

# Demand-supply imbalance increases ECA role in new projects



**Gary Wigmore (above) and Mark Plenderleith**  
Milbank Tweed Hadley & McCloy  
Tokyo

The sustained high growth of the large regional economies of China and India in an environment of global economic growth has resulted in more demand for energy and natural resources than existing supply can meet. The lasting significance of the Chinese and Indian economies causes some to observe that demand and supply for these commodities will be in a long-term state of imbalance. The short-term demand-supply imbalance has resulted in high commodity prices and demand for new projects. Since the response to the price signal by private market participants was not enough, policy oriented government lending institutions and export credit agencies have begun offering favourable financing and political risk cover in an effort to secure stable domestic supply.

Meanwhile, after several years of reduced investment, demand is once again challenging the capacity of existing infrastructure in Asia, and we have entered a new phase of development and investment. This coupled with the demand for energy and natural resource commodities results in dramatically increased opportunity for new project development (both expansion and greenfield).

Most of the players that have responded to the demand are experienced regional players who played a role in the most recent cycle of boom and bust. But there are many new players who are shaping the bid structures and deals with aggressive pricing and financiers who are offering structures and terms that challenge the traditional models in Asia. China is playing an increasing role, both as a financier and as a EPC supplier, not only in Asia, but also in the Middle East and Africa. In addition to resource scarcity and energy security policies driving ECA lending, the entry of new equipment suppliers and new EPC contractors may result in more aggressive ECA lending to support domestic client firms. The prominent ECAs have responded to the challenges faced by their clients with a willingness to embrace new products and increased flexibility. Additionally, demand-supply imbalance results in developers and ECAs taking a more favourable look at countries with challenging political and legal environments.

It is in this context, over the past year, we have noticed the following trends.

- **ECAs are reinventing themselves to be relevant to the changing marketplace.** ECAs are increasing their slate of products. Stemming from their recently established status as a participant in the project-based leveraged acquisition market, regional ECAs have indicated an appetite for future exposure in mezzanine tranches and equity-linked positions. Increased competition for resources has resulted in pressure on the ECAs to relax policy constraints applicable to natural resource projects. On the other hand, increased collaboration among agencies and MDBs on multi-sourced deals has contributed to harmonization of environmental and social requirements – a positive trend.
- **Chinese contractors and financial institutions are quickly coming up the learning curve.** The structures and financing packages employed by the regional heavyweight The Japan Bank for International Cooperation (JBIC) and recently embraced by The Export-Import Bank of Korea (KEXIM) are increasingly being adopted by new participants – notably China Exim and Sinosure. India Exim may be just around the corner. Chinese firms supported by generous government-backed financing are making their presence felt throughout the region with aggressively priced construction and supply contracts. The Project owners and developers in the Philippines, Thailand, Laos, Vietnam, and Indonesia may be the immediate beneficiaries of China's appetite for growth. Assuming that the quality

of their final product does not disappoint, one can safely predict that the Chinese contractors and suppliers will become a force to be reckoned with – even on the same pricing terms – in the not too distant future.

- **Long-term supply concerns fuel a desire for secure energy sources.** Japan, China, Taiwan and Korea continue to aggressively seek control of acreage, supply and marketing contracts for oil and gas, LNG and other natural resources. Due to the expanded hunt for commodities, many natural resource companies are venturing into countries where they have little or no prior experience. High prices have driven oil and gas and mining developers into challenging environments in Western Africa, the lesser developed MENA countries and North Asia resulting in some of this year's headline deals. The need for political risk mitigation in these challenging countries has encouraged developers who otherwise have no need to finance off balance sheets to use project finance with ECA and/or MDB lending. We expect this trend to continue as long as forecasted commodity demand is high and projects are pushed into challenging countries; or until the commercial bank market forgets the importance of political risk cover, as it historically tends to do.
- **Return of activity levels in green-field and brown-field Asia power development.** The project finance market has had a stable flow of activity in the power sector. The acquisition deals of recent years (including the Mirant asset sale this year) have been followed by brown-field expansions. Now, new green-field deals are appearing in Thailand, Indonesia, Vietnam, the Philippines, Laos and Taiwan. In addition to the traditional power developers, the electric utilities have shown an appetite to take larger roles in consortiums although appetite for country risk remains low, indicating a continued role for ECAs and MDBs.
- **Private Equity.** So far, the tie-ups between private equity groups and regional companies have been limited in the power and energy sector, but over the next 24 months we anticipate that the effects of both private and government linked investment money will be felt in the project finance environment. With the so-called sub-prime credit crisis in the US and Europe, funds have shifted focus to infrastructure projects in Asia and other developing regions. We are increasingly seeing US, European and regional hedge funds making investments in infrastructure and development including, for example, coal mining projects in Indonesia, transmission and power deals in the Philippines, toll road deals in China and real estate projects in India.

New projects, the entrance of new players, a changing appetite for risk by project participants, and the opening of new markets makes it a very exciting time to be serving the legal needs of our clients. From our experience the current period will continue to be a period of innovation in project finance.