WELLSPRING IN THE WILDERNESS

IN AUGUST, THE MITSUI AND ACWA POWER-LED CONSORTIUM ACHIEVED FINANCIAL CLOSE ON THE SALALAH II IPP, A TRANSACTION THAT INVOLVED THE ACQUISITION OF AN EXISTING 273MW OCGT PLANT AND THE GREENFIELD DEVELOPMENT OF A 445MW CCGT PLANT. PASCAL MARTESE, EXECUTIVE DIRECTOR, ACQUISITIONS AND PROJECT FINANCE, AND LESLIE ABRAHAM, SENIOR MANAGER, ACQUISITIONS AND PROJECT FINANCE, OF ACWA POWER, PROVIDE A BIRD'S EYE VIEW OF THE PROJECT.

The Salalah II IPP is located in Raysut, within the Salalah Free Zone, in Oman. The 273MW open-cycle gas turbine (OCGT) plant (existing plant) comprises seven GE Frame 6 turbines and one GE aero-derivative gas turbine. The greenfield plant (new plant) will be located adjacent to the existing plant and comprises four GE Frame 6F gas turbines, four HRSGs and two steam turbines, and two air-cooled condensers.

The Salalah II power project is connected to the Salalah power system, which operates isolated from the main interconnected system of Oman. The project was awarded to the consortium of Mitsui, ACWA Power and DIDIC (Dhofar International Development and Investment Holding Company) after a competitive tendering process. OPWP, Oman Power & Water Procurement Company, is the sole offtaker.

The total investment amount in the project is approximately US$620m, including the acquisition cost of DGC's equity, and is being funded by debt and equity in a ratio of 70/30. Both the existing and new plants are owned by the Dhofar Generating Company (DGC), which is the project company. Financial close was reached in August 2015 and the new plant is scheduled to be in operation in early 2018.

Acquisition

Prior to the tendering process, the existing plant was the generating asset of the fully government-owned, vertically integrated Salalah generation, transmission and distribution system, operating under a concession regime with the government.

The original private procurement project as conceived in 2001 included development of an OGCT generating asset and the takeover of the transmission system under the Dhofar Power Company (DPC) and Dhofar Generating Company (DGC) group. The power plant was commissioned in May 2003.

The original developer was Public Services Enterprise Group (PSEG), a US-based diversified power company, and the EPC contractor was Larsen & Toubro (L&T), one of the largest engineering companies and contractors in India. The concession arrangement was on a BOT framework for a period of 20 years until May 2023.

Subsequently, the government entered into several discussions with the stakeholders to restructure the arrangement to bring it in line with the IPP structure followed in the sector. In November 2006, PSEG divested its stake to a group of Malaysian investors who eventually divested their interest to the Omani government by July 2009.

In January 2014, the generating asset was unbundled, the concession agreement was terminated and DGC entered into a power purchase agreement (PPA) with OPWP.

In line with Oman's privatisation objective for power generation, as part of the tendering process, the sponsors signed a share purchase agreement (SPA) in April 2015 to acquire 100% of the shares and shareholder loans in DGC, which was completed in June 2015 for a consideration equal to OR60m (US$156m) plus an amount reflecting the net working capital and debt position of DGC. DGC also entered into a PPA amending agreement to reflect the technical and financial offer tendered by the sponsors.

The acquisition of shares and shareholder loans in DGC was financed by sponsor-backed equity bridge loans raised at the level of the holding companies. The EBLs were arranged individually by the sponsors to fund their respective shares of the acquisition. Lenders include Mizuho Bank, Sumitomo Mitsui Banking Corporation, Sumitomo Mitsui Trust Bank and Bank Muscat, and financial close for the EBLs was achieved by May 2015, in time for the completion of the SPA on June 4 2015 and two months prior to the financial close of the senior debt.

Contractual structure

The sponsors, Mitsui, ACWA Power and DIDIC, now own 45%, 45% and 10% shares in DGC. Mitsui, one of the largest general trading companies in Japan, is a leading developer of power projects with a gross capacity of 36GW

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across North and Central America, East Asia, Australia, and Japan, as well as the MENA region.

ACWA Power is a Saudi Arabia-based IPP developer with 17GW of capacity – in construction or operation – in the MENA and Sub-Saharan African regions. DIDIC is one of the largest investment companies in Oman with significant interests in banking, insurance and other diversified sectors.

The Omani Government has structured the IPP programme with the intention that the general public (particularly the Omani public) should have the opportunity to participate in projects developed by private developers. Therefore, as a part of the IPP programme, the sponsors are required to offer 40% of DGC's issued shares to institutional and retail shareholders by no later than the fourth anniversary of the SPA (June 2019) through a listing on the Muscat Stock Market.

The EPC contract is a lump-sum turnkey contract with SEPCO III of China and key equipment from GE of the US. The O&M contract is a fixed-price contract including long-term gas turbine services and maintenance with Dhofar O&M Company, which is held by the sponsors. The O&M is fully subcontracted to NOMAC Oman, a wholly owned subsidiary of ACWA Power.

The offtake of both the existing and new plants are under the PPA with OPWP. As is the market standard in Omani IPPs, the PPA term is the 15th anniversary of the scheduled commercial operation date. The natural gas is procured by DGC under a gas supply agreement with the Ministry of Oil & Gas.

A full suite of financing documents underpinned the long-term limited-recourse project financing, with the lenders also benefiting from direct agreements with the procurer (PPA Direct), the gas supplier (NGSA Direct), the EPC contractor (EPC Direct) and the O&M operator (O&M Direct).

Financing structure

The senior loan is structured on a 100% uncovered, commercial basis with a US dollar tranche and an Omani riyal tranche. The senior lenders include Standard Chartered Bank, KFW IPEX-Bank, Mizuho Bank, Sumitomo Mitsui Banking Corporation, Sumitomo Mitsui Trust Bank, Bank Dhofar and Bank Muscat.

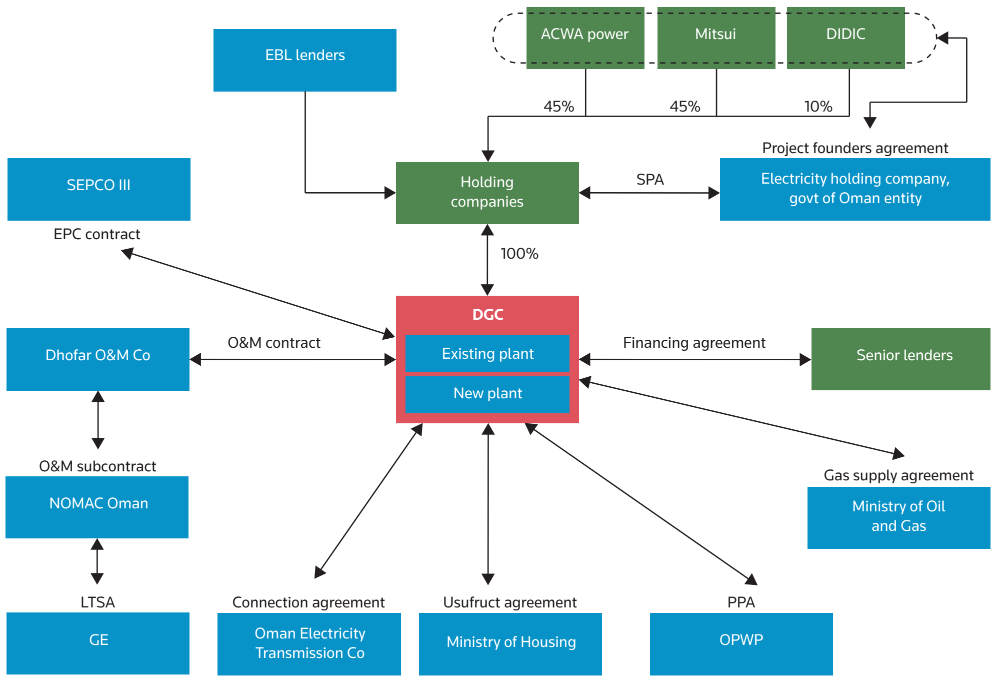
The loan has a 17.5-year door-to-door tenor, including a construction period of 2.5 years. The loan is structured to fully utilise the PPA term and also includes a small balloon that is payable on maturity. The amortisation profile was sculpted to meet the requirement of a 1.2x flat DSCR.

The equity in the form of EBLs was drawn upfront, followed by the drawdown of senior debt. As the acquisition price, exclusively funded by the EBLs, exceeded the amount of equity required to fund the project, such excess EBLs were prepaid at financial close out of a drawdown of senior debt.

During the construction period of the new plant, the existing plant will continue to generate power and produce cashflows that are also used to fund the construction in the base case. Lenders derived comfort from the significant reliable operating history of the existing plant, and the financing terms have no requirement to back-stop such existing plant revenues.

In order to diversify the pool of funds and improve their bargaining positions, sponsors have

FIGURE 1 - CONTRACTUAL STRUCTURE



also tapped into the Omani riyal market. The key challenge in utilising Omani riyal debt for long-term funding is that there is no mechanism in the market to fix interest rates over the long term as there is no benchmark rate.

Omani banks are able to offer a fixed interest rate for a duration of four to five years, and after that period the rate would be reset based on publicly available market rates and fixed for a further period.

The sponsors have worked with the Oman riyal lenders to put in place an innovative structure that mitigates the risk of resetting at higher level of rates than expected over the loan term, which is acceptable to the US dollar tranche lenders as well. This structure enabled the sponsors to effectively tap into the Omani riyal market for long term financing without material concerns to the US dollar co-lenders.

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Conclusion

The Salalah II IPP represents an important milestone for the sponsors. For OPWP, the transaction represents the fructification of the unbundling and privatisation objective for Dhofar Generating Company that was ongoing since the early 2000s. ACWA Power has further solidified its footprint in Oman after the acquisition of a majority stake in the 427MW and 20m gallons a day Barka 1 IWPP in 2010, and the two water desalination expansions, totalling 22.5m gallons a day, contracted since then. This project also represents Mitsui's first foray downstream into the Omani IPP sector.

The financial adviser for OPWP was PricewaterhouseCoopers. The legal advisers are DLA Piper, Allen & Overy and Shearman and Sterling for OPWP, sponsors and lenders respectively. Parsons Brinckerhoff Power acted as the lenders technical adviser while Fitchner acted as the technical adviser for OPWP. ■

The existing plant