

market intelligence

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GETTING THE
DEAL THROUGH 

Project Finance

Phillip Fletcher and Aled Davies lead the global interview panel covering key economies, regional analysis and PPP

Energy market
conditions to increase
M&A opportunities?

The Americas • Asia-Pacific • Europe • Africa • Middle East
Activity levels • Keynote deals • Industry sectors • 2015 trends

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Welcome to *GTDT: Market Intelligence*.

This issue focuses on the global project finance markets.

Getting the Deal Through invites leading practitioners to reflect on evolving legal and regulatory landscapes. Through engaging and analytical interviews, featuring a uniform set of questions to aid in jurisdictional comparison, *Market Intelligence* offers readers a highly accessible take on the crucial issues of the day and an opportunity to discover more about the people behind the most interesting cases and deals.

Market Intelligence is available in print and online at
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GLOBAL TRENDS

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Phillip Fletcher is a partner who practises in the London and Washington offices of Milbank, Tweed, Hadley & McCloy LLP and is a member of the firm's project finance group. Phillip's experience includes representing parties in the development and financing of oil and gas, natural resource, independent power, satellite and other infrastructure projects in the Middle East, Africa and Europe. He has been recognised as a leading project finance lawyer by a number of journals, including Chambers UK (which has designated him among the top 100 commercial lawyers in London and in the first tier of projects lawyers in both the London and Middle East markets), Who's Who Legal: Project Finance (which designated him the Global Project Finance Lawyer of the Year for two consecutive years), Euromoney (which has recognised him as among the top 35 project finance lawyers in the world) and The Legal 500. Phillip is on the advisory board of the International Financial Law Review (IFLR) and is a member of the Council on Foreign Relations. He is a Solicitor of the Supreme Court of England and Wales and is also admitted to practise in New York and Washington.

Aled Davies is a partner in the Tokyo office of Milbank, Tweed, Hadley & McCloy LLP and a member of the firm's project finance group. Based in Tokyo for almost 20 years, Aled regularly represents key stakeholders, including sponsors, lenders and export credit agencies, on the development and financing of, and acquisition of interests in, large-scale infrastructure and energy projects throughout the world, including major LNG, refinery, power and mining projects. Aled advised on the Sarulla geothermal power project in Indonesia and is currently advising on a methanol facility in Trinidad, a floating storage and receiving unit to be deployed to import LNG in Uruguay, and petrochemical plant in Vietnam. Notably, Aled led the team representing the sponsors on the Ichthys LNG project – the largest project financing to date.

Aled is listed by Chambers as a first-tier lawyer in both Japan and the Asia-Pacific region and as a leading lawyer by The Legal 500 Asia-Pacific. He has also been included in IFLR's top 35 project finance lawyers in the world. His published works have appeared in Infrastructure Journal as well as publications by the Japan Overseas Investment Organization.

2014 was an extremely active year for project finance with total debt raised reaching \$257.5 billion (*note: financial data in this overview compiled by Thomson Reuters*) representing an increase of over 25 per cent from the previous year. Global project finance activity grew sharply in 2014, expanding at a faster rate than the conventional loan market with bank project finance debt increasing at a faster rate than bond financing. However, it was also a year that saw political and economic volatility causing a shift in the areas and sectors that were active.

North America saw a boom in activity whereas Latin America experienced a modest slowdown. Europe remained stable and although the Middle East saw some transactions close, activity was less than in previous years as sponsors focused on implementing some of the mega deals closed in the immediately preceding years. Eastern Europe and Central Asia were less active than in recent years, and Russian projects were deferred or shelved in the face of sanctions. Some significant project financings were successfully closed in South East Asia (although it is always a challenge to reach a successful closing in the region) and Australia also remained active.

In terms of industrial and product sectors, power generation remained core to the project finance sector accounting for about 32 per cent of total project finance activity, but the oil and gas and transportation sectors were also significant and (given the increased level of activity in the United States) more frequent borrowers of project financing.

On a regional basis, 2014 saw the following trends.

NORTH AMERICA

Global growth in project finance debt raising can be attributed to the significant upturn in activity in North America, with debt financing in that region totalling \$93 billion, up a staggering 83 per cent from 2013. The power sector again was the cornerstone of deal volumes (representing 39 per cent of the market), but there was also significant activity in the oil and gas sector (amounting to 35 per cent of total debt raised). Shale oil and gas production in the United States was the driver behind many of the projects financed during 2014. Activity spanned projects in oil and gas production but also in pipeline gas transportation, as well as new builds of (or conversion to) gas-fired power stations. The 'shale gas revolution' also fuelled activity in other downstream industrial and petrochemical sectors (although on a per deal basis, petrochemical projects in North America remain somewhat dwarfed by the world-scale plants developed in the Middle East in recent years).

The financing for the Cameron liquefied natural gas (LNG) (\$7.765 billion) and Trains 1 and 2 of the Freeport LNG (\$4.4 billion and \$4 billion, respectively) projects were among the world's largest deals to reach financial close in 2014. The interesting aspect of the US LNG projects is that such projects take advantage of the existing on-site infrastructure of the regasification terminals developed in the early 2000s, when the United States was in dire need of imported LNG – how times have changed! The financings for Cameron LNG and Freeport LNG adopt a different underlying structure from the prior financing for the Sabine Pass LNG terminal. The Sabine Pass LNG financing adopted the approach of the project company procuring natural gas and selling LNG to the buyers at a Henry Hub linked price plus a markup to cover fuel consumption and transportation costs plus a fixed constant to cover capital and operating costs. The Cameron LNG and Freeport LNG financings, on the other hand, are based on tolling arrangements with the gas purchasers paying a tolling fee to the LNG liquefaction company, providing it with a predictable infrastructure-style cash flow, leaving the gas purchasers with the task of managing risks through the LNG value chain by transporting gas and in some cases dealing with pricing exposure between the 'hub-based' United States price for gas and the JCC oil-based price for LNG in Asia. Financings of the US LNG plants, therefore, did not have to deal with the entire LNG production chain (extraction, processing, transportation and liquefaction) and therefore are different from the fully integrated and larger LNG financings closed in prior years in Australia, such as Ichthys LNG.

However, the North American story is not all about LNG. 2014 also saw the closing of the \$4 billion financing of the Sasol Chemical plant in the United States and the \$791 million Northwest Redwater bitumen refinery plant in Canada. Power also saw a number of significant financings of both gas-fired and renewable energy plants. One notable project was the financing of the NRG Energy and JX Nippon Oil & Gas Exploration sponsored carbon capture and enhanced oil recovery project in Texas – the first of its kind in the world to be project financed. It is clear that project financing in North America was very active in 2014.

EMEA

EMEA also enjoyed a significant level of activity, totalling \$95 billion. Specifically, western Europe saw more growth than the Middle East as sponsors focused on implementing some of the massive petrochemical projects in the region that had closed in recent years, such as the \$12.5 billion financing (including a sukuk (Islamic bond) issuance) of the Sadara Project and the \$9.5 billion

“2014 also saw the project bond market establish itself as a viable financing tool, in particular in the infrastructure sector in North America and Europe.”

financing of the Satorp petrochemical complex in Saudi Arabia. The United Kingdom represented the largest country in terms of total value of deals, but project financiers in France remained prolific in the PPP sector.

From a sector standpoint, power represented a large portion (32 per cent) of the market share (bolstered by the financing of large offshore wind power projects such as Gemini), but transportation and oil and gas each also enjoyed about 20 per cent of the market share. The financings of the \$5 billion Wa'ad al Shamal phosphate project in Saudi Arabia and the \$3.3 billion financing of the Aliaga Star Refinery in Turkey were the largest to close in the EMEA oil and gas and downstream industries sector. However, there were also significant financings in the transportation and power sectors, the largest being the \$3.7 billion financing of the IEP rail project in the United Kingdom.

Looking further afield, a number of project financings were successfully closed in Africa, notably the \$2.6 billion financing of the SAFI coal-fired power plant in Morocco and the \$1.17 billion financing of the Awash-Weldia/Hara Gebeya Railway Project in Ethiopia. The development of natural resources projects in Mozambique (coal and LNG) will bring opportunities for further downstream industry development and a need for new infrastructure (power, rail and port projects) to enable Mozambique to realise its full potential. The successes in 2014 indicate even greater potential for future project financings in Africa.

ASIA-PACIFIC

Asia-Pacific saw project financing activity grow by 14 per cent to \$72 billion with the greatest concentration of deals (and the largest in terms of individual size) taking place in Australia (the \$7.1 billion financing for the Roy Hill iron ore project being the largest). Australia also saw the successful closing of a number of transportation and infrastructure project financings such as the \$1.23 billion refinancing of the Newcastle Coal Infrastructure Group coal terminal in New South Wales.

Deals in South East Asia are notoriously challenging and take a long time to bring to financial close. Nevertheless, this region saw some notable successes last year such as the \$2.2 billion financing of the Gulf electric power plants in Thailand (which has established a successful IPP programme), the \$1.5 billion debt financing package for the Donggi Senoro LNG project and the \$1.2 billion Sarulla Geothermal plant in Indonesia. India still remains an attractive project finance market even though activity has halved there since 2012 because of the dominance of domestic sponsors and lenders. It is projected, however, that the new government will be able to introduce programmes that will offer more opportunities for international players in future.

THE DEBT PLAYERS

Globally, the three Japanese mega banks (BTMU, SMBC and Mizuho) took the podium as mandated lead arrangers. On a regional basis, the French closely followed by the Dutch banks led the pack in EMEA while National Australian Bank and State Bank of India maintained significant market share on their home turf. 2014 was also the year that saw the project bond market establish itself as a viable financing tool, in particular in the infrastructure sector in North America and Europe. Funding costs and liquidity in the bank market also improved with the cost of funding for western European banks getting closer to that of the Japanese banks.

With a slight drop in major project financings in the developing world, there was a reduction in the multi-sourced export credit agency and multilateral financings that we had seen in the past; however, notwithstanding an improvement in general liquidity, export credit agencies did play a key role in the financing of major projects in North America and Europe such as IEP, Gemini, Roy Hill and Cameron LNG. JBIC, KEXIM, IFC, the European ECAs and regional multilateral agencies actively mobilised sufficient debt liquidity to finance the ever increasing cost of major infrastructure and natural resource projects.

WHAT A DIFFERENCE A YEAR MAKES

The historical statistics of the past year's closed deals reveal only part of the story. 2014 saw oil prices tumble from \$105 per barrel in January to below \$50 per barrel at the year end. This has resulted in the suspension or cancellation of some projects (most notably the recent announcement by QP and Shell to cancel the Al-Kaarana petrochemical plant in Qatar). Bankers and sponsors have been required to revisit their oil price assumptions for new upstream oil and gas projects, and to wait and see how the oil price stabilises. This may slow down the flow of new oil and gas production, but it does give rise to the challenge of capitalising on the opportunities that exist further downstream in the energy value chain and managing feedstock that is already available. The 'low price cycle' is not unique to oil and gas; the continued low price for copper, gold and other natural resource projects has led to deferral of a number of mining deals as well.

PREDICTIONS FOR 2015

So what will 2015 bring? It is hard to predict, but it certainly should not result in a lack of opportunities. It is likely that the collapse of the oil price will shape the outlook of the oil and gas industry this year. Predictions are that the current market conditions could lead to a significant increase in M&A activity in the oil and gas sector; larger companies will look for M&A opportunities to reshuffle their investment profiles (potentially taking advantage of depressed pricing to acquire smaller players) while smaller companies may need to resort to M&A for survival rather than growth. The low oil price is also likely to cause companies to cut back on their capex programmes so it is expected that new 'upstream' production projects will be delayed, if not cancelled. However, the abundance of new LNG production in North America and elsewhere may lead sponsors to focus downstream by developing LNG regasification terminals and gas-fired power stations, taking advantage of government policies and economic opportunities to secure long-term supplies of competitively priced gas. Governments, who for a number of years have been seeking to introduce legislative reform and promote infrastructure development, will continue to do so. Mexico recently implemented revolutionary energy sector reforms and is promoting four new power plants, and will likely undertake additional oil and gas sector projects. Government initiatives to promote the development of renewable energy stimulated significant activity in wind power generation in western Europe. The UK government is now seeking to promote the

development of low-carbon energy (including nuclear power generation) through its 'Energy Market Reform' policy, which includes the provision of a 'Contracts for Difference' (CfD) mechanism that is intended to assist developers of low-carbon electricity generation technologies and to raise finance to cover the large up-front capital costs typically required for such projects. In addition, the UK government has introduced a liquidity enhancement mechanism for nationally significant infrastructure projects in the form of the UK infrastructure guarantee programme. Both the CfD and the UK infrastructure guarantee will facilitate the development of EDF's Hinkley Point nuclear power plant and it is anticipated that they will also form a key part of the financing plans for Horizon's Wylfa nuclear power plant and NuGen's Moorside nuclear power plant. Turkey and Abu Dhabi (as well as a number of other countries around the world) are also seeking nuclear power generation capacity, although the challenges are significant.

Sponsors in South East Asia are currently actively seeking financing for a number of new and expansion power plants in the Philippines and there is always optimism that progress will be made on the Central Java, Cirebon and Sumsel power projects in Indonesia, and Nghi Son 2 IPP in Vietnam. Indonesia also presents opportunities as there is a massive need to plug the power supply-and-demand gap. There is also potential to develop new power projects in Bangladesh, Mongolia and East Africa.

2014 was a very active and successful year, and although 2015 starts off in the shadow of the fallen oil price, demand and ingenuity suggest that sponsors and financiers will seek to adapt to make the most of any opportunity that comes their way.

“Current market conditions could lead to a significant increase in M&A activity in the oil and gas sector.”

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