Brunei Methanol - Brunei's first project financing

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Mitsubishi Gas Chemical (MGC), Itochu and PetroleumBRUNEI's US$360 million financing for their Brunei Methanol project is the first international limited recourse financing ever to take place in the rich Asian Sultanate - and should set a precedent for future deals there

The financing is paying for the construction of an 850,000 tonne per year methanol manufacturing plant to supply the growing Asian market (and Japan in particular), at a time when several other methanol facilities worldwide are struggling with production problems.

Japanese involvement is extensive, with MGC and Itochu providing 75 per cent of the equity, Mitsubishi Heavy Industries (MHI) handling the engineering, procurement and construction (EPC) and three of the four commercial bank lenders coming from Japan.

The deal's importance to Japanese government policy can also be seen from the US$252 million slug of debt put up by the Japan Bank for International Cooperation (JBIC) - accounting for 70 per cent of the total debt raised for the project.

From Brunei's point of view, the plant can be seen as a first step in the country's efforts to diversify its economy and build up its industrial base - with a focus on the natural resources that has already made it so rich. Project finance should play a large part - and a Japanese flavour looks more than likely given the efforts it has put in for and alongside this transaction, plus the historic relationship there.

The project

MGC, Itochu and state-owned PB Petrochemical (a subsidiary of state-owned PETROLEUMBrunei) established the Brunei Methanol Company (BMC) project company in March 2006, with the following shareholdings:

- MGC (50 per cent)
- Itochu (25 per cent)
- PB Petrochemical (25 per cent)

After feasibility studies a final investment decision was made a year later in April 2007 and then financial close was reached on 5 May.

The plant will be located on a 16 hectare plot in the 271 hectare Sungai Liang Industrial Park zone, which Brunei wants to turn into a world-class centre for oil and gas-based industries. It will use the Mitsubishi Methanol Process technology jointly owned by MGC and MHI, which has already been deployed for similarly-sized plants at Jubail in Saudi Arabia and

Jose in Venezuela.

A local authority called the Brunei Economic Development Board (BEDB) has been driving force for the development of Sungai Liang. BEDB's role is to attract foreign investment and thereby stimulate the growth, expansion and development of the economy - and its focus has been on the preparation and development of industrial sites and facilities for priority industries. This includes the development of Sungai Liang and another site called Pulau Muara Besar.

UK-based engineering consultancy Halcrow put together the master plan for Sungai Liang on behalf of the BEDB. Tim Catchpole, one of three project managers from Halcrow working this, says: 'There was a need for a master plan for a site next to the existing LNG plant that has its own jetty. It is part of the thinking of the Brunei government to expand its interests and diversify its economy and introduce further heavy industry with view to further downstream development.

'The heavy industries that showed interest were methanol and ammonia/urea [via a consortium including Mitsubishi and Australian firms WestSide and Incitec Pivot]. There was also interest in an aluminium smelter, but as it turned out there was not enough room on the site for this.'

But the idea for an industrial park and methanol plant within it goes back much further, as pointed out by Tomonori Miyagawa, who handled the structuring for project financial adviser Bank of Tokyo-Mitsubishi UFJ from Tokyo.

Miyagawa says: 'The initial plan of the Brunei Methanol Project started from 1992, when MGC and Itochu submitted a methanol project proposal in response to a request from Brunei government for oil and gas downstream planning. Through a re-planning stage [launched in 2003], the government selected the MGC/Itochu methanol project as a possible downstream project in August 2004, and MGC, Itochu and PB executed a joint venture agreement in November 2005.'

With capacity at 850,000 tonnes per year, construction costs are estimated at US$400 million. Total project costs including financing are around US$550 million.

The project will benefit from a favourable tax regime in Brunei including no sales, payroll, manufacturing or export tax. It will also get low cost gas for 21 years from Brunei Shell Petroleum (BSP), a 50-50 joint venture between Royal Dutch Shell and PETROLEUMBrunei.

MGC is sole offtaker, and will own the plant with Itochu and PB under a 20 year build-own-operate-transfer (BOOT) concession with the government.

Why methanol?

Methanol, with the chemical formula CH3OH, is the most basic type of alcohol and is produced commercially in a three-stage process from natural gas (methane) and steam. Its most widespread use is as an industrial chemical, for the production of formaldehyde, acetic acid, solvents and antifreeze amongst other things, though it is also used as a fuel for gas turbines, engines and new fuel cell technologies.

Demand has been increasing at around 3 per cent per year, with Asia (and China especially) leading the charge.

Matthew Bubb, a partner for the sponsors' legal adviser Ashurst, says: 'I believe that the drivers were primarily twofold. From the Brunei side, there was a desire to diversify the manufacturing and export base and increase the value add on their gas reserves, while from the Japanese sponsor side, there was a desire to source methanol from another stable, long-term supplier.

'Japan is 100 per cent reliant on methanol imports and projects and increase in demand for methanol in future years. As Brunei has been a long-term, reliable suppler of LNG to Japan for many years, I imagine that there was a high degree of comfort in having Brunei as a methanol supplier as well.'

Japan's strategic interests were paramount in getting the project off the drawing board, as is shown in the large proportion of funding put up by the Japanese government via JBIC. In a statement submitted to IJ, JBIC said: 'This project enables Japan to secure long-term methanol off-take contract which contributes Japan's energy source diversification and energy security', adding that the overall rationale from its point of view was:

- To support Japan's energy diversification
- To support Japan's stable energy security
- To support Japanese companies business
- To further improve relationships with resource rich countries like Brunei

As for why the parties went for a methanol project rathern than another LNG plant for example, Miyagawa focuses on the Brunei government priorities as follows:

- Job creation - 120 to 130 direct jobs. Indirect jobs will also be created in supporting enterprises and spin-off industries
- Human resources development - the investors intend to have the plant operating independently as soon as able with the bulk of the technology transferred to local staff within 1½ years of operation
- Economic diversification from spin-off industries - a wide variety of spin-offs, namely from the production of methanol derivatives, is possible, including the manufacture of dimethyl ether (DME), formaldehyde, acetic acid and methylamines.

Financing

The financing was composed of two tranches with tenors unconfirmed but said to be 'very long term' and said to be around 15 years based on the concession agreement and gas sales contact with Brunei Shell Petroleum. The two tranches are:

- A US$252 million JBIC tranche
- A US$108 million commercial bank tranche

The commercial bank lenders are:

- Bank of Tokyo-Mitsubishi UFJ (also financial adviser)
- Mizuho
- SMBC
- Standard Chartered

There are no plans for a general syndication, though bank interest was high so could be some parcelling out further down the line. There is also space for an expansion project on site which could bring in other interested parties.

A White & Case Hong Kong team led by Matthias Schemuth advised the lenders including JBIC on the deal, while Ashurst (led by Matthew Bubb in Singapore) advised the sponsors.

Bubb says: 'Financing was completed on a fast track basis - first draft of the term sheet was released in late February and core financing documents were agreed by the end of April (for a signing on 5 May in Brunei). This was an aggressive time line for any project financing of this magnitude but all the more impressive when you consider that this was the first international project financing in Brunei.'

Conclusions: ties that bind

The strong relationship between Japan as consumer and resource-rich Brunei as producer was clearly a key determinant in getting Brunei Methanol off the ground and to financial close.

Japan already had a significant and long-standing interest in the Sultanate via Mitsubishi's leading role in the Brunei LNG liquefaction plant situated next door to Sungai Liang. This 6.7 million tonne per year facility has been operational since the 1970s and currently supplies around 10 per cent of Japan's LNG imports via major utilities Tokyo Gas, Tokyo Electric and Osaka Gas.

But alongside this deal the Japan government put in a lot of extra-curricular effort to build its relationship with Brunei. JBIC clearly played a major role here, and not just through providing more than half of the construction costs.

Japan's motives for building such a close relationship are clear - for it is almost completely reliant on energy imports, and it has no intention of letting demand from the other rapidly-growing economies of Asia endanger its security of supply. Brunei is already a close partner, and the Sultanate's disputes with China over territorial waters in the South China Sea further favour the Japanese geopolitical position.

In terms of deals, Brunei Methanol looks likely to be the first of several project financings in the country as it looks to build up its industrial base.

Bubb says: 'There is clear support from the Brunei government to diversify Brunei's industrial base, for example though the investment in and development of the Sungai Liang Industrial Park and the offering of various incentives to foreign investors.

'The government has been actively seeking downstream projects for Brunei and in that sense the investment climate being created is very positive. That said, the financing was still challenging to put together, principally because of the pathfinder nature of the project - everything we were doing was being done for the first time in Brunei, so there was a learning curve (at times a steep one) for all involved, particularly in understanding and appreciating the requirements of international financiers.

However, the Bruneians are keen to use project financing techniques to further develop downstream and other projects in Brunei. For example, JBIC has held project finance workshops on Brunei to support the government's efforts at capacity building, and I am sure that the experience gained from this financing will prove invaluable in the financing of future projects.'

The project at a glance

Project Name	Brunei Methanol
Location	Sungai Liang Industrial Park, Brunei Darussalam
Description	An 850,000 tonne per year methanol plant in the Sultanate of Brunei
Sponsors	Mitsubishi Gas Chemical (50 per cent) PB Petrochemical (25 per cent) Itochu (25 per cent)
Operator	The Brunei Methanol Company Sdn Bhd (BMC)
EPC Contractor	Mitsubishi Heavy Industries
Project Duration (Including construction)	approx. 15 years
Construction Stage	3 years
Long-term Gas Sales Agreement	Brunei Shell Petroleum Company
Total Project Value	US$550 million
Total equity	US$190 million
Equity Breakdown	Mitsubishi Gas Chemical - US$95 million PB Petrochemical - US$47.5 million Itochu - US$47.5 million
Total senior debt	US$360 million
Senior debt pricing	N/A

Debt:equity ratio	65:35
Agency loans	Japan Bank for International Cooperation (US$250 million)
Mandated lead arrangers	Bank of Tokyo-Mitsubishi UFJ Mizuho SMBC Standard Chartered
Legal Adviser to sponsor	Ashurst
Financial Adviser to sponsor	Bank of Tokyo-Mitsubishi UFJ
Legal adviser to banks	White & Case
Technical and commercial adviser to government	Halcrow
Date of financial close	5 May