah was oversubscribed but not sufficiently to cover Marafiq as well, that would have been a particular problem towards the end of the financial year.'

Clearly perceptions have changed somewhat since then and those eager to invest in the country have the success of Shuaibah to thank for that.

That is not to say that all is rosy for project finance in the Saudi power market, given that it is still a relatively young child.

Not all aspects of the deal could be covered via offshore agreements and as one source said: 'One is always looking over the shoulder to see what the board of grievances decide.'

Gharrah (uncertain) is the watchword which lenders will be keeping their ears pricked open for and what, paradoxically, the market needs is for issues to emerge which require Saudi arbitration.

Once the courts rule in favour of the foreign investors then banks hoping to get in on future deals will be able to present this favourable precedent before their credit committees and with it the Saudi market will have been deemed to have come of age.

Overview of deals coming up

Four major IWPPs will have been closed by this time next year. In addition Shuaibah units 1 and 2 are to be tendered in the near future.

Project	Capacity	Value	Status
Shuqaiq	850MW 212,000cum/day	US$1.25bn	13 teams are prequalified and are being asked to bid by July 30th
Ras al-Zour IWPP - phase 1	2,500MW 800,000cum/day	US$3 bn	EoI expected to be requested Q2 2006, water content could be increased if Jubail 3 is cancelled. HSBC is advising.
Jubail IWPP - phase 3	1,100MW, 340,000cum/day	US$1.4bn	EoI expected by Q3 2006 but may be pushed back depending on Marafiq
Marafiq IWPP	2,500 MW and 795,000cum/day	US$3.5 bn	Bids due May Declared a scheme of national importance with Ministry of Finance guarantee

To top it all off, the Saudi government is receiving counsel on how to proceed with possible privatisation options of SWCC - the Saline Water Conversion Company - estimated to have a replacement value of some US$12-13bn. The initial report from the consultants has just been submitted and we could expect to see a deal any time between December of this year and March 2007.

IJ has information that the most likely path it will take is for the 30 plants that form part of the company's portfolio to be tendered as IWPPs following the Abu Dhabi model - an IPO is not as attractive as proceeds would just go straight back into investment in the infrastructure - while the 3,000km of water piping will be retained by the government, but receive capitalisation from the market.

Then there's the RFPs for the advisory mandates on the privatisation of the regional water distribution company in Riyadh, for which two major international law firms have been shortlisted, to be followed soon by that of the city of Jeddah.

Shuaibah at a glance

Project Name	Shuaibah IWPP
Location	120km south of the city of Jeddah, Saudi Arabia
Description	900MW and 880,000 cubic metres of water/day
Sponsors	SAMAWEC
Operator	Joint Venture: SWEC - Saudi-Malaysia Water & Electricity Company (indirectly owned by ACWA Power, Khazanah Nasional Berhad, Malakoff Berhad and Tenaga Nasional Berhad) (60 per cent) Public Investment Fund (32 per cent) and SEC (8 per cent)
EPC Contractor	Siemens and Doosan Heavy
Project Duration (Including construction)	3.5 years
Construction Stage	20 years post-completion
PPA	20-year PPA to Water and Electricity Company (WEC)
Total Project Value	US$2.5 billion
Total equity	US$530m
Equity Breakdown	US$530m equity bridge loan (GIB and Mizuho split 70:30)
Total senior debt	US$1.96bn
Senior debt breakdown	US$947m commercial US$210m Islamic and US$855m ECA tranches
Debt pricing	Commercial and Islamic Tranches 115bps to 170bps ECAs -KEXIM 20bps HERMES 45bps
Debt:equity ratio	80:20
Mandated lead arrangers	ABN AMRO Arab Bank Saudi Hollandi Riyadh
Participant banks	ABC, Arab National Bank, Apicorp, Bayerische Landesbank, Bumiputra, HSBC/Saudi British, HSH Nordbank, KBC, Mashreqbank, Mizuho, Natexis, National Bank of Bahrain, NordLB, RHB, Samba, Saudi Fransi, Saudi Hollandi, SG, Standard Chartered, SMBC, WestLB, Woori
Control account details	DSRA
Legal Advisers to sponsor	Trowers & Hamlins Allen & Overy
Financial Adviser to sponsor	Standard Chartered
Technical Adviser to sponsor	ILS
Legal Adviser to banks	Milbank Tweed Hadley & McCloy
Tecnical Adviser to banks	Black & Veatch
Legal Adviser to government	Clifford Chance, Al Jadaan
Financial Adviser to government	HSBC
Technical Adviser to government	Fichtner
Date of financial close	21 December 2005