Yemen LNG

Leigh Elston

11/12/2008

The landmark US$3.7 billion Yemen LNG plant in the port of Balhaf closed on the 19 May 2008 - representing not only the largest ever limited recourse financing, but also the largest project of any kind in the country.

The plant, which has a capacity of 6.7mtpa, will be developed on a build-own-operate (BOO) basis and will source gas extracted from fields in the Marib region of central Yemen [Projects Database].

Yemen LNG has committed all of the guaranteed plant capacity under three 20-year take-or-pay LNG sales and purchase agreements with:

- Korea Gas Corporation - 2mtpa
- Total Gas & Power - 2mtpa
- Suez LNG Trading - 2.55mtpa

Building on the site started in 2005 - with Technip, JGC and Kellogg Brown & Root employed as contractors - and the first train slated to go online by the end of 2008.

The project is sponsored by:

- Total - 39.6 per cent
- HuntOil - 17.2 per cent
- Yemen Gas (YGC) - 16.7 per cent
- SK Corp - 9.5 per cent
- Hyundai - 6 per cent
- Kogas - 6 per cent
- GASSP - 5 per cent

Financing

From the outset Yemen LNG focused on two aspects to ensure the project's successful financing: thorough due diligence and solid structuring.

On the due diligence, the sponsors offered export credit agencies the opportunity to fully assess Yemen's country profile in term of both law and security, in addition to the usual evaluation of the technical, security and environmental aspects specific to the project.

Ahmed el-Gaili, a senior associate at Sullivan & Cromwell who worked on the sponsor's advisory team, said: "The challenging aspect was to familiarise the ECAs and the banks with the country risks they would need to accept. This took some time; through several in-country meetings, project site visits and meetings with the government, they ultimately got comfortable. That's why, in terms of the papers - with minor exceptions - there is nothing unique about the structure that had to be tweaked, other than accepting the political risk of Yemen."

Pascal Breant, chairman of the Yemen LNG finance committee and Total's corporate finance manager for the Middle East, adds: "In terms of structuring the financing, as it was a first-in-country, we decided not to push the envelope too far and to stick to what was done in the recent past in precedents such as LNG project financings in the Gulf."

Two other major features that helped to ensure the financing's success was the strong support of the Yemeni government and the robustness of the project itself; Yemen LNG signed its lump-sum turnkey contracts in 2005 - prior to the dramatic increase in engineering and construction costs - and secured three long-term off-take contracts with three credit-worthy firms covering the full capacity of the plant.

El-Gaili: "Most of our interaction was with the government and that was one thing the ECAs were specifically looking for - to see a firm commitment from the government for the project.

"Obviously there was a firm contractual commitment, but meeting the government they got the right level of enthusiasm for the project. And that is not surprising; this project will be the single largest source of income for the government and is central to the future development of the country."

Stewart Robertson, partner and co-head of Sullivan & Cromwell's EMEA project development and finance group, adds: "The project makes economic sense in the long-term for both the sponsors and the government - that is the best basis for sustainability."

Breant concurs: "The project benefits from a very strong support of the government of Yemen at all levels of the state. The project is indeed a fundamental piece of the development plans of the country.

"Such a support, including for the implementation of the project financing, for which the ministry of oil and minerals was deeply involved and the ministry of finance provided a completion guarantee for the Yemeni sponsors, is key in term of assessment of political risk. In addition, the financing involves four ECAs which makes a huge difference in terms of political and commercial risk insurance."

Heavy export credit agency involvement was a predicate to getting commercial banks involved in the deal; providing support to the financing both in terms of the actual cover it provided to banks, but also the confidence it gave the banks to provide a US$647.93 million uncovered loan.

Another key driver for many of the banks for their involvement with the project was their relationships with the main sponsors.

Aside from its strong credit rating, the presence of Total as a co-lender in the financing, which significantly increased its exposure to YLNG, raised the confidence of lenders in the project itself.

Structure:

The US$2.8 billion senior limited recourse project finance facilities comprise:

- **US$647.93 million** uncovered bank-funded term loan facility with a maturity of 11.75 years. The tranche pricing is Libor +165bp, rising to 175bp, with a commitment fee of 15bp and MLA participation fee of 40bp
- **US$432 million** bank-funded loan facility guaranteed by Coface with a maturity of 15.75 years. The loan is priced at Libor +40bp, with a commitment fee of Libor +15bps and MLA participation fees of 40bps. The loan has a 95 per cent comprehensive cover
- **US$80 million** bank-funded loan facility guaranteed by Nexi with a maturity of 15.75 years and pricing of Libor +40bps. The commitment fees were Libor +15bps and MLA participation fees of 40bps. The loan has a 95 per cent commercial insurance cover and 97.5 per cent political cover
- **US$120 million** export credit loan from JBIC with a tenor of 15.75 years and margin of Libor +35bp. The tranche commitment fee is 15bp and MLA participation fee Libor +25bp.

- **US$160 million** bank-funded loan facility guaranteed by Kexim with a maturity of 15.75 years. The loan has a 100 per cent comprehensive cover
- **US$240 million** export credit loan from Kexim with a maturity of 15.75 years

Seven banks were appointed as book-runners on the debt, including:

- Bank of Tokyo-Mitsubishi UFJ (BTMU) - facility agent
- BNP Paribas
- Citigroup
- ING
- Royal Bank of Scotland (RBS)
- Société Générale
- Sumitomo Mitsui Banking Corporation (SMBC)

Debt syndication launched on 2 April 2008 and closed prior to signing. Participants in the financing were:

- BNP Paribas
- British Arab Commercial Bank - BACB
- Citigroup
- Dexia Group
- Fortis
- ING
- KDB
- Lloyds TSB Bank
- BTMU
- Mizuho
- RBS
- Société Générale

In addition, the MLAs have committed a US$1.1 billion multi-tranche, bank-funded loan facility, guaranteed by Total. Calyon joined the initial seven MLAs on this tranche of the debt which has an initial margin of Libor +35bp, stepping up to Libor +45bp and a tenor of 15.75 years.

The debt service cover ratio (DSCR) on the financing has a minimum base rate of 1.90.

Citigroup is acting as financial advisor to the sponsors and Sullivan & Cromwell as legal counsel.

The banks and the export credit agencies are being advised by Milbank.

Risks

Though there have been ongoing acts of terrorism for the past two decades in Yemen there was a two-year lull in activity after 2004. However since September 2006 the number of terrorist attacks has been on the rise again; new actors have emerged in the country and are using new, Iraq-related tactics.

This year there were a number of increasing incidents in the capital, Sana'a - which had previously escaped the suicide car bombings which occured to its east - and a serious attack on the US embassy which demonstrated the improved proficiency of the terrorists.

"So," Heinrich Matthee, a Middle East analyst for independent, specialist risk consultancy, Control Risk, concludes, "Terrorism is on the increase - not only geographically, but in terms of its ability."

In the South of the country, the site of many oil resources, there are old grievances stretching back to the unification of Yemen in 1990 which still need to be addressed. Particularly as the country's Northern elite has moved in and seized

Southern resources, such as property, trade and access to energy.

Matthee : "Over 18 months we have seen a movement of protest building up and this year not only demonstrations that were put down violently, but also a low-scale insurgency campaign, the formation of an alternative assembly - all the first signs of a separatist movement reappearing.

"Combine this with the tribal unrest that is always there, there are at least four major security challenges to the government - North, East, terrorism in general and the southern protest movement. As a result of declining funds, the government's ability to address all these challenges is overstretched."

Matthee describes Yemen as an "interesting case" because it relies on a system of patronage - the government does not have complete physical control of every inch of the territory and therefore relies on alignments with other local forces to enforce security.

He adds: "Basically, the amount of revenue available to do that has shrunk, due to mismanagement, more demands and lower oil prices, and as a result the system is creaking - various demands - there is too little money and too little authority to do anything about challengers pursuing power or their claims through violence.

"As a result of these political and economic conditions, in the past years we have seen several rebellions in the North, driven by a tribal, religious grouping, the Mujahidin Group. This rebellion has broken out again in January 2008, after a cease-fire was concluded last year.

"The government has used tanks, planes, everything - quite harsh methods - and it wasn't able to crush the rebellion. Depending on how you define it, this is the fourth rebellion from the same group in the passed four years. So that shows the government is unable to establish, not only its authority, but even physical control in the North."

Security

Stewart Robertson, Sullivan & Cromwell, said: "The YLNG sponsors have been dealing with a challenging operating environment for many years. Before going out to the bank market, the security plans for the project were very well developed and had been reviewed by an independent consultant. That was an important, proactive step that the sponsors and the financial adviser took, recognising it would be a significant element that the banks would want to see addressed."

YLNG and the relevant Yemeni authorities signed an MoU providing the basis for cooperation in terms of intelligence sharing and ensuring the physical security of Yemen LNG premises and construction sites. For example, a dedicated base for military personnel has been built near the Balhaf site and more than 200 soldiers are stationed there permanently.

Lead shareholder, Total, which has extensive experience operating in countries with high political risk, used its expertise to help ensure security for staff and assets of the Yemen project.

Total's Breant: "We consider the security measures as adequate to secure personnel and assets against any kind of threat, those threats being re-evaluated on a continuous basis, and measures adapted accordingly."

This includes liaising with community actors, tribal chiefs and security forces on the ground to try to mitigate many of these risks and can manage it from week to week with dedicated personnel and resources.

Breant continues: "Control Risk Group was the consultant for the lenders and ran a comprehensive review of measures in place. They concluded in a report that security arrangements are in accordance with or even, in certain areas, go beyond industry best practices."

Robertson: "Both the ECAs and the commercial banks agreed to take political risk from day one through political risk exclusions in the completion guarantees from the sponsors. That was a notable accomplishment from the sponsor's perspective given the environment in Yemen."

Legal Challenges

Sullivan & Cromwell's el-Gaili, says: "Part of the challenge was that there is really no precedent in Yemeni law for dealing with a financing of this complexity. We spent a lot of time with local counsel and with the ministry of legal affairs to make sure that the deal happened. It was challenging but in the end it got done."

Despite the Jabal Salab zinc mine [Projects Database] project financing closing only a few months before, there was not any collaboration on the development of new Yemeni legislation for the projects.

Although the US$216 million zinc mine was a far smaller deal and had a hybrid project finance structure Alexander Currie, who led the Herbert Smith team working on the financing, noted similar legal difficulties: "The arrangement came with all the usual challenges of a full-blown project finance deal, but was unique as the Yemeni legal council had never dealt with this kind of transaction before.

"We needed to introduce specific legislation in Yemen for the project and work closely with the authorities to push this through."

Conclusion

The successful close of Yemen LNG will provide a benchmark for future international LNG projects, particularly those with strong support from the government. Not only did the location of the project prove a challenge, but the financing was arranged and signed in a challenging credit market.

The very fact that the lenders accepted to close this financing while there was the pending arbitration with Hunt on the upstream assets shows the importance of the support of the government.

The banks were comfortable - firstly because the upstream section of the project is separate from the downstream, and secondly because the government was firm in its commitment to continue to supply FEED gas.

Robertson: "The market has changed - ECAs are back, even for projects where you wouldn't previously have needed ECA involvement, and they are going to be looking at Yemen LNG closely as a template for other first-in-country LNG deals where political risks may be an issue."

Though Yemen will not become the next Qatar or Oman, Total's Pascal Breant is confident that YLNG will encourage further financing in the region: "Lenders did intensive due diligence on the country, including Yemeni law, and this transaction clearly demonstrated that project finance is possible in Yemen.

"In recent years, Total farmed in new exploration blocks and started extensive exploration programmes. The company does not have immediate new project financing plans in place, but having brought the banks into the country we are hoping this will open the door to further development in the energy or infrastructure sector".

Heinrich Matthee: "In principle the Yemeni government wants companies to invest in the region, it will offer assistance. Yemen is going to a difficult patch where the quality of their assistance won't be enough, so companies will have to look elsewhere too. But I don't think, looking at it globally, you will see much disinvestment. In the energy sector we will see continuous interest.

"The perception of financing risks in the Yemen is higher than it was two years ago, and rightly so. Next year we will have elections and the opposition will boycott them, so we are likely to see more of the same next year in terms of the risk profile and the risk perception."

However as the current projections are that there are only a few years left on the hydrocarbon resources - perhaps two decades depending on the calculations and the fuel resources being analysed - there is a window of opportunity for many companies. As a result companies are willing to accept the political risk in Yemen, to mitigate it and continue operations.

The project at a glance

Project Name	Yemen LNG
Location	Balhaf, Yemen
Description	The project involves a construction of a LNG liquefaction plant at Balhaf and pipeline connection to the Marib gas field upstream. The project will comprise new and existing upstream gas processing facilities
Sponsors	Total - 36% Hunt Consolidated - 17.2% Yemen Gas Co - 16.6% SK Corp - 9.5% Hyundai Corp - 6% KOGAS - 6% GASSP - 5%
EPC Contractor	Technip JGC Corp KBR Spiecapag
Total Project Value	US$4,801.93 million
Total equity	US$2,020 million
Total senior debt	US$2,421.93 million
Debt:equity ratio	55:45
Export credit agency support	KEXIM JBIC Coface Nexi
Mandated lead arrangers	BNP Paribas Citigroup ING Bank Royal Bank of Scotland Societe Generale Bank of Tokyo Mitsubishi UFJ Calyon
Participant banks	British Arab Commercail Bank Dexia Korea Development Bank Mizuho Financial Group
Legal Adviser to sponsor	Sullivan & Cromwell
Financial Adviser to sponsor	Citigroup
Legal adviser to banks	Milbank
Financial adviser to ECAs	Calyon
Date of financial close	19 May 2008