Dolphin Energy Refinancing

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Few deals in the current market can generate the level of excitement and interest that the US$4.1 billion refinancing of the Dolphin Energy pipeline managed to inspire.

When it closed last month the project's sponsors were able cut back the value of its over-subscribed commercial debt facility by 45 per cent thanks to the popularity of a separate bond issue for the project.

The refi's popularity in both the international debt and capital markets also enabled project sponsors Mubadala, Total and Occidental to drop a planned Islamic finance facility completely.

Its success, claim those close to the deal, was a vindication of the sponsors and their financial adviser Royal Bank of Scotland's strategy to position it as the one deal banks would want to do in the current constrained market.

Ticking every box

Dolphin Gas is the Middle East's largest cross-border gas project, involving the production of raw gas from the North Field, processing at Qatar's Ras Laffan Industrial City, a sub-sea pipeline to Al Taweelah in Abu Dhabi and a further connection to Oman [Projects Database].

The US$4.8 billion project was initially financed in 2004 with a US$1.36 billion five-year commercial bridge loan, but was refinanced and extended in September 2005 using US$2.45 billion of four-year commercial debt plus a US$1 billion Islamic finance facility.

Refinancing of the project debt really began in earnest when RBS was mandated as financial adviser in May 2008, with the target of securing at least US$3.45 billion. Although this predated the Lehman Brothers collapse and nationalisation of major international banks, the credit crunch was already very much in full swing with bank liquidity all but dried up and the price of debt soaring. By any measure this was far from the ideal time to refinance a multibillion dollar debt facility.

With the existing debt due to expire by 31 July 2009, it was imperative that RBS found a refi solution with debt at a price the project could afford.

The key to success, said one banker close to the project, was understanding the debt tenors that banks would be willing to lend against.

"Coming in off the credit crunch we worked to position the debt as 10-year tenor fully amortising," he says.

"That was popular because tenors longer than this were painful for lenders, and by being fully amortising it meant there was no refinancing risk. We were able to do this because the project's cashflow is very strong. Along with its very strong credit rating and strong coverages, we made sure it was the deal that the banks wanted to do in the current environment."

Indeed it was. Eight of the 11 banks that were on the commercial debt tranche for the bridge loan signed up for the refi, joined by a further 15 institutions to create a club of 23 banks, announced in April.

With the late additions of Arab Bank and Commercial Bank of Qatar to this tranche the refinancing's commercial debt facility managed to secure 25 banks with lending commitments of US$2.6 billion across ticket sizes ranging from US$50 million to US$300 million. Debt was priced at 275bp over Libor for the first three years from signing, 300bp from years three to six, and 350bp for the final four years.

In addition to the club of 25, a further five banks committed US$400 million to a facility guaranteed by Italian ECA SACE, priced at 175 bp over Libor.

With its attractive tenor, strong coverages, strong sponsor companies and regional political significance, the Dolphin refi was attractive to lenders, says one banker, because it "it really got a tick in every box" of the requirements needed for projects to make it through credit committee.

"There really are very few opportunities like this one," he adds.

Dolphin and its advisers aimed to secure all the necessary debt for the refinancing with the commercial debt facility, the SACE facility, sponsor co-lending of US$1.225 billion and a US$500 million Islamic finance facility.

However, despite these combined facilities potentially taking the debt raised in the refinancing to near the US$5 billion mark, RBS and BNP Paribas were also mandated as bookrunners for a bond for Dolphin. This project bond would run in parallel with the traditional project financing in the hope that Dolphin's positive reception in the banking sector might be replicated in the capital markets.

Bond boon

Dolphin had never issued a bond before, but the same qualities that made it popular with the banks also ensured it received a strong credit rating, the key to a successful bond issue.

Credit ratings agency Moody's assigned a provisional Aa3 rating to the bond and bank debt, covering US$4.1 billion of 10-year amortising senior secured debt.

Fitch Ratings meanwhile gave the Dolphin Energy bonds an expected rating of 'A+' with a Stable Outlook.

Just as Dolphin was a safe bet for the banks, so was it a safe investment for the capital markets, says Moody's Project Finance Group senior Analyst William Coley.

"There's a market for bond investors but predominantly at the single A rating level rather than at the Baa level (a rating which is more typical of, for example, a UK PFI scheme)," says Coley

"Investors are more nervous for projects with construction risk which are usually more risky compared to more mature projects in operation.

"Both the RasGas [a Qatar LNG project which successfully issued a US$2.23bn bond weeks prior to Dolphin] and Dolphin projects are operational so there is only a modest level of construction risk.

"Also they operate with strong financial coverage ratios. Additionally, both projects benefit from Moody's Government Related Issuers methodology.

"Where you have an issuer which is held by a government party by more than 20 per cent [as is the case with Mubadala], then uplift may be applied to take into account assumed support from government stakeholders. For the Dolphin project, the Government has a very compelling interest to keep the project operational given its regional strategic significance; if there was one project they would support above all others, this is it."

During the marketing process for the bond it became apparent that Dolphin was likely to easily raise funds in the US$500 million - US$1 billion range that its sponsors were aiming for.

With the project's Islamic finance facility struggling to raise just US$200 million of its targeted US$500 million, the sponsors were in the luxurious position of being able to drop the debt tranche, safe in the knowledge the bond would cover the shortfall.

There was also the likelihood that should the bond size around the US$1 billion mark, banks on both the commercial and SACE tranches would see their ticket sizes cut back. This possibility was something that all banks were made aware of at the outset of the deal, says one banker close to the deal.

"Everybody knew going into the deal that the bond would scale back the banks, although obviously nobody knew what the size would be," he says.

"Having got the capital allocation the deal teams were reluctant to be scaled back because their front end fees reflect a financial close."

Although braced for a reduction in ticket size, few bankers involved anticipated by just how much their commitments would be scaled back by the bond.

Following a brief delay to allow a rival Abu Dhabi state-sponsored bond to hit the capital markets, the bond was finally issued on Thursday 23 July.

After securing US$4.7 billion of orders the bond sized at US$1.25 billion and priced at 337.5bp over the US Treasuries 10-year fixed rate, with the bond notes due to mature in June 2019. Its take-up from 220 investors had a fairly even geographical spread: 37 per cent of notes were purchased in the US; 35 per cent in Europe; 24 per cent in the Middle East; and 4 per cent in Asia.

Sizing the bond at US$1.25 billion meant nearly halving Dolphin's commercial debt facility to US$1.42 billion, with the majority of bank ticket sizes scaled back on a pro rata basis.

The SACE facility was also scaled back from US$400 million to US$218 million as the refinancing reached financial close the following day, Friday 24 July.

The sizing of the bond and scaling back of the banks was all ultimately a judgement call by the sponsors, says one banker.

"The sponsors could have gone higher but decided US$1.25 billion was the right compromise," he says.

"They [the sponsors] were a little apprehensive about scaling back the banks too much and the level of disappointment this might create in the market - if you were to go any higher with the bond you would be making it bigger than the bank debt...those sorts of decisions are down to touchy-feely stuff."

Blueprint or one-off?

Whether or not the bond could have sized above its US$1.25 billion, what matters is that the sponsors did push it beyond its anticipated maximum US$1 billion, and the reasons for this are far from "touchy-feely".

"This deal shows how the bond market is a lot more competitive in terms of the cost of debt than the bank market," says this banker close to the deal.

"The capital markets represent the most competitive pricing by a huge margin."

A senior PF banker active in the Middle East adds: "The bond piece on Dolphin was about 100bp cheaper than the bank on an all-in cost basis. Pricing in the banking market is driven by liquidity issues and most of the banks are going to remain balance-sheet constrained.

"The liquidity issues we have in the banking market today will only improve over time. In the meantime there is a need for that gap to be filled by other sources of funds - and the capital market has demonstrated itself to be competitive.

"Projects sponsors will sit up and take note of that."

Indeed, Coley agrees that project bonds may appear preferable to bank funding right now, but that it will be difficult for most projects to match Dolphin's perfect mix of credentials - operational, strong coverages, strong political support etc.

"The appetite is certainly there and the cash is certainly there, but the difficulty is for issuers to structure projects at the right level from a credit rating perspective, in order that they achieve a strong rating that is attractive to the capital markets," he says.

"We are definitely aware of some other projects in the pipeline considering both bank and bond debt, and they will do what makes sense."

Most notably Saudi Aramco and Total's US$9.6 billion Jubail refinery [Projects Database] hit the debt market last month looking for US$8 billion in debt but is also planning to run a bond in parallel, with a view to scaling back bank lending in much the same way as Dolphin.

Sources close to this refinery deal are not so bullish on the potential for bond financing. One says: "I would guess that a project like this would get a low rating of BBB - and for it to get that the sponsors would have to tighten up the structure a good deal.

"I would say that they would be better placed to put commercial pressure on the banks to finance the deal rather than take the risk of issuing a bond."

Imitation is the greatest from of flattery, but those looking to repeat Dolphin's success might have a rude awakening when they discover the capital markets do not provide a panacea for the ailing debt market. Maybe Dolphin's successful bond issue, just as with its popularity with the banks, is simply down to the fact that it was on of those rare deals that "ticks every box".

The project at a glance

Project Name	Dolphin Energy Refinancing
Location	UAE, Oman and Qatar
Description	US$4.1 billion refinancing of a gas pipeline
Sponsors	Mubadala, Total and Occidental
Operator	Dolphin Energy
Total Project Value	US$4.1 billion
Total senior debt	US$1.42 billion
Senior debt pricing	Years 1-3 - Libor +275bp Years 4-6 - Libor +300bp Years 7-10 - Libor +350bp
Export credit agency support	SACE-guaranteed US$218 million tranche
Agency loans	Export Development Canada (EDC)

Mandated lead arrangers	Abu Dhabi Commercial Bank Arab Bank Arab Banking Corp Bank of Tokyo Mitsubishi BayernLB BNP Paribas Calyon CIC Commercial Bank of Qatar Europe Arab Bank EDC First Gulf Bank HSBC KBC Lloyds TSB NAB National Bank of Abu Dhabi Natixis RBS Samba Financial SMBC Société Générale Standard Chartered Union National Bank WestLB
Legal Adviser to sponsor	Shearman & Sterling
Financial Adviser to sponsor	RBS
Legal adviser to banks	Sullivan & Cromwell
Date of financial close	24 July 2009