



# Specialized Financing in the Oil & Gas Industry

June 2011



# How to proceed ?



- What are our needs when starting a project ?
- What are our objectives when we approach financings?
- Why we can rely on banking financings ?





# Case study



## ■ What are your expectations ?

A specific financing, a specific client, list of potential questions coming from your side...

- What is the bank appetite for specific project finance?
- What is the bank preference in respect of the project size?
- Which are the main characteristics that make such a project attractive/bankable?
- What is the most preferable financing scheme (B/S vs. project financing) ?
- Which are the optimal parameters (structuring targets, amounts, maturities, securities, sponsor requirements, indicative costs)?
- Is the bank willing to be single lender/arranger or would prefer to syndicate? How this would impact the price?
- Is the bank willing to consider involving in equity also (most likely not) and in case not, can the bank can help raising equity (investment funds under the bank's administration can be interested in)?
- What are the rest of the restrictions requested by the bank (eligibility criteria): developer/sponsor quality/ involvement/track record, IRR of the project, financial covenants (e.g.: cash-flow predictability, debt service coverage by cash-flow, total bank debts/EBITDA<=?, EBIT / expenses with interests >= ?)
- What are the securities requested for project financing (minimal to optimal): LT PPA, LT sales agreement; parental support, coverage degree of the risks (externalized to insurance company, taken by the sponsor/developer), FX and IR risk, other...
- What is bank position in respect with regulatory uncertainty (new regulations, 220 law not approved by EC secondary legislation not issued)?
- What are the main risks related to a specific project projects?
- Milestones and timelines for arranging a project financing - B/S financing; due diligence requirements



## Objective

- **Practical strategies and techniques for successful oil and gas project financing**



# Qualitative risk analysis for banking financings



- **Specialized financings address any segment of the standard international petroleum industry**
  - From upstream to downstream – the hydrocarbon value chain
  - Upstream – exploration, development and production
  - Refining – from raw material to end-product
  - Pipelines – transmission and distribution
  - Liquefied natural gas – a fuel of the future
  - Petchem
- **How to address different risk/reward objectives of sponsors and lenders**
- **Structural pricing and drivers in oil&gas lending**
  - Country/political risk
  - Reservoir/Reserves
  - Sales / offtake
  - Environmental / regulatory
  - Sponsors
  - Technology and construction/completion
  - O&M (operations and maintenance)



## Quantitative risk analysis for banking financings

- Key ratios – loan life and project life covers
- Balancing equity and debt
- Features and design of oil and gas models
- Sensitivity analysis:
  - Choosing/calibrating sensitivities
  - Getting to loan value



# 1. Understanding Upstream Oil&Gas Financings

- **Reservoirs and reserves – a technical grounding:**
  - From exploration through appraisal to development and production
  - Nature of hydrocarbon reservoirs
  - Estimating volumes
  - Reserve classification: PROVEN / PROBABLE / POSSIBLE 1P/2P/3P
  - Reserves for banking purpose
  - Due diligence and consultants' reports
- **Growth of the independent sector**
- **Emergence of the borrowing base as a tool of choice**



## Structural features of the borrowing base, especially:

- **Balancing development and producing assets**
- **Adding/removing assets**
- **Hedging as revenue protections and debt support**
- **Treatment of abandonment**
- **Payment waterfalls/account structures**
- **Typical and variant distribution controls, reps & warranties, undertakings, events of default**



## 2. Getting to grips with Refinery Finance

- Refinery operations
- Greenfield or expansion financing
- Cash flow volatility – key risk for lenders
- Operational mitigation of volatility risk
  - Geographical margin protection
  - Tolling-based structures
  - Hedging to reduce volatility
- Debt structuring to mitigate lender risk, including:
  - Debt/equity balancing
  - Repayment profile optimization
  - Cash sweeps
  - Distribution controls and information / covenants
- Refinery market analysis for lenders
  - Choosing consultants
  - Scope of work for due diligence studies
- Modeling / sizing debt for refineries

### 3. Oil & Gas Transmission & Distribution Lending

- Trunk pipelines and distribution networks
- Oil and gas transmission pipelines (high fixed costs) – multi partner undertakings
  - Key risk factors – especially upstream supply issues, construction contracts and sale/off take contracts
  - Balancing the interests of private and public sectors players
  - Environmental/social issues – a make-or break factor
- Gas storage & distribution finance
  - Liberalized/regulated gas distribution has increased financing needs
  - Gas storage in depleted fields and salt caverns – developing tailored financings packages
  - Funding the acquisitions and build-out of gas distribution networks
  - Financing gas metering
  - The role of regulation and its impact on financing





## 4. Liquefied Natural Gas Finance

- The growth of the LNG debt market
- LNG liquefaction finance
  - Risk profile of the liquefaction projects, especially:
    - Sponsor / equity issues
    - Construction contracts – structure and risk allocation
    - LNG sale contracts
- LNG ship finance
  - Corporate vs project finance
  - Structural drivers in project-based LNG vessel financing
  - Types of project debt structures
- Recent trends in financings
  - Financing integrated LNG chains
  - Changing downstream markets and trading patterns
  - Increasing flexibility in LNG sales and financing contracts



## 5. Other downstream Finance – Petchem and Gas-to-Liquids

- Financing petchem / on the flowchart, from naphtha based feedstock to end-products
- Waves in petrochemical sector – adding value to domestic gas resources
  - Risk profile of petrochemical projects
    - Construction – issues and contractual structures
    - Technology – bankability and licensing
    - Feedstock – volume, price and quality factors
    - Sales / Off take – agency/licensing issues
  - Financing gas separation & treatment plants – the first step
  - Polyolefin projects
  - Increasing sophistication – aromatics and beyond
- Gas – to – Liquids – financing clean diesel projects



## **Additional case study : Why to discuss about Reserve Based Lending (RBL)?**

- **One of the fundamental similarity that will be encountered is a reliance on the oil and gas reserves that will secure any financing that is made**
- **RBL allows a company to take out a structured loan backed by the value of its oil and gas reserves, securing debt financing by using future cash flows of assets, rather than immediate balance sheet strength**
- **RBL can be used by large or mid-sized independent oil companies that have a need to finance projects but lack the same access to corporate loans as the majors**



## Facts

- Oil price uncertainty is dampening both reserve-based lending and mergers and acquisitions activity for upstream producers.
- Junior independents face a crucial period in their struggles to raise cash and avoid sales of assets at distressed prices
- The oil price has been a wild ride for the last years. After a steep rise in prices between 2006 and 2008, including a sharp spike in the price in 2009, prices dropped sharply. After, they have started to recover. Today, bankers covering the sector, normally at home with volatile commodities risk, are ready to help producers fill their funding gaps



## How it works



- **Two objectives that need to be recognized in making each lending decision:**
  - . **The first:** to determine the ability of the reserves that are being evaluated to generate sufficient net cash flow to amortize the loan within a reasonable time frame after all necessary operating, development and income tax requirements
  
  - . **The second:** to judge what might be realized from the sale of the properties if it should become necessary to foreclose.
  
- **Energy orientated banks are fully aware of the value of reserves, and are able to structure loans to fit the needs of a producing company with repayment to be derived from the proceeds of the sale of future production.**



## Type of RBL financings

- Three of the basic types:
  - . term loan
  - . production payment
  - . revolving credit/term loan
- Typical covenants and conditions that are required
- All of these loans are based on an engineering appraisal of the reserves, the cash flow available for debt service, and the particular circumstances of the borrower.



# RBL - ENGINEERING AND FINANCIAL APPRAISAL

- An evaluation of the reserves backing a production loan is of utmost importance
- In virtually all cases a bank will require an appraisal report
- This report will be reviewed by the technical staff of the bank at which time any necessary adjustments will be made to comply with bank practices, and a loan value will be calculated.

## Engineering Appraisal

- Basis of reserve estimates** - a judgment will be made on the accuracy of the reserve figures. Estimates based on well established production performance will be given with estimates derived from volumetric, analogy with similar reservoirs, or a computer simulation of new producing zones given lesser weight.
- Classification of reserves** - Generally, only proved producing reserves are acceptable collateral for a bank. This is basically because only producing reserves provide cash flow for debt service, and only the proved category are certain enough in magnitude. In particular instances, proved non-producing or proved undeveloped reserves are included if wells are simply awaiting a sales outlet, or there is a firm development commitment from the borrower.
- Geologic considerations** - The bank engineer will evaluate such geologic conditions as sand continuity, faulting, reservoir energy, spacing, well productivity, and history of the formation to arrive at a judgment on the quality of the reserve figures.
- Production forecast** - An analysis will be made as to the method of arriving at a production forecast, e.g. decline curves, well tests or analogy, and any potential effects of market or physical restraints on production.



## Financial Appraisal

- **Number of areas to be reviewed in an oil and gas company's financial statements, to be used in conjunction with the results of the engineering analysis**

**i.e.: operating costs, reserve replacement, finding costs; drilling success ratio**

**= historical data on how the company developed reserve base, operated its reserves and evaluation on how will progress in the future**

- **Standard review on the balance sheet, income statement and cash flow statement**



## Why banking financings ?

- Bankers covering oil and gas sector are able to provide comprehensive solutions combining the lending function with the hedging products
- The ability to integrate the lending function with the hedging products enable the bank to provide competitive advantage:
  - . The reduction of the pricing risk will allow you to have access to better pricings
  - . The borrower interest rate protection is only one of the value added service available in the banking environment



## How to proceed ?

Nothing is complicated ... but complex





## Best way: to work together

The pillar of our business philosophy is the customers viewpoint.

We are here to team up for:

- Financial advisory
- Structuring and arranging financings
- Specialized lending
- Solutions for debt and equity capital rising



**Local presence + international knowledge & experience**



**THANK YOU !**

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