BOYADJIAN & ASSOCIATES

PROJECT FINANCE & MANAGEMENT CONSULTANTS

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Project Finance in Middle East and North Africa

Over the past few years, driven by the needs of the rising population and the increased liquidity as a result of the sustained strength in oil prices, there has been a new wave of billion dollar investment projects to provide energy, raw materials or services in the Middle East and North Africa region. Indeed, the Middle East has become one of the largest Project Finance market in the world. Of the global total of US$ 90 billion in project finance debt raised in the first half of 2006, US$ 23 billion was raised for the Middle Eastern projects. In such a context, the necessity to use new financing approaches and innovative techniques in setting up these large scale projects is more than important.

Project Finance from 1/1/2006 to 6/30/2006:

Region	Proceeds (US$m)	No. Issues
Americas	20,131.1	49
Africa/Middle East	23,128.6	17
Europe	32,151.4	106
Central Asia	800.0	1
Asia-Pacific	13,049.7	62
Total	**89,267.8**	**235**

Key Characteristics of Project Financing Structures:

Despite the multitude of definitions, Project Financing typically includes the following basic features:

- Project Financing involves raising funds to finance an economically and legally separable capital investment project in which the providers of the funds look primarily to the cash-flows expected to be generated by the project for the repayment of its loan and the remuneration of the equity.
- Project Financing is a limited recourse financing. The Project debt securities rely on the profitability of the project and on the collateral value of the project's assets, rather than on the general credit of the project sponsor.

An Attractive Option to Raise Finance

Project finance has long been an attractive option for raising finance especially in capital intensive projects. With recent growth in world trade, privatization opportunities and foreign investment, there is an increased interest in the application of project finance to provide the necessary debt capital. The rapid rise in demand for project finance is symptomatic of the rapid growth in regional economies, the rising profile of the Middle East in the global investment community, and the recognition of international debt providers of the fundamental strength of the region in terms of risk.

With the world investment community increasingly seeing the Middle East as an attractive investment opportunity, international banks have substantially increased their presence in the region both on the ground and in terms of the amount of debt they are committing to the regional borrowers. But even with these new entrants, there could be a shortage of debt capital to support the level of funding required by the enormous projects planned for the region. The answer will come from the region accessing the international debt capital markets.

An Historical Perspective

Project financing is not a new financing technique. It was used to finance maritime voyages in the days of ancient Greece and Rome. In the 16th century, the explorations for new lands, gold and spices were financed by Project Financing techniques. The first modern applications of Project Financing date back to the fifties with the development of large-scale oil projects in North America. Financing techniques based on the estimation of the reserves and production rhythms were elaborated on the basis of which it was possible to ask limited recourse financing. These projects were exploited by start-up corporations or created affiliates with no balance sheet or income statements.

In the eighties, this method of financing had to be spread to areas like the electrical generation plants launched by independent power producers in the United States. The Project Financing began to develop and expand in all the economic sectors and in the entire world: mining projects, industrial projects, transportation, telecommunications, etc.

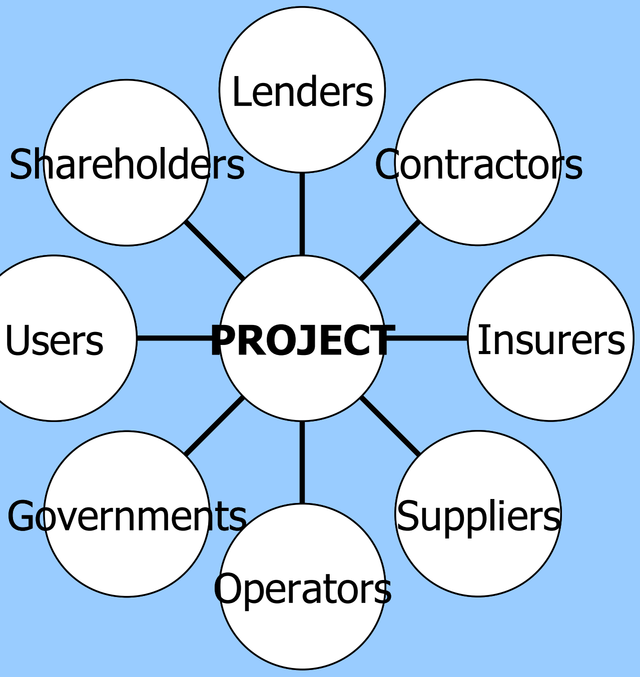
Project Financing in the developing world peaked around the time of the Asian Financial crisis, but the subsequent downturn in industrializing countries was offset by growth in the OECD countries, causing worldwide project financing to peak around 2000. In recent years, project finance schemes have become increasingly common in the Middle East and North Africa.

Investor Profiles

As with the financing alternatives, investor profiles vary widely from project to project. Investors include sponsors/shareholders, lenders (banks and financial institutions), contractors, end-users (customers), suppliers, operators, insurers and governments.

- The sponsor of a project usually participates in promoting a project. For instance, when a potential private sector provider recognizes

Project Finance Stakeholders:



the value (value for money) it can add to an existing or potential service, it can submit an unsolicited bid to the relevant government department. These investors are primarily interested in the prospect of earning dividends or appreciation on their investment, and in achieving their social objectives.

- Banks are involved at least as short-term lenders and frequently as long-term lenders and financial arrangers. On large projects, several banks may form a consortium to raise funds together. South African banks are currently bundling and scrutinizing large project loans, and selling them to the public. The equity investors usually select a bank to manage the consortium or the process of raising funds. This selection is based on the banks' experience and capacity for raising funds in a certain industry. Fees generally vary between 1,5 and 5 per cent of the amount raised, depending on the size of the project, the type of security, the risk associated with the project and the level of commitment provided.

- Although the bank usually raises debt, it may also raise equity. The fees for raising equity are generally higher than for raising debt.

- Suppliers may also provide funding in the form of short- to medium-term debt or extended terms on accounts payable. A supplier may also be a sponsor and take an equity interest in a project. As with construction and management companies, the suppliers' primary interest in the project is usually the supply contract with the project company. Project companies may also enter into other risk-reducing agreements with suppliers, such as a long-term fixed price and quantity agreement. Investors will closely scrutinize the supplier's credit rating when an agreement involves the future delivery of services.

- End-user financing can be prepayment for the future delivery of services, but is more often a take-or-pay contract in which the end-user commits to purchasing a minimum amount of services over a period. Although this is not a straightforward form of financing, it can reassure investors.

- Government may not necessarily directly finance a project, but it often provides indirect financing through guarantees, take-or-pay contracts, sole provider licenses and other commitments. In each case, it should fully understand and be in a position to undertake such risk. The government's objective is to provide affordable and best value-for-money services to the end-user.

- Operators may promote or sponsor a Project too. This is more common in a straight privatization, where the government provides incentives such as subsidized loans. Management and employees are usually part of the overall sponsor team that bids for a project, as they will ultimately continue as employees of the project.

- Public participation in the financing of a project usually comes at the operating stage. The process of listing a company's equity and/or debt is often included in an understanding between the sponsors, the government and the lenders, to allow the original equity investors to plan their exit strategy.

Advantages

The Project Financing offers to the promoters and to the bankers many financial, strategic, technical and statutory advantages.

- **Financial leverage.** Project financing can allow the realization of projects requiring investments that exceed their equity or their assets. A broad range of projects have been financed with capitalization consisting of 80 percent or more debt.

- **A wide range of financial instruments.** Project financial engineering requires examining all possible sources of debt & equity - not just the traditional ones- to determine which markets can provide the needed funds on acceptable terms at the lowest possible cost. To raise adequate funding the Project settles on a financial package that both meets the needs of the project and is attractive to potential creditors and investors.

- **Risk Sharing.** Project Finance aims to strike a balance between the need for sharing the investment risk among multiple stakeholders. The sponsor is not alone to bear all the project development risks. Project Financing permits the sharing of operating and financial risks among the various parties, contractors, operators, sub-contractors, banks and clients. A financing structure that facilitates risk sharing allows to minimize the financial consequences and to allocate them to parties best able to bear such risks.

The major disadvantage of this complex financing is that it may take a long period of time to analyze, structure, negotiate and document a project. The consequent costs and fees of these studies can be high.

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