Alba Line 5 financing - A review of the deal

The US$1.55bn financing for the Aluminium Bahrain (Alba) 5th Potline Expansion has been finalized, with the financing agreements executed in Bahrain on April 7. In an extremely capacity constrained debt market, under the spectre of conflict in the Gulf region, Alba's unique financing structure was able to efficiently tap multiple pools of capital in an expeditious manner and deliver an overall cost of financing to the borrower that was substantially less than originally predicted by the market nine months ago. By Terry Newendorp, chairman and CEO, Taylor-DeJongh.

In an international competitive bid process last summer, Alba selected the independent finance advisory house, Taylor-DeJongh, to be the financial advisor on the development of the financing plan, capital structure, commodity risk management program, and debt raising process for the Line 5 Expansion Project. Working with Alba and its shareholders, Taylor-DeJongh assessed various strategies for raising the US$1.55bn finance package, and, suggested a debt sourcing plan that optimized cost-effective debt from multiple sources in an efficient manner for the borrower, including bank debt, capital markets, commodity linked finance and Islamic finance.

Competitive bids were held for lead arranger roles for each of the following five separate tranches of senior debt financing: International uncovered commercial bank tranche - US$500m; Regional Islamic bank tranche - US$250m; Metal-linked commercial bank tranche - US$300m; Local bond Issue - US$200m; and ECA-supported facility - US$300m.

This final tranche has the option of being either a JBIC direct loan (with a substantial co-funding by commercial banks), under the JBIC Import Financing scheme or, in the alternative, an ECA covered commercial loan tranche, based upon European procurement for the aluminium smelter and 400MW power plant portion of the expansion project.

Especially noteworthy within the financing structure has been the achievement of the harmonious integration of an Islamic loan (one of the Gulf Region's largest) amongst multiple other tranches, all on an unsecured pari-passu basis.

Financing strategy

Taylor-DeJongh ran a competitive process for each of the tranches among various groups of banks to ensure that Alba obtained the lowest cost, optimal terms. In order to minimize constraints on Alba's operations and financial management, the borrowing structure is supported by Alba's full balance sheet and cash flow potential from existing and future aluminium production.

When conducting the initial bankability analysis as a Phase I financial advisory exercise in 2001, it was already evident that bank capacity was beginning to disappear from the markets, both internationally and even regionally. Consequently, considerable time and attention was spent on evaluating the options of bringing ECAs into the transaction in meaningful way. Also in the Phase I analysis, there was considerable discussion about what level of sovereign support was going to be necessary to achieve favorable pricing for Alba's borrowing. Despite the fact that many regional and European commercial banks insisted to the Ministry of Finance and National Economy of Bahrain (the 77% shareholder of Alba) that ECAs would be required in order to attract the debt, and that direct sovereign support would be required in order to obtain reasonable pricing, Taylor-DeJongh saw the market differently.

Rather than approach commercial banks with the entirety of the US$1.55bn, which would have in deed strained the available capacity and driven pricing up and tenor down, a tranching of the debt into sizes that could be accommodated by each type of capital provider was decided upon. Not only was there competition for the lead arranger slots in each of the tranches of capital, but moreover there was competition among the tranches of capital in order to optimize terms offered from each. For example, initially the Islamic tranche had pricing estimates significantly higher and tenor significantly shorter than those that were ultimately achieved. By identifying to the Islamic institutions the terms coming on offer from the commercial banks, the Islamic institutions brought pricing down and extended tenor, to become one of the most favorable Islamic financings in the region. As a result of the competition among tranches, in the end, Alba had significant oversupply of debt on offer, and at terms both longer in tenor and lower in price than had been originally offered by the market.

Taylor-DeJongh had teamed with Islamic Finance Consultants (IFC) of Bahrain, in the organization of the financing plan and the Islamic finance. IFC had extensive experience with Islamic structures and with the Islamic finance houses throughout the Gulf. The Islamic structure looks to Western banks a lot like a sales and lease back of property plant and equipment. Consequently there had to be a specifically ring-fenced category of existing Alba plant facilities that could be identified for the Islamic tranche. But, while doing so, a term sheet was drafted that, in the event of a default, Islamic institutions will be pari parssu with commercial lenders and not able to accelerate on their assets. Thus the structure proved to allow international commercial banks and Islamic banks to participate along side each other without one being in a more secured position than the other.

Similarly, a hedge mechanism was identified that could support US$300m of financing based on Alba making financial settlement, not physical settlement on its performance on the hedge. This structure was also crucial so that the commercial banks and Islamic institutions could see that the metal-linked facility had no senior priority to either of those tranches.

The local bond was something that was strongly encouraged by Alba's largest shareholder, the Ministry of Finance and National Economy of Bahrain. Initially it was thought that perhaps only US$100m of bonds could be floated in the market. However, initial reaction by institutional investors was so strong that the bond underwriters, National Bank of Bahrain, Bank of Bahrain in Kuwait, GIC, and Securities and Investment Company raised the underwriting commitment to US$200m.

That left only the remaining US$300m of debt for the Alba requirements. The initial plan was to utilize export credit agencies financing in conjunction with the power plant which was part of the expansion. In the summer of 2002, there was identified US$300m of ECA financing attached to the power plant. However, as the procurement decision on the EPC contractor for the power plant, and, hence, the equipment sourcing (for ECA determination) moved later into 2002 than originally planned, it became apparent that it would not be possible to obtain an ECA firm commitment before the beginning of 2003, which was past the date at which Alba wanted to have all commitments in place.

Consequently Alba and Taylor-DeJongh turned to a relatively unique program, the import financing scheme of Japan Bank for International Cooperation (JBIC). Because a substantial amount of Alba's metal is exported annually to Japan, and because Japan would also become a substantial market for the additional capacity realized by Line 5, an approach was made to JBIC to provide US$300m of financing through the import financing scheme, rather than an export financing scheme (tied to equipment exports) in lieu of a European ECA commitment. In the early months of 2003, some commercial banks which had not been able to participate in the commercial financing tranche of Alba (the US$500m) because their credit committees had not been able to approve without ECA cover, mounted a renewed effort to try to bring ECA cover based upon export financing, again targeted at the power plant, as was the original concept of Alba and Taylor-DeJongh from June of 2002.

Background of Alba

The achievement of this financing was due to several key factors of the deal. For one thing, Alba boasts a track record of successful expansion financings, and has a strong reputation as an experienced borrower. With more than 15 long-term debt facilities involving over 65 different lenders, Alba has always serviced its debt on schedule. The firm also has had successful, uninterrupted, and profitable operations for 31 years, helping Alba to establish an impeccable reputation for product quality and proven technology. The company also boasts strong, supportive shareholders and an experienced, dedicated management team.

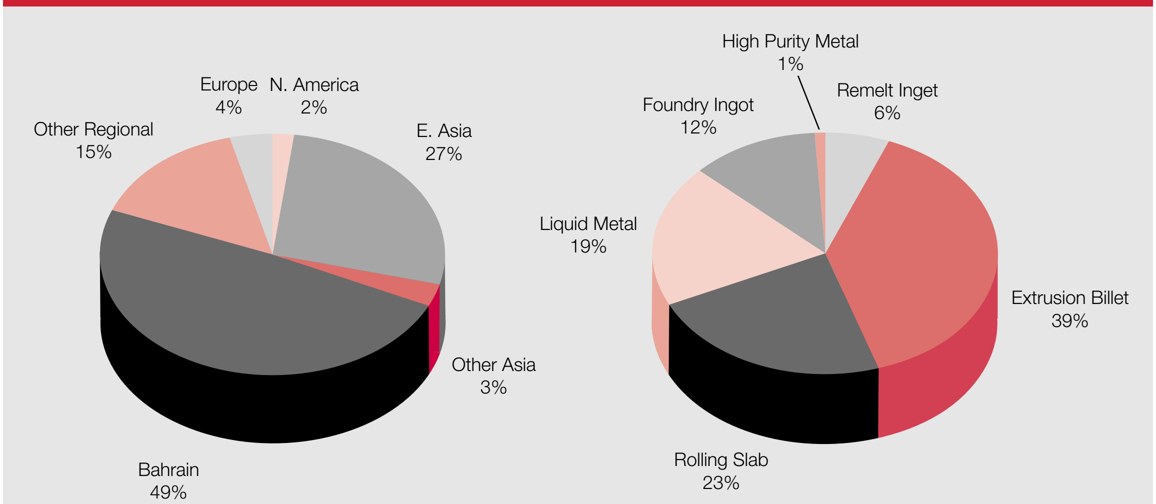
Alba was founded in 1968 as the Middle East's first aluminum smelter and started operations in 1971 with 2 lines and 120,000 tpa of capacity. Through the years, Alba's growth trajectory has been exemplary, having been fostered by the company's strong fundamentals, committed shareholders, and sustained demand for its products. The result has been a continuous and profitable pattern of expansions that have permitted Alba to reach record production levels. The chart below outlines Alba's stages of growth from its inception to the present day:

Alba has established itself as a vitally important company for the Bahraini economy. The company provides more than 2,600 jobs directly (90% Bahraini), and Alba's gross revenues are equal to approximately 10% of Bahrain's GDP. The Line 5 expansion plan, scheduled for 2005 completion, will work to further improve Alba's efficiency.

Currently, Alba is among the lowest 20% cost producers in the world, and the planned Line 5 expansion will maintain or improve its cost leadership position. Some 66% of Alba's production comes from leading edge technology. The supply and use of such proven technologies, including smelter or expansion components, not only optimize assets and lower production costs, but help maintain product quality.

The graphs below show Alba's current geographic and product breakdown of sales.

Current geograhpic and product breakdown of sales



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The Line 5 expansion represents the realization of Alba's business philosophy and strategic plan. By further leveraging Alba's low-cost advantage, and reducing costs as a result of the expansion, the project will maintain its competitive position. Alba will continue to support and serve its growing local demand, as well as move forward with plans of expanding its market and further establishing it world-class position. Alba's continued emphasis in demanding superior technical performance will maintain its competitiveness. Moving up the value-added chain through an increased share of high-premium products in the product mix will serve to enhance Alba's overall earnings.

Results of the financing

As the largest structured borrowing in the Middle East region in 2002/3, with total project costs at US$1.7bn, Alba achieved several key strategic objectives. Alba partitioned an overlapping liquidity pool by using five tranches of to extract maximum liquidity at attractive pricing from the market in the face of regional political tensions and a capital constricted market. The mix of financing sources resulted in a substantially lower cost of capital, and did not result in a loss of flexibility.

Following the competitive bidding on each of the tranches of capital, which was held in November 2002, the following lead arrangers were selected for each of the tranches:

- US$500m commercial tranche: Sumitomo Mitsui Banking Corporation, HSBC, Gulf International Bank, Bank of Bahrain and Kuwait, Mizuho, Bank of Tokyo-Mitsubishi, National Bank of Bahrain, National Bank of Abu Dhabi, Qatar National Bank, and the Saudi British Bank.
- US$300m aluminium-linked tranche: Goldman Sachs and Gulf International Bank;
- US$250m Islamic tranche: ABC Islamic bank, Dubai Islamic Bank, Gulf International Bank, Bank of Bahrain and Kuwait, Riyad Bank, HSBC Amanah Finance, and Islamic International Arab Bank.
- US$200m bond: National Bank of Bahrain, Bank of Bahrain and Kuwait, Gulf Investment Corporation and Securities and Investment Company.

The syndications of the uncovered commercial bank tranche, the Metal-Linked tranche, and the Islamic bank tranche began in January 2003 and were essentially completed in February, with documentation finalized in April 2003. All tranches were successfully syndicated, exceeding their target sell down in all cases. The Local bond issue was fully underwritten and will close subscription in the coming weeks.

Conclusion

Alba's largest financing ever will help the company increase production capacity by 60%, making it the second largest aluminium smelter in the world, and largest outside of the FSU. By pursuing a competitive financing process throughout the transaction, with the assistance of an independent financial advisor, Alba was able to extract liquidity from the optimal sources, raise long-tenor financing all on an unsecured structured corporate basis without sovereign guarantees, a remarkable achievement for the largest project financing in the Middle East region in 2002/3.

Stages of growth and production levels

Year	Growth Activity
1968	Alba founded.
1971	Operations commence with 120,000 tpa capcity with 2 Lines.
1981	Line 3 added increasing production to 170,000 tpa.
1991	Production increased to 225,000 tpa through addition of 76 pots to Line 3.
1992	Production to 460,000 tpa through the addition of Line 4.
1997	Production to 497,000 tpa through the addition of 76 pots to Line 3.
2001	Record production level of 512,000 tpa reached.
2002	Alba commissions a 450,000 tpa coke calciner plant.
2005	Line 5 commissioned for a total production capacity of 819,000 tpa.