RABIGH 1 REFINANCING – UNLOCKING VALUE

ON JUNE 30 2016, RABIGH ELECTRICITY COMPANY ACHIEVED FINANCIAL CLOSE ON THE US$1.83BN REFINANCING OF ITS EXISTING SENIOR FACILITIES. BY **SHARATH COORG**, DIRECTOR, AND **HAOYONG CHEN**, MANAGER, ACQUISITIONS AND PROJECT FINANCE, **ACWA POWER**.

Rabigh Electricity Company or Rabec, being a special purpose company, owns the 1,204MW fuel oil-fired Rabigh 1 IPP power project located about 150km north of the city of Jeddah on the western coast of the Kingdom of Saudi Arabia. The project is 40% owned by ACWA Power, 40% by Kepco and the remaining 20% by the Saudi Electric Company (SEC). ACWA Power played the pivotal role in orchestrating the refinancing transaction in its role as financial adviser to RABEC.

Project background

The Rabigh 1 IPP project was developed as a greenfield power generation project on a build, own and operate (BOO) basis. The project was tendered by the SEC in November 2008 and was awarded to the ACWA Power-Kepco consortium, which had delivered a winning tariff lower by 24% to that of a competing consortium.

The sponsors closed the transaction on September 14 2009, when the markets where in the throes of the global financial crisis. When it was financed, the US$2.5bn transaction was the first IPP project in the Kingdom of Saudi Arabia to be procured without a sovereign guarantee.

It was also the first time a project financing within the Middle East and North Africa (MENA) region where the major power plant equipment was supplied by a Chinese manufacturer and the project was executed by a Chinese EPC contracting consortium. It was the first privately financed infrastructure transaction of any kind in the MENA region that was structured with long-term debt on a project finance framework since the onset of the global financial crisis.

At original financial close the total project cost of US$2.5bn was funded through a combination of senior debt facilities made up of two Islamic tranches and a Korean Export Insurance Corporation (K-Sure) covered facility, early generation revenues (EGR) and the shareholder funding. The project reached its commercial operation date on April 10 2013 and has been fulfilling its contract dispatch obligations since then.

Sponsors' objectives and strategy

The original financing, which was underwritten and priced based on pre-construction conditions, was put in place during a less stable market environment. Given that market conditions had substantially changed, and the construction risk and the early operation risk had been successfully eliminated, the sponsors decided to refinance the project's long-term non-recourse facilities to reduce the cost of financing and use the balance tail available within the PPA term. The refinancing was important to unlock value for the shareholders and offtaker.

The power purchase agreement (PPA) signed in 2009 incorporated provisions for refinancing of senior debt in the coming years. The agreement was prescriptive on how the benefit from the refinancing would be calculated and the formula to be applied for sharing of benefit between the offtaker, namely the SEC, and the shareholders of the project.

The value created from refinancing is determined based on the improvement in the net present value of the equity cashflows. Once the size of the pie is determined, the PPA lays out the proportion that would be shared with the offtaker. The benefit to the offtaker would be transferred in the form of a discount in capacity payments during the remainder of the PPA term. The remaining upside flows to the shareholders by way of upfront distributions at refinancing. Thus the arrangement enabled the value created from refinancing to be shared between the different stakeholders, making it a win-win for all of them.

The discussions on refinancing commenced among the shareholders of Rabec and the offtaker in the third quarter of 2015. In the spirit of involving all the stakeholders right from the beginning and achieving the best possible result, it was decided to form a joint consultative team comprising representatives from the SEC, ACWA Power, Kepco and Rabec. While ACWA Power played the critical coordination and execution role, the purpose of this team was to facilitate the refinancing in a smooth and timely manner while ensuring that the interests of stakeholders were adequately protected.

At the preparatory stage, various refinancing options were evaluated keeping in mind the changing liquidity environment in the Kingdom

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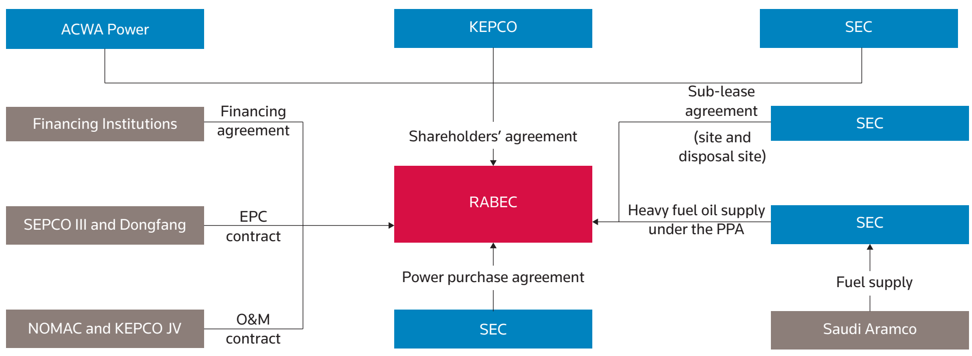
FIGURE 1 - RABEC CONTRACTUAL FRAMEWORK



and the tightening of US dollar liquidity for long tenors. All the stakeholders finally agreed on an implementable refinancing plan based on the following structure:

* The existing K-Sure covered facility to be replaced with an uncovered US dollar tranche provided by commercial banks. The scheduled tenor to be extended until the end of the PPA term. This new US dollar facility proposed to be structured as a mini-perm debt with a margin step-up at the end of seven years and provision for cash-sweep during the period thereafter.
* The existing Islamic facilities were proposed to be replaced with corresponding Saudi riyal-denominated facilities with longer tenor and lower margins.

Formation of the bank group

A refinancing request for proposal (RFP) was floated to a wide array of international and local banks. ACWA Power carried out substantial groundwork prior to issuance of the RFP. All the lenders' advisers were appointed and a due diligence package was made readily available to the lenders.

In order to elicit serious interest from the banks and expedite the subsequent process, the RFP package contained the full set of amended finance documents and due diligence reports. This ensured that when the banks responded with their interest, they had completed their initial credit approvals, and were comfortable with the amendments being made to the finance documents.

The project had several salient features that made it attractive to the lenders. The key aspect was the strong tried-and-tested IPP framework in the Kingdom of Saudi Arabia. Adding to that the successful mitigation of preliminary risk demonstrated the ACWA Power led consortium's ability to deliver on the construction and operation of the project. The deal was presented to the market on the back of its top-notch construction and operation record.

The RFP received an overwhelming response and there was an oversubscription of more than 20%. The interest in the Saudi riyal-denominated Islamic facilities far outweighed the amount the project was seeking. Initially, there was a shortfall on the US dollar front partly due to the tight liquidity for longer tenors among the commercial banks.

In partnership with Natixis, ACWA Power approached several insurance companies in South Korea, which showed considerable interest in participating in the debt on a long-term fixed-rate basis. Having received interest from this new quarter, the US dollar shortfall was successfully bridged through inclusion of this set of non-traditional project investors. While there were several new lenders that expressed interest to participate, almost all the existing lenders also offered to increase their commitments going forward.

Structure of the refinancing

Based on the response received from the lenders to the RFP, the final bank group was formed by broad-basing the lender group with new lenders, and final fine-tuning of refinancing terms to allow for fixed-rate debt. The refinancing facilities of US$1.83bn equivalent in aggregate were provided on a combined conventional and Islamic basis. The two classes of financing parties would share the transaction security package.

The Islamic financing was structured as wakala ijara and procurement facilities, which was the same as the existing financing structure. The conventional facility was structured partially as mini-perm and partly as long-term fixed-rate debt.

The Saudi riyal-denominated wakala ijara tranche of SR3.2bn was provided by KSA banks, namely Alinma Bank and Al Rajhi Bank. The Saudi riyal-denominated procurement tranche of SR2.5bn was provided by KSA banks, namely National Commercial Bank, Banque Saudi Fransi, Arab National Bank, Samba Financial Group and Saudi British Bank (SABB).

The uncovered conventional debt consisting of the US dollar-denominated international tranche of US$312m was provided by the group of South Korean insurance companies – including Samsung Life, Dongbu Insurance and KB Insurance – and international commercial banks Natixis, MUGF, CA-CIB and Standard Chartered Bank.

The interesting part of the transaction was the incorporation of the long-term fixed-rate portion from the South Korean insurance companies. This structure, while widely implemented in the infrastructure space in the developed world, is first of its kind in Middle-Eastern IPP project finance. This pioneering financing arrangement represents a new pocket of liquidity for future financings in the region.

The mini-perm nature of the floating rate Libor-linked US dollar debt would imply that the project will go through a further partial refinancing in five to seven years.

Successful closing of the transaction

This refinancing transaction is expected to be the largest refinancing in the IPP space in the MENA region in recent times. The pricing achieved for both the Saudi riyal and US dollar tranches is very competitive under current market conditions in Saudi Arabia. US dollar liquidity has been complemented significantly by very competitive long-term fixed-rate debt provided by the South Korean insurance companies.

During the course of the execution of the transaction, Saudi Arabia's credit rating was downgraded by major rating agencies, which undertook a cascading rating downgrade of major banks in the country. Additionally, the liquidity situation has been very challenging over the course of the past year owing to the conditions created by the prevailing low oil price.

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The SAIBOR benchmark, both the spot rates and forwards, moved up drastically and the spread between SAIBOR and Libor has widened. In these difficult conditions, ACWA Power was able to hold the bank group together and ensure the commercial terms remained as originally agreed over the course of the refinancing process. That the refinancing has been achieved, not only in a challenging and dynamic bank market, but has also introduced a significant new pool of liquidity to the infrastructure sector for the first time in the Middle East, adds to the significance of the achievement.

The refinancing of Rabigh 1 IPP project is an important milestone for the project and its shareholders. This has been possible due to the strong credibility enjoyed by the sponsors and the effort from the refinancing team in keeping the banks engaged over the long-drawn process.

This re-leveraging of the existing financing demonstrates the success of ACWA Power's business model of continuously creating value along the life-cycle of its investments. ■

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