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Roundtable

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Project Bonds in the GCC

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Project Bonds in the GCC

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Editor
Rod Morrison
Tel: 44 (0) 20 7369 7570
Fax: 44 (0) 20 7369 7482/3/4
email: rod.morrison@thomsonreuters.com

Participants
Derek Rozycki (Mubadala)
Simon Dickens (Latham & Watkins)
Paul Fairbairn (RBS)
Hussain Hussain (RBS)
Paul Chivers (BNP Paribas)
Rajiv Shukla (HSBC)
Mike Redican (Deutsche Bank)
Andrew Davison (Moody's)
Rod Morrison (Thomson Reuters)

Editor-in-Chief
Keith Mullin

Managing Director
Elly Hardwick

Associate Publisher
Ann Worsley

Advertising Director
Chris Keene

Head of Production
Clive George

Assistant Production Manager
Nita Webb

Senior Production Executive
Gavin White

Production Executive
Angela Allwright

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FOREWORD

Welcome to the Reuters Project Finance International "Project Bonds in the GCC" roundtable – sponsored by Mubadala, Latham & Watkins and Royal Bank of Scotland. The event was held in Abu Dhabi and followed the two highly successful bond issues during the summer from leading GCC issuers Dolphin and Rasgas.

In today's challenging credit environment, opening up a new source of capital for projects is an important endeavour – and that it what Dolphin and Rasgas did, in spite of the views of the sceptics pre-issue. Before the bonds were placed, there was a good deal of market commentary as to whether the effort of structuring the bonds was worth it. But it was, in both cases.

Using bonds in project finance is, of course, not new, but neither are bond issues for projects in the GCC countries. But at the start of the year the global capital markets were more or less shut down. Getting two significant and competitive priced issues transacted by mid-year was an important milestone, and opened up a new source of capital.

It was not just an important milestone for the projects themselves and their funding plans and strategies, but it was important too for the wider market. It is true that the bank market is returning to life and bank credit is becoming available for strong projects. But as the full and long-lasting impacts of the credit crunch hit home in general and the specific effects of Basel II come more into play, banks will no longer be able to do all the heavy lifting when it comes to funding projects.

The only real alternative to cheap and ever-flowing bank capital, which is now no longer guaranteed, is the bond market. Dolphin and Rasgas represent what is hoped will be the start of a long line of deals.

There are challenges. Both Dolphin and Rasgas were projects at the top of the ratings curve and some other schemes will struggle to match their profile. Both projects are operational. Both have extremely strong and government-linked sponsors. Yet on both, the tenor was more limited than in the past. But both set a template that GCC issuers and their advisers are now examining to see how it can be developed.

A whole range of themes and market issues came up during the discussion, which I hope you will enjoy. One theme was that the bank and bond markets should live together in funding GCC projects. Paul Fairbairn from RBS pointed out: "I think the first thing to remember is the banks haven't gone away." Simon Dickens from Latham & Watkins added that the two sources of financing were coming together more often

Mubadala's Derek Rozycki said at the end of the Roundtable discussion: "I think that the future of project finance, which is something that we are clearly keenly focused on, is largely a bank bond solution."

Participants

Derek Rozycki, Mubadala
Derek Rozycki has responsibility for the development and execution of comprehensive financing strategies for Mubadala. Before joining Mubadala, Derek worked for Barclays Capital in the investment banking relationship management, structured finance and credit risk management units.

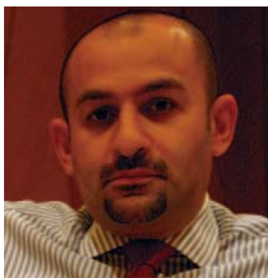
Paul Chivers, BNP Paribas
Paul Chivers is Head of Debt Capital Markets, CEEMEA at BNP Paribas, he has been with the bank for three years. CEEMEA DCM is responsible for the origination of all debt products within its region, with seperate teams specifically focussed on the Russsian, Middle Eastern, Central European and African markets.

Simon Dickens, Latham & Watkins
Simon Dickens is a partner in Latham & Watkins' Project Finance and Development group. Based in London, he represents developers, lenders, underwriters and governmental entities in oil and gas, LNG, petrochemical, fertiliser, power generation, solar power and other commodity-based projects.

Rajiv Shukla, HSBC
Rajiv Shukla is a Managing Director and heads HSBC's Debt Capital Markets group for the MENA region. He has been with HSBC for over 5 years. Rajiv has been closely associated with and led developments in the Saudi Arabian financing space, before taking on the regional role since last year.

Paul Fairbairn, RBS
Paul Fairbairn has 20 years' advisory experience, as a banker and a lawyer. He joined RBS in 1997. Paul recently advised Dolphin Energy Limited and its sponsors (Mubadala, Total and Occidental Petroleum) on its US$4.1bn financing, raised from commercial banks (US$1.4bn), export credit finance (US$218m), capital markets (US$1.25bn) and sponsor co-loans (US$1.22bn).

Michael Redican, Deutsche Bank
Michael Redican is a Managing Director, Debt Capital Markets, in the Global Markets division at Deutsche Bank and is primarily responsible for the structuring, negotiation and execution of structured bond transactions in the infrastructure sector. He has 28 years banking experience having worked initially with Citibank before joining Deutsche Bank in 1986.



Hussain Hussain, RBS
Hussain is a Director in RBS' Corporate Debt Origination team in Dubai, assisting GCC based corporate clients in raising funding via the capital markets. During the course of 2009, he has worked on the successful execution of a number of regional debut issues.

Andrew Davison, Moody's
Andrew Davison is Team Leader, EMEA Project Finance for Moody's Global Infrastructure Group. His current analytical responsibilities focus on limited recourse financings of energy and infrastructure assets, and include conventional project finance, PFI and PPP transactions. Andrew has a broad background in energy and infrastructure finance.

Rod Morrison, Thomson Reuters
Rod Morrison is the editor of Project Finance International.

Project Bonds in the GCC roundtable

Rod Morrison: So welcome, everyone, to this PFI Project Bonds in the GCC Roundtable. Our first question relates to the issuance by Dolphin and RasGas of project bonds. Maybe we could start with Derek Rozycki of Mubadala to talk us through the Dolphin project.

Derek Rozycki: Sure. Very pleased to be here. First of all, thank you everybody for joining us today. Dolphin was obviously a fantastic success for Mubadala, Total and Occidental Petroleum, our partners. It achieved everything we wanted to do and more. It was a transaction that had been long in the making and had been anticipated by the market for a long time. I think a project bond on Dolphin had been talked about since the initial financing back in about 2001.

We were very pleased with the efforts of all of the people involved, and I think it proved that the project bond market is back. It was the first 144a bond from a debut issuer – and I think that is an important distinction – since about 2007, and it was extremely well received by the market. It was not just a US dollar or US investor trade, as many of the transactions had been in the past, but in fact was very well distributed through multiple geographical areas. In fact, only 29% went to the US, which I think is much lower than we have seen in the past, and that suggests that there is a significant amount of demand out there from the market as a whole.

I think one of the great successes of this transaction was that we succeeded in competing multiple pools of capital together, so at a time when capital is constrained at the banks, having an alternative source, especially one that likes longer tenors, is very, very valuable for project sponsors.

So we had succeeded with our financial advisers – and I will let Paul Fairbairn speak about this a little bit more – to compete different capital pools against each other, if you will, or alongside each other, for the process of structuring. We had ECAs; we had Islamic finance in the equation; we had, of course, conventional finance; and we had the project bonds all along. In the end, in fact, it proved our efforts, despite all the nay-sayers that we would get a project bond done, especially given the challenges in the marketplace, the project bond came inside the bank, even on the pricing, which is a great success for us. This validates the project bond concept in terms of being a very competitive source of financing against the banks.

From Mubadala's perspective, this is an important development for the long term, because obviously bank capital is severely constrained and our perception is that it will continue to be severely constrained for the long run, so having this market develop is crucial and important to the development of project finance globally, I believe, going forward.

With that overview, I would like to pass on to Paul to speak a little bit more about the details of how the transaction was progressed.

> "We were very pleased with the efforts of all the people involved and I think it proved that the project bond market is back. It was the first 144a bond from a debut issuer and it was extremely well received in the market."

Paul Fairbairn: Thanks, Derek. The bond on Dolphin wasn't a last-minute event; a lot of time and effort had gone into planning it, we presented to the rating agencies in January of this year, and when we came out with the information memorandum in February, it clearly envisaged an important role for the bonds in the financing of Dolphin.

That was for a couple of reasons: one, as Derek said, there was a strategic ambition on the part of Mubadala and its partners to see the bond market in the region develop, and Dolphin was identified as being a transaction to facilitate that process. But also, when you looked at the debt sources that were available, clearly a requirement of US$4.1bn, of which US$1.2bn would be met by sponsor co-loans, still left a very significant amount that needed to be raised in the debt markets, and I don't think anybody could seriously envisage raising US$2.9bn from the commercial bank market. And of course even export credit financing these days is facing its own challenges if it is bank-funded, because that is also utilisation of liquidity. The old days where export credits were a way out of dealing with limitations on bank capacity simply don't apply any more.

So we were keen to minimise the demands that we were making on the commercial bank market, and with that we went out with a plan that envisaged round about US$1.5bn from the conventional banks, and we wanted to look at the possibility of accessing the Islamic market as well, alongside the Sace tranche and a bond piece.

The key thing, I think, was that we developed all those sources in tandem. Ultimately we didn't proceed with the Islamic tranche because of additional considerations in the context of this particular transaction; although we could have done an Islamic piece, it didn't really add a lot to the process, so we focused our efforts on the other sources.

I think the interesting thing with the Dolphin bond was the way that it really gathered impetus from a market perspective in the closing weeks because, as Derek said, there were nay-sayers through the process, saying "Why are you bothering, this isn't going to be competitive". We maintained the process all the way through the market – we were lucky with the market, I don't think we should underestimate that – and at the end of the day the bond was significantly upscaled.

I think to me, the key message coming out of it is developing multiple sources; maintaining that momentum across the

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The Roundtable panellists led by Derek Rozycki, centre

alternatives; keeping a competitive environment, establishing and maintaining a competitive environment; then making the ultimate decision on the funding structure based upon where the markets are as you approach closing. Particularly for the large-scale projects coming out of the Middle East, and you see that in a number of industrial sectors, that is going to be very important. You can't look to any one source.

Mike Redican: Do you think the fact that we actually had an operating track record with Dolphin was a huge issue in the marketplace? We may well come on to it, about greenfield/brownfield, but if you look at RasGas 2, that is something that started off life 10 years ago, a bit like Dolphin, as a project financing, and of course it managed to get its regional project finance bonds in a way that made it a landmark transaction at the time. But I think today's issue is that RasGas, with its track record of delivery, has turned itself into a structured corporate, almost, and I think similar things could be also applied to Dolphin as well: that you actually have a real business going that could be identified as a real business, which helped the marketability. Do you think that is a fair comment?

Paul Fairbairn: Absolutely. There are a number of factors that were very important for the success of Dolphin, not just a wider market liquidity issue. Given the very nature of the project: it is strategically important to the majority shareholder, who is government owned; it's vital to the economy of the region; it was operating. Those are definitely big pluses, but I don't think they are necessary conditions to a project bond succeeding. I don't think the operating track record is a necessary condition.

I think you will be seeing bond issues coming out of the region, there are obviously mandates out there at the moment with greenfield developments. That obviously brings its own issues from a structuring perspective, but I think the advantage that the bond issues coming out of this region have for strategically important projects is that people will pin the bond – to a greater or lesser extent – to the post-government sponsor of the project, and that will be a very important consideration in the marketability of the issue.

Rod Morrison: The market did move in your favour. I guess you had structured the deal so that you didn't have to do the bond.

Paul Fairbairn: That's right. We had an external debt requirement of US2.9bn and we had US$3bn of commitments across the commercial bank facility and the Sace facility, so if the market wasn't there, there was certainly no requirement to do a bond.

Paul Chivers: Personally speaking, I think it was a much more significant event than just another bond coming out. In fact, I think it is a huge step forward for the sector, and as Derek has already pointed out, really has opened up a new asset class that we haven't seen for a couple of years.

I think that people in this room have witnessed several false dawns for the project bond product really over the past decade with its most successful applications probably coming out of the PPP sector, but never with a sort of sustained run in hydrocarbons, telecoms and other industrial sectors.

I don't think it was any mistake that it was as huge a success as it was, in fact,

and I think that partly that's due to the fact of the momentum that was gathered in the region, of which the sponsors took full advantage at the right time. So I think a key lesson that I think the sponsors really grasped very early on, and their advisers in the Dolphin exercise, was that they were ready to go to market at the right time should the market be there.

The market in the Gulf region really didn't do anything for the first quarter, and again, it's no surprise that the countries that have really sponsored the market opening with the highest quality credits – the sovereigns of Abu Dhabi and of Qatar – have both taken advantage and have allowed their corporates and higher rated credits to access the market by providing liquid curves out there that suddenly produced the level of transparency necessary to get the bonds priced appropriately and give investors confidence that they were buying something of relative value.

The final point I would make on that is that as a result of that, we have seen both Qatar and Abu Dhabi lead with the first two project bonds in this region, and I think that these are very, very strong benchmarks and we certainly expect more to come as a result of that.

Derek Rozycki: Could I just add very quickly to that. You mentioned momentum in the market. It was developing very quickly and very favourably, and I think the Dolphin issue certainly benefited from the fantastic success of the RasGas transaction. We have some folks who can speak in depth about that now, but that was certainly a key component of our success in the transaction. It was very important to get these two very high-grade, very rock-solid credits out into the market early to really open up this space, and then, as you have said, Paul, the fact that they were both completed, that they were up and running, is very helpful but not necessary. I think it really opens the doors for new credits, including greenfield issuers.

Rod Morrison: Derek, you mentioned diversity of sources. How did you come up with US$1.25bn – because I guess you could have gone further – as to the size of the bond?

Derek Rozycki: Sure. This is always the tricky question at the time of execution when we are actually pressing the button. Right-sizing the deal and getting the pricing right is something that is absolutely crucial. Truth be told, in retrospect, I wish we had left another 12.5bp on the table or so in that trade. I think the reason being, we sort of conceptualise that 12.5bp upfront as an upfront fee, or similar to an upfront fee in the banking market. Aftermarket performance, I think, is something that issuers often underestimate the importance of, and we would like to see a bit stronger performance in the Dolphin bond. We are going to get it right on the next one.

So it was a question as to whether or not we would do a billion – as demand developed and our order book firmed up – and then what the right pricing is. We decided that shifting incremental capital away from the banks and into the bond market is something that's good globally for the development of the markets in the Gulf, so a little bit more of a pan-Gulf view on that one, if you will. Validating the strong demand in the market was very important to us, so we chose to bring it a little bit bigger, and we thought we would – it pleased investors also. I think investors were also looking for a bit of a bigger issuance to ensure more liquidity in the trade.

Rod Morrison: Andrew in London, it has already been said that there were two rock-solid credits. Would you say they were very conservatively structured from a ratings standpoint?

Andrew Davison: Yes, in terms of our anticipating the credit quality of both Dolphin and the RasGas 2&3 issuance, the building block we used to describe that credit quality refers to the underlying credit quality on a standalone basis, which we refer to as the baseline credit assessment, and then reflecting the importance of the sovereign sponsors under government related issue methodology, we see a substantial credit enhancement as a result of the sponsor interaction and the relationship of those sponsors with the government.

So in Dolphin, the underlying credit quality was positioned at a baseline credit assessment of 8, but that's equivalent to a Baa1 rating, with a number of enhancements to take it then to the definitive Aa3 rating. So that is evidence therefore of the strength of the underlying credit and the substantial credit enhancement of the sovereign component.

In relation to RasGas 2&3, our published ratings don't actually give a point output based on credit assessment that sets the underlying credit quality in a range that is equivalent to the Baa category. Then again, there is substantial credit enhancement we believe appropriate to reflect the importance of the local liquefaction project within the RasGas 2&3 portfolio to the sovereign level of Aa2.

So to answer your question, yes, we believe the projects are very, very robust.

Rod Morrison: Moving on to Mike. Do you see these two deals as landmark transactions?

Mike Redican: I think they are very important. I think the fact as well that only 29% was sold into the US shows that there is now at last a wider appetite for this type of asset class. I think there has always been a problem with education, and one of the problems we have had generally in infrastructure for the past eight or nine months has been that there has been a lot of plain vanilla corporate issuance out there at very good pricing. Now that is actually shifting a little bit and people are starting to look for yield, new asset classes, and it was very, very important to get this asset class out across a wider distribution network.

That gives me a lot of heart for the future, actually, but taking on from Andrew's point, one of the things that is going to help deals to be done in this region is the quality of the sponsor support, government involvement in shareholdings, and I know a number of deals that are out there at the moment will have some either direct government or a government entity in the sponsorship structure, which will be massively important for the region.

So it's going to be either government or extremely strong corporate sponsors driving the deals out there. That will be a big factor. Because it's both a management and an essentiality issue, which I think will be important to getting wide acceptance from investors.

Paul Chivers: I think it is fair to say these were the right deals at the right time. I think the timing of bringing two very, very highly rated projects to the market, you know, within a week of each other, shouldn't be underestimated. The market demanded top quality and it got top quality.

I think that it would be interesting to hear from Andrew how many other sort of Aa rated credits there are out there in the project world, and then suddenly two

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come along pretty much at the same time and open the market up.

I think that's been necessary. I think it got investors more comfortable as a result of that and, no question, gave a lot of momentum to each of the deals as a result of exactly that credit quality.

Andrew Davison: I think the point that Paul has spoken to in relation to the timing for the Dolphin and the RasGas 2&3 issues; I think that's a very important point. It comes on the back of sovereign issuance by Qatar and by Abu Dhabi earlier in the year, and then subsequently in the first quarter the issuance by a number of quality corporates that prepared the ground for subsequent project issuance, with reference to the quality corporate and positions by Mubadala, by DIC, Aldar, TDIC, and in Qatar, the issuance of Qatar Telecom. For example, in Qatar Telecom's case, I understand that the US$1.5bn debt issuance was itself nine times oversubscribed.

So in that context, while there hasn't been a great number of project deals in this type of rating category, that is the very strong part of the rating range, I think what was a very significant contributing success factor was clearly the ground that had been prepared by the sovereign and the quality corporate issuance earlier on in the year.

Rod Morrison: Rajiv, you worked on RasGas. Were you surprised by the success of the orders you got? US$17.5bn, wasn't it?

Rajiv Shukla: We were rather pleased by the eventual subscription, but as has been said for both transactions by other people, the market was one angle. I think a lot of trouble had been taken to structure the project ahead of time and ticking all the necessary boxes. Of course, the sponsor support, the fact that Qatar is gas, was an important story. But simply getting the structuring done in the best possible manner, and yet presenting it lucidly to investors was – to bond investors who typically have a much, much shorter attention span than project finance loan bankers do – very important.

In Qatar RasGas's case, this presented the final bit of debt-raising of its US$10bn programme. What helped was the fact that the amount to be raised was absolutely definite and announced ahead of time. It goes back to your point, Derek: you were not looking for an infinite amount of money; you would have been very disciplined about it. In that case, the market knew what was to be taken and they would not take more, so that kind of snowballed the demand a lot more.

In RasGas's case, this represented the third time they have actually approached the bond market, and it was very clearly their desire to try and shift the positioning to a corporate – these were bullets, which is not typical of project finance amortising structures. But again, there were three, five and 10-year bullets across which the placement was done, thereby giving the benefit at the one end of pricing, at least shorter date of transaction, providing that pricing benefit, and yet if you model it, it still gives kind of an amortising feel to the whole structure from the project perspective, at the same time achieving the whole objective of becoming more corporate, so the next time they approach the market, it will be as a corporate and not in a project finance transaction.

The dynamics on pricing, of course, reflected the way the market received these transactions. Dolphin was a success, but preceding that, RasGas, a success to come well inside the secondaries of RasGas where they were trading and bring the whole Qatar curve down. All the various Qatar people who were out there actually came in as a result – through the period as the price whispers went out, the price guidance went out, and eventually RasGas came in at one of the tightest spreads to the sovereign by the time it was priced.

Mike Redican: Did you consider going longer than 10 years? Obviously, we have seen longer amortised deals in the past. I think when I first saw it I expected at least one piece to be longer than 10 years.

Rajiv Shukla: It was a possibility, but ultimately it was a question of what would be accepted in the market. Actually, the 10-year tranche itself went a little beyond 10 years, and that created a problem for some of the investors who have 10-year limits. But when they were happy with the rest of the transaction, going a few months over didn't matter.

Paul Chivers: I think that point on amortisation, though, is actually quite an interesting one when you look at the two projects, because on Dolphin we had a fully amortising profile for the bond and we had the three tranches with bullet maturities on RasGas. I think it is fair to say that the sponsors considered the bullet maturities on RasGas. But the advantage that RasGas had, I think, was a much longer operating history and a more corporate-style profile, as Mike mentioned earlier, and I that's to its advantage; and it really gets away with almost a synthetic amortisation through the various maturities.

I think on Dolphin, though, that investors looked at the maturity, understood it; I think the investor group globally now is pretty sophisticated. They are well educated, the questions on the road were good, and they absorbed that amortisation profile, and it was certainly one of the key facts that were part of the discovery in terms of marketing the bond.

Rajiv Shukla: I think that is absolutely right. We would be a little cautious in saying that these two transactions have created a new asset class. It's probably the precursor of a project bond asset class, but of two strong corporates – two strong projects with corporate-like characteristics in a market that is really seeking those. Yes, as we move from that continuum to the more Greenfield-like projects, that will be the real test. At the same time, the momentum in the market, in the investment market, seems strong, but it will be overlaid with: Is the market acceptability there?

Hussain Hussain: I would agree with that. I think the advantage of RasGas, as well, the sheer size that they were looking to raise, gave them the ability to structure it as well to kind of three different tranches. I think with Dolphin, while at the end they did do US$1.25bn in terms of financing, so it would have been able to do it in various tranches. Initially, they were looking at somewhere from 750 to 1.25. So it wasn't yet certain that it would attain the benchmark sizes that one would need for various tranches in order to get investors to get inside and participate in these deals.

Again, echoing what has been said so far, clearly these are two of the strongest corporates and two of the strongest projects to come up to the markets, and I think it is important for this asset class to reopen that it starts with the strongest projects to emerge, to perform well, to price well, to get the market excited around it, and that will subsequently lead more of the Greenfield-type projects to subsequently emerge.

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It is essentially an orderly progression of issuance as we have seen in the corporate market, where it started with the sovereigns, moved on then to the quasi-sovereigns and the corporates, and in time more cyclical type of issuers should emerge, and maybe even an issuance out of Dubai from the GCC region as well, as people get more comfortable with the project and the asset class.

Simon Dickens: With respect to RasGas, I think one of the keys to the success, as has been noted, is that this is not the first time RasGas has gone to market. One of the benefits of having these capital market programmes in place is that you do have the ability to time things much more quickly than you do if you are a greenfield issuer. When RasGas 2&3 went to the market the second time, they didn't feel that the bond market was going to be there, they were able to structure a bank transaction, they were able to take a little bit more time. In 2005, they went to the bank and bond market; in 2006, just the banks. This time I think they were perfectly willing to go to the bank market if the bond market wasn't there, but there was a feeling following on the strength of the sovereign offerings in the region that the bond market was going to be a viable choice. I don't think anybody expected it to have the response that it did get, being eight times oversubscribed.

To me, one of the very interesting features is the tenor, both of the RasGas bond and the Dolphin bond. Five years ago or more, when people were looking at structuring project bonds, the last project bond in the state of Qatar was the Nakilat bond in 2006, and that was significantly longer than 10 years. I believe it was about 19 years. People were looking at the bond market particularly to stretch the tenors, and it's very interesting to me that the two very successful project bonds that have come out recently are both capped at 10 years. I am wondering if this is just a temporary reaction to changes in the market or whether this represents a real shift in what project investors are going to find acceptable in the medium to long term.

Derek Rozycki: That's an interesting point and something I can address. We actually have a project where – in 2007 and again in 2008 – we tested the markets; that's Emirates Aluminium. We tested the markets for longer tenor deals, 20s and 30s,

Derek Rozycki and Rod Morrison

and actually we had a bid from the market, it was pretty thick pricing, and we decided not to proceed with that. But the bid was there, and I think that's important.

Now, I agree with you completely: the question right now is whether it continues to be there. There are certain advantages and disadvantages to going out that long. Obviously I think for projects that by their very nature require a little bit more flexibility than straight corporates in many senses, it's nice to have banks there who are a shorter tenor bond, I think issuers and sponsors get very nervous about having a 20-year project bond out in the market, from the perspective of how much it ties the sponsors' hands in terms of expansion, other joint ventures, and just the normal challenges that come up in the project bond market as a single asset entity.

But we have tested that, and it has been there in the past, and I guess our view is that it will come back again in the future, and this is important for the development of one area that we look and hope to push forward in the future, which is the PPP space in Abu Dhabi specifically. We have a number of university projects that are hopefully going to be entities that will be strong potential issuers in the 20ish year tenor.

Hussain Hussain: I think it is a matter of time essentially for the market to progress from where it is right now. Even in terms of the corporate market, it has really been limited to 10 years, if you look at all the issues that have come, even from the sovereigns, but I think in time that is going to progress.

Mike Redican: The US market has been used to taking longer bonds for a good many years. You have seen obviously in the UK and Europe the development of long duration bonds. There are absolute natural homes for that.

One of the problems I think is that in this region, because the sovereign issuance has been relatively short, we have not seen many people going long beyond the sovereign, and therefore for investors there's just a little bit of – I won't say "resistance" – but a little bit of inertia, shall we say, to progress a long way away from where the sovereign's longest trade has been.

Having said that, I am glad you raised the PPP model. I think, as these things are greenfield – I am sure Andrew will say – you know, the agency does get very concerned about refi risk on these sort of concession type deals. Clearly, being able to get a longer piece of bond debt together with some shorter bank debt actually helps manage that refi risk in a much more effective manner.

We are talking to people the whole time. If you have, for example, a 12-year bond, what do you do with your bank debt? Because you don't want it all coming to you at the same time or within a year, so even if you could get a 10 or 11-

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> "Let's just try and remember for a minute how far we have come. We are still getting towards the end of the third quarter in 2009. Let's remind ourselves that in the first quarter there were absolutely no capital markets issues in the region, whether it be sovereign, corporate financial or otherwise."

year bank debt, you wouldn't necessarily want it if you only have a 12 or 13-year bond, because it puts too much pressure on the refi risk.

So we are trying to encourage the market to go a little bit longer so we can manage the maximum liquidity in the bank market with the liquidity in the bond market.

You can have an amortiser with a bullet, because you know you are always going to try and work off the economic life of the asset. On the concession agreement, for example, if you have a 30-year concession, you would not want to have a 15-year amortising bond. That would be inefficient. But you can definitely do a partial amortise.

Paul Chivers: Let's just try and remember for a minute how far we have come. We are still getting towards the end of the third quarter in 2009. Let's remind ourselves that in the first quarter there were absolutely no capital markets issues in the region, whether it be sovereign, corporate, financial or otherwise.

I think that the maturity issue is really driven by the investor base at this point in time, and I think that the five and the 10-year in US dollars is absolutely the sweet spot, and whether it is projects at the moment, sovereigns or corporates, most people coming to the market, most issuers coming to the market are targeting those two maturities, and that's very much driving the capacity of the market at the moment.

Derek Rozycki: There is a very interesting question there, and I put it obviously to the banks, to the investors as well, to Andrew. Is a hard semi-perm facility – that's what we term it in the bank market – something that the rating agencies would consider, and how would you consider it? In other words, having, say, 40% of the notional amount amortising and a 60% bullet in year 10 in order to achieve an effective tenor of significantly longer? Because we are definitely hearing that five or 10 years is a sweet spot, but there are projects out there that just don't work with five or 10 years, and if you want to layer in some bank financing alongside it, the banks certainly don't want to be structurally subordinate to the bond market in terms of the bond investors getting out first, so how do we deal with that challenge? I can tell you that, certainly from our perspective, a five or 10-year issuance on our PPP projects is not something we are terribly interested in. Perhaps in a refinancing spectrum down the road some years, but we would like to get the market moving before that.

Andrew Davison: Given that there aren't that many projects that have been rated, that actually work through some of the tensions between different senior credit groups in relation to the issues that you outlined, the guidance that the agencies can give to an issuer or to an adviser is to some extent a moving feast at the moment. Some of the tensions that are clearly evident include the potential for there to be a divergence of the pari passu nature of a bond issuance vis-a-vis a bank syndicate, and that creates some degree of tension. There is, in relation to some transactions we have seen, potential for there to be a corrosive and adverse introduction of terms, which perhaps work against the interest of bond holders, and as a rating agency, we are sensitive to a potentially – an increase in the divergence between the credit quality of a transaction viewed from the perspective of a bond investor which may be exposed to long tenor, may be exposed to refinancing risk in the sense that the banks are out early and therefore the exposure is weighted more towards bond investors, and so on.

So I think it's very much an evolving area, which is responding to a theme that as a rating agency we see across a range of different project finance sectors. Our thinking – in terms of analytical framework to try and capture the issues and benchmark them – is evolving, but clearly, where you do have refinancing risk in the mix compared with a fully amortising project, the credit is negative. The key question is how much and what it does to the rating.

Mike Redican: We have done work with a number of rating agencies, and on a previous deal, we did a deal with Moody's where we had this effective amortising structure with a bullet, although it was more in a utility space type transaction rather than a project transaction. But we are very aware of the maturity book issues on refi risk. Certainly, we recently did an acquisition finance structure that was rated where we actually contemplated take-outs of the financing on a 3/5/7 year basis from the bank financing, where again we dealt with the rating analysis of how a bond would look, and the intercreditor arrangement between those various classes.

Now, this actually wasn't something that Moody's worked on, but the principles and the issues that you have just mentioned all came up in that analysis.

We were able to structure around a lot of those issues to get a decent investment grade rating, certainly not an Aa2 or Aa3 level, but we were certainly able to get up there by structuring it.

So we are cognizant of the issues, but I agree with Derek: if you are doing a PPP structure with a long economic life of the asset, and providing you manage the refi risk among the various sorts of finances correctly, then it should be reasonable for us to demonstrate that you can manage that refinancing risk on the basis of a contractually robust contract structure.

I think we are looking to bring transactions to the market where you would give a lot of weighting for their essentiality, their government involvement, and the other

things that we mentioned earlier, around a more robust structure. The only thing I would say to governments is that they have to realise that they are not in the old days where a lot of infrastructure project was pushed in the bank market right at the most marginal level, if they want access to the bond markets in this space. But I do think we should be able to bring deals of say 15 years with some amortisation and some bullet, because we can manage the concomitant refinancing risk.

Rajiv Shukla: Actually there isn't much of an investor issue as much as issuer issues, other structuring issues and perhaps credit rating agency issues.

In the project bond space it is a structured bond and it is not the typical corporate type of investor that you are looking at. Sure, if you bring the reference back to these two deals, there was a lot of corporate feel about it. But for most of the more Greenfield-type or even the slightly more brownfield-type project bonds, the assessment that will be done is a fairly sophisticated assessment, and for those classes of investors, our analysis is, especially following the last couple of deals, that if they are willing to do that sophisticated analysis, they will take different amortisation profiles and more sculptured profiles if necessary and they will price the refi risk if necessary.

Simon Dickens: This is where you get an advantage by having a multisource financing, because not only do you create the competition between the various markets, but you are able to address certain of the risks for the overall transaction while maintaining a certain profile for a particular product class.

We have been involved in certain transactions where you have a 25-year amortisation schedule but only a 12-year debt horizon, and in fact it was Moody's that was the rating agency we were working with on that particular project bond that had raised this as a particular concern. We were able to structure around that to the satisfaction of the rating agencies and achieve an Aa rating by addressing certain of the factors in the bank pieces rather than in the bond pieces, and then also creating overall incentives for the sponsors to address the refinancing risk early.

Mike Redican: There's the soft mini-perm rather than hard mini-perm argument here, because what you are always trying to avoid is cost of default. Simple as that. Cost of default through failure to refi is the big issue. So if you can get to a soft mini-perm situation, it actually puts the pressure on the sponsors and it buys you time to get the refi done.

Rod Morrison: Paul Fairbairn, moving on to the question about benefits of project bonds, I have heard a lot about the mix of various sources of funding, but where do project bonds stand at the moment in terms of the overall capital markets and what's available from the capital markets?

Paul Fairbairn: We had two issues come out of the region that had particular characteristics, which meant they were well suited to the bond market, and clearly the benefits in terms of better pricing and diversification of funding sources were evident in spades on those two transactions. And with the very large financing requirements coming out of the region, there are a number of projects that are making no secret of their plans to access the bond market to give that diversification to avoid over-dependency on any single debt source. That, I think, is going to be a continuing theme.

There are two aspects: there is the positive and the negative. When you look at the negative aspects, there are constraints on liquidity, and that is impacting commercial bank capacity for uncovered debt; it is also impacting the ability to raise very large amounts of export credit finance. That is pushing people to look at alternative sources in the bond market and has got to be there for that reason.

Maintaining parallel tracks gives you the flexibility to be able to explore the different alternatives, because it is difficult, given the lead times with projects, to know that when you want to execute in 18 months time that particular debt source is going to be available. That is always going to be an issue for greenfield projects.

I think what is the greatest opportunity for the bond market in reality is that the deals that are being done in the bank market and have been done in the bank market for the last 12 months or so have been done at historically very high pricing. They will need to be refinanced; everybody is saying they will need to be refinanced in the next two or three years. Those obviously prime candidates for refinancing in the capital markets as they move out of the construction phase, and again, once you see that momentum build up, more and more transactions coming into this area, you might start seeing more venture into the – more scope for the capital markets in greenfield projects as well.

So I think the basic issues of construction risk are always going to be there. That's obviously mitigated to the extent that you have very strong corporates who are able to address that. But I think the most immediate or a fairly immediate opportunity for the bond market is going to be refinancing of the deals that are being done today in the bank market.

Rod Morrison: Were you surprised that the Dolphin bond came out cheaper than the bank loan? Do you see the banks having to respond?

Paul Fairbairn: I think that is happening anyway. Banks out there now are prepared to write business on the basis that they see this as pricing that is not sustainable, it's going to go south, so, frankly, they want to grab the fees while they can.

As to the particular dynamic there, that's a function of timing. If the bank deal had priced not in April, as it did, but had priced in July, I'm sure it would have come in tighter than it did. So the bank market is already recognising that times are changing.

Derek Rozycki: One of the challenges that we have had historically, because there have been a number of false starts in the project bond market, is that the bank bid has been so strong. The days of what I believe were ridiculously tightly priced deals hopefully are gone. I think that the pendulum was too far to the tight pricing side of the equation for quite a long time. It's swung back in the other direction now, to the high side, but in our estimation, it's not going back to the days of PPPs pricing sub-100bp, and that's a good thing from our perspective, because it's not long-term sustainable.

So that's one of the key drivers of why this market is going to develop, because the long tenor bank pricing is essentially significantly higher than it has been in the past.

Paul Chivers: We can observe two dynamics right now. We have started with the resurgence of the bond market. Actually we have a bank market that is under tremendous economic stress and is

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Husssain Hussain and Rajiv Shukla

deleveraging worldwide. Compounded by that is an undercurrent of the effects of Basel II, which I think has been overlooked in the financial press as the headlines are caught up by other major economic and political events.

So in that context, pricing has to go up, and the effects of Basel II will be making bank loans less competitive in the future by them being more expensive. At the same time, you have a resurgent bond market and I think that at this point in time, where the two have met. I think there is some surprise that the bond market came in so fast, given where we were at the beginning of the year, and ultimately, on a swap basis, priced inside the loan.

In fairness, the loan market dynamic is quite different to the bond market, and both Paul and Derek have pointed that out. So the fact that the marketing exercise for a bond is over within about a week to 10 days and the bond is launched and priced gives issuers a very opportunistic way in which to take advantage of that market to the extent that it's there and the underlying sort of coupon that we are paying on the bond meets with their overall pricing targets.

Rod Morrison: Obviously Basel II has been around for a long time. Is there anything new?

Paul Chivers: I'm not implying that it is new, but I think that as of January this year, banks were forced to adopt it rather than voluntarily so. As a result of that, the pricing models in banks are really quite radically changing, and the cost of capital and the ability to put capital out for term is really focusing a lot of balance sheets right now.

Mike Redican: There are two issues, and you have hit them in one sentence there. Pricing and term. Today, I agree with both Pauls: I think pricing will come back in the bank market but it can't come back to anything like it did because of the constraints that Paul's just mentioned.

So that starts to make, on a price relationship, the bond more competitive than it was. But what we have been finding is that where banks have really started to become constrained is the number of players who were really prepared to take the basis risk of doing a 15/20-year bank loan. So they might have, say, a 15-year legal, but actually, if you look at the sort of step-ups they have in years seven and 10 and whatever, there is no equity in the world that's going to want to live with it, quite frankly. That seems to me the issue that we have to address.

If you are having a small deal, arguably, is it worth going to the project bond market? The greater the capacity of money that you need; the more you get. If you are just looking at a bank deal, the more you are looking at the marginal players to fill your capacity, and the marginal players are the guys who have the biggest problems. So the term will come in, the price will go up, conditions will be tougher.

What the project bond market offers over time – providing you can live within the rating constraints, which are both for the agencies and for the liquidity where the market is – will be that longer term, because of the asset liability and issue of the investor base. And that's where I see the opportunity. Because banks are struggling to go longer term, and I think that really sort of helps the development of the market.

But you can't shy away from the fact that on a mixed financing you have to deal with the refinancing risk and you have to avoid the default risk. So when we are talking to banks, we say: actually it's helpful if you have a soft mini-perm structure rather than a hard mini-perm, because we don't actually have that default. We have a messy cash sweep to deal with, but we can honestly say hand on heart to the agencies they can't default the bonds just by failure to refi, which again is a helpful thing in managing the position. That's why I think we have a good chance of getting this market going.

Rajiv Shukla: Quite apart from the diversification of funding benefit that comes with expanding it to the capital market space – it is perhaps just a function of time that for some deals, the bond market has come in below the bank pricing. I think the banks are going through some stress, but ultimately, if we look at it, they may not be able to match the bond tenors, or be comfortable with the kind of long-tenor bullet maturity. Ultimately, and sponsors play this game very well, it is going to be a relationship thing. Bond investors are relatively more agnostic, they will look at a bond, look at the comparables and then price it up, whereas banks will look at the other ancillaries, they will look at everything else around, and they have a much more flexible process. They have a lot more to offer the sponsor in terms of the flexibility of the financing and the other services they bring. When things stabilise, as they ultimately will, and perhaps it will go again into la la land – at that point in time bank financing is expected to be very competitive as well.

Hussain Hussain: One thing to bear in mind as well is there has been a paradigm shift of liquidity, a lot of it has gone into bond funds, and those bond funds, they need to invest it, they need to find homes for asset classes. They have started off with the best asset classes, but in time the investors also want to have higher returns, and this type of asset class, with the robustness it gives, with the security and

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all that, is going to clearly provide them with additional yield at very attractive levels. So from that perspective, in terms of the risk they are taking, from that perspective, clearly it is going to open up the road for longer tenors in time and appetite for maybe more risky, if you would like to say, newer types of project.

Derek Rozycki: A quick thought to that from the sponsor and issuer side: certainly in our discussions with investors, as we reach out to the community both as a corporate and as a potential sponsor of project bonds, we've found that they like the tangible nature of project bonds. In other words, it's an asset, they can very simply define it, they can go and visit it and kick the tyres and make sure it's there, it's not a slice of a slice of a slice of a million different things like we have seen in some of the structure bond space, so it's something that is very tangible, and they get very comfortable with and do their analysis on that.

They also, as you said Hussain, like the concept of having yield enhancement and a yield pick-up relative to like-rated entities, so a Single A sovereign, a Single A corporate and a Single A project are going to be priced differently, and that's something that people have identified as obviously beneficial to their portfolios.

In addition to the important drivers from the sponsors' perspective of increasing liquidity, diversifying pools of capital, etc, the investors have to be there on the other side, and that dialogue is picking up. People are taking note of this investment class, which is fantastic news, and I think very different from what we have seen in the last ten years as the market has started and stopped and started and stopped.

Rajiv Shukla: Wouldn't you say that also one additional benefit to the sponsors, apart from what you have said, is that visibility? It's the natural financing progression: initially you are confined to banks and when you go out to the bond class it brings more visibility and therefore more profile with knock-on benefits from customers and everything else, makes you a little more transparent.

Derek Rozycki: Absolutely, and Mubadala itself has a drive towards transparency, as the market will have seen in the last year or so. We have issued our financials, we are encouraging transparency across the spectrum in our joint ventures, etc, and that is a very important aspect for us, and something that we look to push forward. I think the region needs to push forward to gain increased acceptability across the global capital markets.

Rajiv Shukla: Just to amplify that point, because the tendency in the region, particularly with relationship banks, has been a very non-transparent kind of relationship. This brings with it its own corporate governance problems and some things have become a lot more apparent now with some of the blow-ups in the region. Certainly by being able to push more of the financing into the capital market sphere, it helps the management get the sponsors to becoming more transparent and taking that financing evolution along.

> "We have had conversations with a number of banks recently and frankly people are all over the shop as to issues like whether they would like a hard mini-perm, a soft mini-perm or a full amortiser."

Rod Morrison: Let's just discuss investors and go around the table on that. But I would like to finish off on the banks. Paul and Paul, do you see project finance banks coming back to the Middle East – notwithstanding the obvious point on Basel II?

Paul Fairbairn: I think the first thing is the banks haven't gone away. The number of players has reduced, for a variety of reasons. The sorts of things that they have been prepared to do have changed. You have seen some banks that have said "we need to focus on our home country issues", whether it be Germany or elsewhere, which has meant there is less capital available for Middle East projects.

Those constraints will ease but you will not see the level of liquidity that we saw two, three years ago come back, because there is a de-leveraging process, that's a fact. Banks are not going to be able to lend as much as historically they did.

In terms of the issue of maturities, it's going to be interesting to see how that develops. Yes, Shuweihat is out there with a 22-year tenor, and no secrets, that's not been an easy process. You have had, on the other hand, transactions like Al Dur, which have been done at much shorter maturities. There are other transactions out there at the moment that are looking for the 15, 16-year full amortisers, so it will be interesting to see, it is very much a dynamic space.

We have had conversations with a number of banks recently and frankly people are all over the shop as to issues like whether they would like a hard mini-perm, a soft mini-perm or a full amortiser. There are very divergent views.

I think what we are seeing is they can't go beyond seven or eight years. Hard constraint is softening; people do expect that we would move beyond that. But I think there is going to be a real question as to whether people will go out and frankly whether sponsors will want banks to go out to a fully amortising 22-year deal, because that does lead to capital inefficiency. It has to lead to higher pricing, there are very real pricing impacts of going longer tenor. I don't think it is necessarily going to be the most efficient way to structure a transaction.

Derek Rozycki: If I could add very quickly to that last point, from the sponsors' perspective, we are very keen on proving up to the banks that we will be able to recycle their capital, that we are driven to recycle their capital. We think that this is an important leg of ensuring the availability of project finance to our transactions going forward. So we are spending a lot of time internally diligencing this issue, diligencing how we can develop mechanics that will ensure that credit committees and capital allocation committees get comfortable with the fact that we are going to take these deals out of the bank market, hopefully post-construction, surely post-construction, and put them into the bond market.

So really from the banking side it is more than a refinancing to another bank facility, we really want to develop that confidence that the bond market, while it may not be there at a certain time, it will be there a year later or a year earlier.

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So we are not proponents of short-tenor construction financings for our projects; rather we would like to see seven or 10-year hard or soft mini-perm facilities that are legitimate project financing structures but where the sponsors have strong undertakings that are backed by activity in the market that these deals will disappear or be recycled in the near term. And that's very important.

I very much see that as the future of project financing, there are not 20-year deals any more. There are absolutely going to be very successful deals like Shuweihat, we had one of our own last December, a 20-year PPP financing for the Sorbonne University in Abu Dhabi, but those will very much be the exception to the rule. We need to have the confidence of a very strong bond market.

Paul Chivers: I think that historically, when we have been through recessionary periods, I have considered the bank market going from being hyper-competitive to just super-competitive. As a result of that just slight deterioration for a short period of time, inevitably the banks have come back and we have gone back quite quickly to very long tenors, very low pricing.

I think this is different, it feels different this time around. We are dealing with much bigger issues and more profound dynamics that are affecting the underlying pricing and profitability of loans.

I think the bank market and the bond market are highly complementary. Let's remind ourselves, the bank market takes short-term deposits and really is getting a little bit out of kilter by making 25 to 30-year loans very cheaply off the back of that. It really needs, I think, to focus on what it's really good at: sophisticated credit enhancements for medium-term financings. I believe this is where the US market got it very right early on: the US market understood risk-adjusted return on capital very early on, the banks withdrew from the project market largely globally and were very happy to play a role of parcelling up risk, financing it through difficult, you know, periods of construction, for example, and then allowing the refi to go to institutional investors. I think globally that's a workable model, it's a sustainable model, and that's certainly where I would like to see it end up.

Mike Redican: Derek made a very good point about the importance of everyone understanding the need for banks to recycle capital. If you think about it, no matter what the will of the bank is, seriously, when they are looking at regulatory constraints and everything else, if you are putting a lot of long-term assets on your books, that by definition is making it harder for you to manage your balance sheet. It just is. If you have committed 25-year money at a price, then that is there permanently for 25 years. You are going to have less flexibility in your balance sheet.

I think it is encouraging to hear an issuer who is alive to the problem: that of course it's an equity issue if you have a refi risk. It's very nice for equity to say, "Great, I have my financing locked in at 20 years, if I manage my operational stuff okay I can manage my equity return". I think it is good to hear an issuer who is actually alive to the issue for banks – obviously someone wants to make his equity return or the return on projects as good as possible, but recognising that you need to use the other tools available in the market.

One of the mistakes that we saw in the UK, when the monolines were at their highest and we were selling AAA bonds very tightly, was there were a lot of people entering into PFI transactions saying, "Yeah, we will do 25 at 85, because the bonds will take us out of the AAA". Well, the monolines blew up and all those deals are haemorrhaging. If they were mark-to-market, there are a number of banks whose numbers would look even worse than they currently do as a result.

So I think banks have learnt that lesson, but you are right; they feel under competitive stress. No project finance banker wants to feel that he can't lend money. He still has to make a living; he still has teams to support, so to take Paul's point, there are still people out there. Where they have the problem is with their capital allocation committees, their credit committees are saying, "Well, the issuer wants 20-year money, you are not going to get it unless you do this".

I think Paul Chivers is right by saying: let's focus on the complementary side. I think the bond markets have a role both in greenfield day one and in take-out financing day one, quite frankly. Clearly, it's for the rating agencies to work with arrangements and structures to determine that the greenfield risk can be managed and get to the acceptable rating. We are looking at very large projects, in particular some of the size of the deals coming out of this region, they need multi-source financing in any event.

So it is important that we all actively encourage this market to develop and make sure that the good start in investor education, which Rajiv, for example, and his team have done and Paul and his team have done on these two important transactions, actually disseminates down through the market.

If you think about it, if the deal is strategic and important, there's a massive incentive for the sponsors and the governments to keep it going, much more so than a normal corporate, if we are absolutely honest. So I think that is a big driver that is not often understood by investors.

Rod Morrison: Moving on to investors and the great bull run in bonds. Simon – do you see the bond rally continuing?

Simon Dickens: I do. It is interesting as you look historically at what bond investors have seemed to want compared with the bank markets, the banks are very willing to roll up their sleeves and get involved with the sponsors. As problems come up or difficulties arise on a transaction, they will sit at the table and work them out with the sponsors, which is of course not what you expect or particularly want from a pretty disparate group of institutional investors that typically want to put their money on the table and get their coupon and be left alone.

As you see the two sources of financing coming together more frequently in capital structures, it's quite interesting. I am a lawyer so I find this stuff interesting, how you structure these transactions to kind of create proxies for the institutional investors, so the sponsors continue to have the flexibility of being able to sit down with their banks and have the benefit of having the long-term investor sitting there without having to educate them. Now, education is a very important thing, as Mike was talking about, making sure the institutional investors really understand the risks that they are being asked to underwrite. And I do think that there will be an increase in understanding among these institutional investors, and I think you will see an increase in their willingness to accept some of the risks that traditionally you would only expect bankers really to take, to understand, particularly construction risk.

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Traditionally, when you look at particularly the US market, institutional investors would back away from any sort of construction risk. If you had an AAA rated monoline insurance wrap, you don't worry about that, and you just kind of rely on the balance sheet of these insurers. When the balance sheets of those insurers deteriorate, they suddenly have to understand the construction risk.

But I do think that they are becoming more sophisticated, and I do think that the differences between the two markets and the profiles, I think they are converging a little bit, and I think you are seeing – certainly from a legal structure in these transactions – a greater commonality in terms of the bank and the bond side than you did 10 years ago.

Mike Redican and Paul Chivers

Mike Redican: The one point I would add to that, actually, is information. Because, obviously, what issuers have been doing with the banks, under confidentiality, is give them everything under the sun. Of course, one of the issues we all have as issuers of public instruments is that information has to go into the public domain, which sometimes has been a conflict for issuers. But we are certainly seeing, and we have been working on, for example recently, is routes of how to put formats for summary information so that investors get their information required. They don't need to see all the nitty gritty that the banks do, but they want to hear, for example, summary progress. Is this performing along with the milestone? Is the current ratio on track? If you disclose it's 1.3 or 1.4 or 2, or whatever the hell it is, it doesn't really matter. But that's becoming a much bigger event, certainly in the UK and Europe, we are finding.

Simon Dickens: I think one of the things that we are seeing more is a heavier reliance on the rating agencies going forward to take a look at these sorts of developments on behalf of the investors. We are seeing quite frequently rating reaffirmation requirements. So I think the role of the rating agencies is actually going to grow in importance as we see the development of the market.

Rod Morrison: Andrew, would you like to answer the point about the need for more transparency and information on the project bonds?

Andrew Davison: I think we would concur with that observation. It is an important jigsaw that is currently not addressed well in many transactions, and I am speaking primarily with reference to the comparator project in the PFI, PPP space. Particularly with the demise of monolines, there has been a very strong resurgent interest from a number of investors to get access to the underlying information, and unfortunately the way in which the transactions have been structured and the obligations that issuers entered into to actually require them to disseminate information to investors – well, to do so. Those obligations are either non-existent or relatively weak.

Notwithstanding that, investors have clearly shown themselves very interested and have pushed hard in a number of instances to get access to information.

On the subject of transparency, within our methodologies for the PPP sector, we have a very detailed methodology that speaks to construction risk, and the different elements of construction risk, and the way in which mitigants may impact on our rating approach, or our rating investment, rather. So I think from that respect, as a rating agency, we do feel that we have contributed to the debate in the sense of making available and transparent and predictable rating methodologies and tools which work at a very detailed level, certainly within the PPP sector.

In the context of Gulf projects, however, there is clearly more that we may be able to do as a greater body of precedent transactions evolves. Certainly, we can try and address the questions as they come in on individual transactions, work with issuers and advisers on an informal basis, and then give further feedback through rating committees, but I think it is an important area and I would concur with the points that have been made.

Derek Rozycki: I would agree with much of what's been said. In fact, on the Dolphin transaction, one of the more prominent questions that we got was, how will we be able to keep track of what's happening with the project on an ongoing basis? We had structured in our market standard mechanics for that reporting, which are – you know from our point of view in retrospect – probably wholly inadequate for somebody to do their full credit analysis if they want to keep up with that on an ongoing basis and not just place reliance on the credit rating agencies.

So we are spending a lot of time as a sponsor thinking by ourselves, with our advisers, and in fact we are actually even engaging investors, about how to address this issue.

Of course, reporting is a double-pronged issue. There's got to be a willingness to do it, which historically I think really hasn't existed in the Gulf. Then there are the mechanics through which you do it. Both of those prongs need to be developed in the Gulf. And I think the willingness to do it is certainly developing again. I think Mubadala is at the forefront of that effort, as well as a number of other issuers around the region.

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The discussion

incremental demand to the market. So it is something we are going to focus on very, very hard.

One of the other very important aspects of this from an investor's perspective is that most of the investment community, they are not mechanically set up from a resourcing perspective to do the kind of credit analysis on these more complex transactions. The reliance has been very much on the rating agencies but certainly we have seen an increased desire to be able to analyse these credits in-house, and that's going to take some time to develop. So one of the questions I wonder about as we look down the road is do we need to take more time, and do we need to educate the market to be a little bit more patient when we are marketing these trades?

In the specific example of the Dolphin bond, again, it was an incredibly busy week. The tome that we put down on the table when we went in to see the investors was intimidating in some ways. There is a lot of information to get comfortable with in a couple of hours of reading, and to put into reports for the credit arms of the investment community.

So how do we change our interaction with the market to allow the investment community to do an appropriate amount of credit analysis, especially given that many of them are under-resourced to do that kind of heavy lifting? How do we enable that, what can we do better as issuers and advisers on the banking side to enhance the flow of information?

I also think the banks are going to drive that in large part because of some of the challenges that the region has faced recently with transparency issues. I think the banks will use their capital to push the process and enforce the discipline of increased transparency, and that's a good thing, absolutely a good thing, for the markets in the long run, but will be a painful transition.

The mechanics through which we effect reporting on project bonds are a little bit more difficult, because of the nature of the market, because of the lack of sort of formalised reporting for a project company, there is a lot of discussion about how we should do that. For example, on Dolphin, we are talking now should we put our financials and even an MDNA on our website. That's a sensitive issue for sponsors and one that's certainly going to take a lot of time to get senior management comfortable with, but I think in the context of enabling the development of the project bond market, people will make the value decision that in fact it's important to do this to enable this capital to come into the market.

Mike Redican: You have to do it because – I am sure you will bear me out here Simon – if you just try and give the information through an encrypted website, or something like that, the problem is that you automatically make those people insiders so you can't trade their bonds. So the worst thing about it is you are in this betwixt and between of – you are happy to give information to your lenders, even if you've got registered bonds, you can identify your own desires; as soon as you make it an encrypted website you have the whole issue that you can't effectively trade the bonds, and of course that would then massively affect your liquidity.

So you are almost forced to work out a format that works in a public domain environment. We have been actually working quite hard at Deutsche right now on how we do that on a website basis and how we do it with – what sort of framework should we be recommending to – issuers that we think meets as many of the demands of the investors as we can reasonably get away with. Plus, I think it has been generally accepted as well, the need for continual employment of rating agencies for the sort of semi-annual/yearly updates as well, which is very good news for them, of course.

Derek Rozycki: It is an absolutely crucial issue. I am 100% sure that we lost investors on the Dolphin deal because of a lack of a specific mechanic through which they could get ongoing financials. And if you have more bid, more liquidity, your pricing is going to tighten up generally in the market, and the after-market.

Mike Redican: It definitely helps your after-market point massively.

Derek Rozycki: Absolutely, and even in the pricing timeframe, because it is going to increase the size of the book, it will bring

Mike Redican: I hate to say, we were getting to the view a while ago that some of the presentation packs seem to be almost like the background for their credit report, quite honestly. We have been sort of moving the shift of those a little bit more to a credit focus explanation of the issues more than we perhaps used to in the past, if I'm honest.

Rod Morrison: We will move on to secondary markets in a minute with Paul, but I just want to ask Hussain and Rajiv what the investor base was on Dolphin and on RasGas in terms of where you saw the investors coming from, Middle East investors versus US and European, etc.

Hussain Hussain: On Dolphin, I think we saw quite a balanced divide of investor interest, of course three principle regions being the US, Europe with the focus really

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with UK-based, London-based accounts, and the Middle East. We did see some Asian investors, but less so in comparison with what we have seen with some of the corporate deals prior to that, but I think in general it came from those three regions. Very much fund managers, insurance funds, pension funds driving them, as well as some banks. What was interesting is some banks that did not get into the Dolphin deal on the bank financing side suddenly saw further opportunity to gain exposure to Dolphin via the project bond, and came in in size to just essentially offset their inability to get everything checked and in line in time for the bank financing.

Interestingly enough, I think also just one point about information to point out as well: I think the Gulf region is a relatively new region for fixed income investors. There has been issuance out of the region in the past but it has been very much concentrated on Dubai, and there has been a misconception of what the Gulf really is. My understandings as well on, for example, the Qatar roadshow, when the sovereign announced the roadshow, people were asking: well, you know, how is Dubai related to yourselves, where does Dubai fit in? It was just a complete misconception of the different countries in the Emirates and how they all function.

Thankfully, this year we have seen a lot of issuance come out of the region, and people are becoming much more educated and much more focused on the region, and understand the fundamentals, what drives these economies over here, the rapid expansion we are seeing leading to a lot of these new projects coming to stream and needing financing. I think investors are finally starting to buy in and appreciate what the background to that is, and where it is going, and how wealthy the region is, and the reality is, where do you get the yields that you do for the type of credit ratings that are apparent here in the region? You don't really get that combination in many cases. So in time . .

Derek Rozycki: We don't want to stick around for too long!

Hussain Hussain: Well, yeah! But I think there is a disparity and that's what has led to essentially why these types of economies or these types of regions are still paying up relative to other regions. As people become more educated with it, as more issuance comes into the bond market, fixed income investors become more familiar and more comfortable with issuance out of this region and also in probably what is perceived to be more risky asset classes as well.

Rod Morrison: On Dolphin you had 24% of the investors from the Middle East. Is that sustainable going forward on the project?

Hussain Hussain: On these types of projects? I think on this one they know the credit well, there is a strong name recognition, Mubadala, Dolphin, especially here in the UAE is a very huge project, people are very familiar with that and the importance of it. And what you will see as well in a lot of these deals is wherever the project is from or wherever the deal is coming from, the domestic investor base is the one that really kind of helps and assists and drives it.

Clearly the UAE has a large investor base in the fixed income project, which came also to the benefit of the Dolphin deal.

Paul Fairbairn: I think also the fact that we are offering a fairly short maturity.

Hussain Hussain: That is one thing. I think with the 10-year tenors, the RasGas distribution, the Middle East was 70% at the end of the deal. The investors here in the region are very much kind of in the five-year space at the moment, at least in terms of what they are looking for. Dolphin was a bit longer, 6.1 years, some investors said that was a bit long for them, but it didn't really deter a large portion of investors, but we did see investors react to that and say: five years we are more comfortable with.

Paul Chivers: And of course rating. We cannot ignore that. We have come with world-class sponsors, great names in the region with tremendous followings. I think more generically, though, obviously, we hit the market right, investors don't want to be in cash at the moment with historically low yields. They don't particularly like the equity risk reward. So the bond market has taken off this year very substantially and sustained its rally as a result of more and more funds coming into the market and buying down.

I think a very key feature to both of these deals was the strong bid out of the region, and also the Euro Dollars in Europe, and that's been true actually of most credits that we have seen out of the region this year. About 90% of the issue has been purchased almost equally between the region, Europe and North America.

So I think, again, this is a very, very interesting dynamic from the banking perspective, from the advisory perspective, historically these deals have been US-dominated from an investor, and also from a lead bank. And I think that it's absolutely critical going forward that issuers have a strong mix of globally recognised banks that have that kind of international footprint to make the most of all those investors bases.

Rod Morrison: As the tenors get longer, do you think Middle East investors will go?

Paul Chivers: I think that Hussain is absolutely right, he has already said it: it is fair to say on Dolphin we probably lost a few investors because we went over the five years.

Hussain Hussain: You should bear in mind that Middle Eastern investor bases are predominantly banks, and banks generally do not want to go to 10 years in terms of where they want to be putting their money towards. There are a couple of insurance companies, some pension funds, so on and so forth, but they are not a large portion of the investor base in the Middle East at the moment. That could clearly evolve in time, but at the moment it is still dominated by banks.

Rajiv Shukla: On RasGas, the aggregate was clearly underpinned by the US, with of course strong bids from the Middle East. The final allocations were 45% to US investors, 30% to European, Middle East got 15%, and the balance went to Asia.

However, the mix across the three reflected the preferences there. In the three-year market it was 20% Middle East, which went down to 7% in the 10-year.

On aggregate, it was a mix of types of investors; fund managers predominated, then there were other institutional investors, central banks, insurance companies. But what was interesting was there was even in this particular asset class a bid from or a distribution into retail investors. So we are seeing that now in a lot of our bond issuances, that private bank clients are actually making bids for these kinds of offerings.

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We have talked about the strong bond markets since the beginning of the year, we have crossed US$1trn and this is just the month of August. We don't yet see a sign of indigestion. We are talking just purely project bond space: we don't yet see anything that would cause us to believe that there is indigestion. In fact, to the reverse: given some of the holidays that are coming up, some black hole periods that are coming up, there is almost a sense of urgency among asset managers and institutional investors as to how do we get some of this money to work before we have to start closing up the books, which is why we have seen a little more active summer than you could otherwise have expected.

There will be issues there within the project bond space, as you get from the more corporate like cashflow generator structures to the more greenfield type. We have talked a lot about the construction risk, the strength of the structuring; and how the sponsor support kicks in during that construction period is going to be a key element in how these investors can get comfort and actually put their money to work in the project bonds.

What is also going to be important is how important are these to the underlying – therefore things like utilities and things that are very, very important to the sovereign, utilities, power, like rail, electricity, etc, will get more of a traction than for instance real estate projects.

Rod Morrison: Re secondary markets. Paul and Mike talked about how those can be encouraged. Obviously that's a big benefit to bond investors. What steps have been done to encourage the secondary trading?

Paul Chivers: The first thing that bond investors are going to be looking for is liquidity, and the liquidity benchmark side is going to be absolutely critical. Liquidity will come at a cost as well, and Derek talked a little bit earlier about getting the sizing of a transaction and the pricing right.

Historically, again, we have seen the project bond really purchased by real money US dollar investors, pension funds and insurance companies, and they haven't really traded that well, I have to say. That's not a reflection on the credit; that's really a reflection on the technicals in the sense that you just can't buy bonds, really.

I think probably everyone would agree that it's been very difficult really coming out of the financial crisis in terms of working with investors and really sort of giving them the confidence necessary that the deals would price as and where they would.

I think a feature, however, I have seen in the new deals and the marketing – Dolphin and RasGas – is that you have seen investors understand the relative value of what's already out there, I think you have seen the RasGas bonds trading in quite nicely as a result of that. There has been a lot of trading certainly we know on Dolphin, the bonds remain very liquid and are active. But I think it is fair to say that over the medium term, the trading activity will probably calm down as the bonds find actually that natural home.

Mike Redican: We saw the same thing even on the longer-term bonds, things like Metronet, that they actually traded a lot as people reallocated, and then they literally did nothing. They just stopped trading.

The difference is that if you have a long-term bond, it is going to have a different investor base than short-term bonds. Banks are going to trade more actively in the three to five-year space and a fund manager or a pension fund is going to be – when he is looking at asset liability, he likes the asset, he buys it – they always claim that they want liquidity, but actually we found that with a lot of the UK infrastructure bonds, they never really traded at all, quite frankly. You have that initial activity, flurry of activity, as people sort of get reallocated between themselves, and then they just . . .

Rajiv Shukla: That's why the allocation decision at primary allocation makes so much of a difference. It's easy to say: those people are my friends, and we will let the leads reallocate, but it has to be a conscious decision and a conscious imposition by the sponsor as well, to be able to support the secondary market. And of course who is actually market-making those bonds, who are your leads, will they actually support the after-market and quote two-way prices?

Derek Rozycki: That's true. It is also important to note that as the market grows, the depth of the bid will grow also, so as more of the investment community gets comfortable with investing in the project bond in part, their senior peers have seen the success of deals. That will be very helpful, and an increased flow of project bonds will also help investors trade to some extent as they look at relative value between a new issue trade and one that's been on their books for some time. So that will be an important development and an important enhancement for liquidity also.

Rod Morrison: What is the future for project bonds in the GCC? Obviously, we have had a couple of energy-linked bonds but there are huge infrastructure ambitions, even industrial ambitions. There is a lot to be financed. Maybe if I could start with Andrew.

From your perspective, Andrew, do you see – particularly with these two issues having been concluded successfully – a lot more people coming to see you from the GCC?

Andrew Davison: The short answer is yes. We have had a big pick-up in terms of approaches, initial discussions, and a level of activity that is currently confidential. We have been undertaking a number of projects in the region that we are not able to disclose publicly, but it goes to public debt issuance in all likelihood.

Other factors I would point to, there has been quite a lot of discussion in relation to the structural constraints on banks versus bonds now. I would also cover those, in particular the strengths that the banks bring to the market: intellectual capital; flexibility of approach; a user-friendly interface. But on the other hand, the structural constraints or impediments to the financing strategies of 18 months, two years ago, the ground has changed, and the challenge involved in summary tenor, depth of liquidity, capital constraints, which are then driving pricing and availability of bank debt, all of which are structural considerations that suggest that the project bond market will become a much more significant focus going forward.

Overlay that with the need to recycle bank debt that is already committed to existing deals, and I think that suggests that the future of the project bond market is relatively bright in the region.

Simon Dickens: There is a very strong future for project bonds in the region. Just looking at the capital markets in general, the region is under-served by the capital markets. Just see a statistic here that in the Middle East/North Africa region, only 3% of their corporate capital is in the

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bond and debt capital markets, compared with 42% globally.

As issuers in the region become more familiar with the opportunities the capital markets provide, as they gain a deeper understanding that some of the things that scared them about the capital markets aren't that scary – we have talked a lot about the dissemination of information. In this region there is not a long tradition of a ratings type of culture where people are disseminating information about themselves. As they see strong corporates like Mubadala and Qatar Petroleum taking the lead in this sort of space, I think it will ease some of those concerns.

There have been a lot of misconceptions in recent years, particularly as relating to the US capital markets, what it means to be an issuer. There was this big concern a few years ago, and I guess it continues to this day, that merely by issuing into the US you suddenly become a reporting company in the US with all of the attendant requirements for making quarterly filings, and that's just not the case. If you are doing a 144a or a RasGas, it doesn't make you a reporting company. People understand that.

People understand that just because you are issuing a bond, it doesn't mean you are suddenly subject to the Sarbanes-Oxley Act in the US and the long arm of the US law. That takes away some of the fear that's in the market.

But I think the most important reason why there is a very strong future for it is that we are talking about projects that are not luxury items. We are talking about necessities. We are talking about electricity; we are talking about monetising the assets that are in the region; we are talking about developing the infrastructure. It would be more difficult if we were talking about real estate.

But talking about necessities to allow the region to continue to grow and to prosper, the projects are becoming bigger, the capital requirements are significantly increasing, and there is this pool of money that just can't be ignored.

It will be interesting to see what happens with maturities, but even in the short term with reasonably short maturities on the bonds, I think it is an increasingly important market for the GCC.

Hussain Hussain: I would agree with that. Clearly, these two deals that have come to the market in July have given both issuers as well as investors and banks pitching this project a lot of confidence that there is appetite for this project; it is there; it is real. We have seen a lot of follow-through demand in the secondary market from some of the investors that could not get the allocations that they desired, and clearly interest for them for further issuance in this type of asset class.

Likewise, for issuers themselves, clearly it has been an awakening to a new asset class; that it's there, it is real, it is not something that one has talked about a lot in the past and unfortunately never came to fruition at the time. I think from that perspective, especially with the projects that Simon was talking about, these types of projects are very important for the governments here and for the region here. They do need to get finance, and with bank liquidity remaining scarce and relatively expensive, they are going to have to look for alternative means. Institutional investors are very much ready and willing to be part of that financing that issuers get involved in.

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PO Box 45005
Abu Dhabi
United Arab Emirates

Contact Number: +971 2 413 0026
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Rajiv Shukla: Yes, the future is bright. I think it is going to be a little more difficult, the roads to be able to get there. It's not as easy. Ultimately it's a structured product, and the challenges or the tractions for the bank market as it returns will cause some amount of discussions within sponsor groups as to whether they should continue or not.

We are in discussions mandated on some of the potential projects that I guess Andrew is talking about, and that kind of thought process is still going on within the potential issuers' minds.

At this moment in time, it makes sense to try and keep as many of the sources open as possible. But clearly, you need absolute fully airtight structuring to be able to take stuff out, and there are particular problems in relation to greenfield project bonds which, in comparison to the flexibility offered by bank loans, make it seem more difficult.

Projects that have a strong state sponsor and come up to the sectors like energy, utilities, ports, rails, etc, will find greater acceptance in the investor community and I think are the ones that will be the natural starters.

We actually think the refinancing game is not going to be as attractive. Or it will not take off as much as some people are suggesting because we have to remember that a lot of the projects that were financed in the Middle East happened at a time when bank margins were at the lowest. So it's a very difficult sale to the sponsors of those projects to go out and refinance in the bond market at much higher margins. Except if you are looking far ahead, as you are, Derek, and saying: but there is a recycling of capital thing, I need long-term sustained access.

So there is great potential, there is certainly acceptance in the investor base, we feel, and I think that the sophistication level of investors in the US and even in Europe now has increased. We are getting some traction in from Asia and the Middle East for the more structured project. But it's not like the floodgates have been opened.

One last point that is interesting – particularly given the region we are in – is in relation to Islamic finance: projects lend themselves better from an Islamic structuring perspective, because they represent actual hard assets, and therefore notwithstanding the complexities surrounding general project financings, from purely an Islamic acceptability, it is a clearer activity. You are actually financing an asset.

There will still be issues in terms of tenor for Islamic finance and Islamic banks, but we are getting to a stage where they are kind of getting more comfortable with a tenor that is a return aspect. So it's not something even in the Islamic finance base that will burst out, but it certainly represents an opportunity.

Rod Morrison: Mike, can you do a PPP bond deal in this region?

Mike Redican: I think you would be able to, but first I wanted to agree absolutely with Rajiv on the refinancing opportunity for exactly the same reasons as I think it is probably overstated, actually. That's the same in the UK and in Europe as well, there is only a very short history of bank deals being done at sensible prices to encourage refinancing. So I'm not a great believer in the future being based around refinancing. That was the first thing I wanted to say.

Specifically on PPP, I think PPP can be done, because people tend to forget, the UK structures were really quite aggressive: they were 90/10 debt/equity structures, 25/30-year concessions, and as time wore on, the government became more aggressive on actually increasing the risk transfer to the private sector.

Do I think the same structures can be adopted here? Yes, but not as aggressively, so in other words I would not expect to see the same degree of risk transfer, because first of all we are not starting off with an AAA sovereign in most cases. I would expect there to be more equity in the deals and/or a more preferable composition and termination regime and perhaps a bit more understanding of how the risk transfer should occur.

So I think that's the first thing: do I think it could be done? Yes. Secondly for investors, I think they are going to focus on, as we said earlier, the sponsorship and government support and the rest of that, but they are also going to be really looking at essentiality. I have seen a number of projects throughout Europe, for example, that are roads to nowhere, to give an example. If you are going to do a route that is an absolute core route, then I think you can demonstrate its strategic importance straight away. There are some in various parts of Eastern Europe that are literally nowhere to nowhere. They will not get funded because nobody really wants to do them, quite frankly. There is a procurement out there to do it but they are going to find it very hard.

I think investors will be similarly discriminate. They will want to know that the government is absolutely behind this, they will want to know it is a very core route.

Universities are something that I think are a very interesting space, because actually it's easily understood. We come back to things that are easily understood by investors. People understand the need for provision of schools, hospitals, universities. If you look, for example, at the UK experience and even the European experience, the things that have done well have been some of the key social infrastructure like hospitals.

PPPs can be done, but I think there has to be recognition from the outset that the structures can't be driven as aggressively as they were done in Europe, because we have to achieve a higher rating threshold to sell the deals, and you are starting off from a different place.

Paul Chivers: I am very optimistic for the region, for a number of different reasons. The region's got a long history in using project financing, and I think that's very meaningful. We have seen the region approach the capital market in the right way, with top quality sovereigns accessing the market and establishing liquid curves, and I think that's underpinned all of the capital market's activity in the region and shouldn't be underestimated.

We've got just great examples of world-class sponsor groups operating down here, and there's good supply. There's good supply of essential projects, as has been mentioned, particularly in the hydrocarbon and infrastructure space; these are very hot sectors, investors always have time to hear about them.

Clearly, now we have precedent. The region has pioneered two tremendous transactions reopening the asset class globally, and I think interestingly has also contributed towards some more international investor base, which historically has been dominated by the US, so now, today, we have a strong bid from the region for the right project at the right price, as well as Europe and Asia. So that's providing very good oversubscription and good performance.

Finally I would like to say that this coincides with a repositioning of the bank market. There's a de-leveraging effect, and the repricing of capital allocations really shouldn't be underestimated, and I think the two together combine to leave me very optimistic that more can be done.

Paul Fairbairn: Clearly, from a demand perspective, issuers are going to be look-

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ing for as many sources of liquidity as possible. I think the interesting thing with the project bond space is that it is part of a wider story, which is that you can't look at project bonds in isolation of what's happening in the wider capital markets. I think as you see more and more issuance from the region, not just on the project bond space but more generally, that's going to be a key driver for continuing access to the capital markets by project sponsors.

So I think the best opportunity for project bonds will be the continued governmental, quasi-governmental and corporate access to the markets, because that increases the familiarity with the region across the investor base.

Mike Redican: I would put one caveat on that: you can occasionally get region overload. You have to be careful on the supply side. But if that's managed, then I think you are right.

Rod Morrison: Paul and Rajiv. You are advising on projects in Saudi. Can we see a project bond from Saudi? Is that possible?

Paul Fairbairn: Yes.

Rod Morrison: Now?

Paul Fairbairn: I think it is entirely possible there will be a project bond coming out of Saudi.

Rod Morrison: Into these markets we have been talking about?

Paul Fairbairn: Yes.

Rod Morrison: Is there anything extra that they need to do to allow that to happen?

Paul Fairbairn: Without talking about the specifics of individual transactions, there are obviously the basic requirements of any bond that is issued into the US market. For example, if the guarantee constitutes a security, you have to have disclosure of information, and that's an issue that has been addressed by other sponsors in other contexts. There are a variety of different ways of handling that, so it will come down to structure. But that's not an impediment; that's simply an issue to be addressed as you are doing the transaction.

Rajiv Shukla: I would answer that one word, yes, as well, at some point in time. One challenge in seeing an international bond out of Saudi project to corporate is simply the Saudi market is incredibly big, much bigger in terms of financing itself than any of the other markets, and stands alone. As an example, we led a five-year for a Saudi electric company a few months ago and that – eventually for a bond that was cut at 7bn riyals size; the book exceeded 20bn riyals. That's all within the domestic market itself.

I think for any sponsor out of Saudi, the difficulty is going to be there is such a big – not just a bank market – but an institutional market within Saudi Arabia that is ready to provide capital, so why should you really have to go through the hoops to access international liquidity outside when this competing liquidity is there?

Nonetheless, in 2005, it led the first euro bond for a Saudi Arabian entity, which was one of the banks, and the issue wasn't Saudi Arabia the country. There

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www.lw.com

Simon Dickens
99 Bishopsgate
London EC2M 3XF
United Kingdom
Phone +44.20.7710.1086
Fax +44.20.7374.4460
simon.dickens@lw.com

Dennis B. Nordstrom
99 Bishopsgate
London EC2M 3XF
United Kingdom
Phone +44.20.7710.1008
Fax +44.20.7374.4460
dennis.nordstrom@lw.com

Jonathan R. Rod
885 Third Avenue
New York
NY 10022-4834
Phone +1.212.906.1363
Fax +1.212.751.4864
jonathan.rod@lw.com

Kenneth A. Schuhmacher
Al Khazna Tower
Level 18, Najda Street
Abu Dhabi
United Arab Emirates
Phone +971.2.495.1701
Fax +971.2.495.1799
kenneth.schuhmacher@lw.com

William H. Voge
99 Bishopsgate
London EC2M 3XF
United Kingdom
Phone +44.20.7710.4789
Fax +44.20.7374.4460
bill.voge@lw.com

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were very few questions about Saudi Arabia. At that point in time, when Saudi Arabia had issues and bond security, there were very few questions on the road about the security, and ironically the only question we got was from a GCC company. Elsewhere in Asia and in Europe they just went straight to the credit fundamentals.

So for a Saudi international bond to come in, we really need to stack up with the internal competing sources of liquidity and how the sponsors view that difficulty, rather than investor accessibility.

Rod Morrison: Derek.

Derek Rozycki: I think that the future of project finance, which is something that we are clearly keenly focused on, is largely a bank bond solution. We do see this as a significant market shift away from the sort of hyperactive days of the banks and hyper-competitive days of the banks.

Project bonds are going to play a role, we certainly hope they will play a role, both at refinancing as well as at the initial stages, and I think our past experience on some transactions has given us confidence in that statement.

We are currently spending a lot of time focusing on identifying structures as well as mechanics that will enhance the growth of the market; that will enable the growth of the market. We are dialoguing with investors to find out what it is that they like about project bonds and what they don't like, what's toxic for them, what will enhance their demand and enhance the bid both in the initial stages as well as in the secondary markets. We are talking with banks also a lot about that.

I am aware that there are other sponsors in the region that are certainly pushing along these discussions.

I think that it is imperative for the development of market that we have increased confidence that the markets will be there. It's important to the banking community because it will affect capital allocation; it will affect their credit decisions. Both of these entities need to have confidence that they are not going to be stuck with a 20-year deal. We continue to have a long string of projects that require long-tenor bank debt. Well, sorry, long-tenor debt generally.

We can't do on some of these projects a 10-year fully amortising facility with a refinancing in year five; that doesn't work for us, so the banks will have to start to get comfortable with the concept of hard or soft mini-perms. Ironically, you get stopped by the capital allocations committee when you try and take a long tenor soft mini-perm facility and you get stopped by the credit guys when you want to do a hard mini-perm with refinancing risk.

So the banks need to develop their views a bit more in that space, and they need to spend some time thinking about why they are comfortable with entities like RasGas having bullet refinancings. Of course, one of the great points there is that it is just such a robust project. But bringing that forward and allowing and enabling the market to have refinancing risks, as long as there is adequate time to execute a bond in that period, so not keeping it at five years or shorter, but in fact having a proper project finance structure with a 10-year window for refinancing. I think people need to get the confidence that they will be able to refinance in that timeframe.

> "So as we look to the future of project bonds, it's quite clear to us that strong projects with strong sponsors will continue to get done."

Of course it is important to investors to have confidence that the market will be there in order to have secondary market liquidity, and have confidence that will be there, and to enhance the strength of the initial bid, and in the end it is important to the sponsors because as we get confidence yet another pool of capital will be there. It will bring more projects to the market, it will enhance and grow the economies of the Gulf and enable the growth of these economies, because the quantum of bank debt that has driven us in the past just no longer is there.

So it is really something that all parts of the market are aligned with, and from our point of view, are actually eager to push this market forward.

So as we look to the future of project bonds, it's quite clear to us that strong projects with strong sponsors will continue to get done, and that the project bond market will clearly play a role in this bullet sector.

Rod Morrison: What's the quantum of opportunity from your company say in the next two years, looking ahead?

Derek Rozycki: I think that's a great question that comes back around to what Mike was saying. The market is extremely sensitive to supply, and sponsors and I think their government entities need to be very careful about flooding the market with trades. So there's no exact answer for that, because what we will always do, we will always approach the market with multi-products or a multi-pool approach where we will optimise it on a transaction-by-transaction basis.

I am quite confident that where we are approaching the market and we feel like there has been too much issuance in the bond market, we will both sense from the market and make the decision ourselves not to tap the bond markets in that instance.

But we certainly have a very, very good list of projects that we believe would be strongly rated in the Single A and better range, on a standalone basis, not having to worry about raps any more, but that have strong importance to the government; that will allow us to credibly come to market and say, "Hey, we have a great project here, is this the right time, is this the right space, are we not going to flood the market?" If all the stars align, then we will bring it to the bond market.

Mike Redican: I think you made a very good point about rating there, because I don't know about anybody else, in my mind I am down to Single A, I feel pretty confident that we will bang that out. When we get to BBB plus, early days, and liquidity starts to drop quite substantially, and don't even bother with anything below BBB plus. That's my current thinking. I don't know if the rest of you share that.

Derek Rozycki: I would agree with that. Again, it comes back to the old statement: strong project, strong sponsors are going to get done. That's what's going to drive the development of this market initially, and it is some time before BBB land is prominent here. There will always be the one-off deal that surprises everyone and is a fantastic success, but it is going to take some time.

Clearly all three legs of the markets are incentivised to ensure the development of this market, which is very different from in the past.

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