And Now What?
Financing Energy Transactions in the Current Environment

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How we got to this point....

- A global financial crisis, coming up to its second anniversary
- An unprecedented drop in global commodity prices, following an unprecedented commodity bull run
- Fundamental changes in the way banks are regulated
How we got to this point.

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How we got to this point....

- A global financial crisis, coming up to its second anniversary, and characterized by unprecedented levels of
  - Loss of liquidity
  - Massive deleveraging
  - Departure of banking competition
    - Transformational events
    - Strategic redirections
  - Sovereign intervention in financial institutions and resulting effects on financial sector governance
  - Uncertainty and crisis of confidence
Broad events in the credit and financial markets

**Average CDS Spreads**

- **Banks**
- **Broker Dealers**


**March 2008** - Rescue of Bear Stearns from likely bankruptcy

**July 2008** - Fannie/Freddie face financing risks

**Sept 2008** - Fannie/Freddie takeover

**Oct 2008** - Treasury injects funds into banks

**Oct 2008** - Lehman Bankruptcy one week later

**May 2009** - Results of stress-tests released

**January 2009** - Concerns mount over increasing credit losses

**November 2008** - Citi shares reach lowest level in 18 yrs

**Oct 2007** - Values on subprime mortgage CDOs in freefall with no support

**Second $20Bn capital injection in Citi and government guarantee of $306Bn asset portfolio**
Fewer players – reduced liquidity

- **Fewer players**: the forced mergers and bankruptcies of 2008 have reduced the number of players
  - JP Morgan / Bear Stearns / Washington Mutual
  - Barclays / Lehman
  - Bank of America / Merrill Lynch
  - Santander / Alliance & Leicester
  - Lloyds / HBOS
  - BNP Paribas / Fortis Belgium and Li
  - Commerzbank / Dresdner Bank
  - RBS / ABN AMRO
  - PNC / National City
  - TD Bank Financial / Commerce Bank
  - Wells Fargo / Wachovia

A smaller lender base - reduced market liquidity
Liquidity contraction and market conditions

TED Spread widens

- TED Spread measures spread difference between the 3 month LIBOR rate and the 3 month T-Bill yield - TED Spread historically has been an indicator of perceived market credit risk
- LIBOR normally tracks closely with the short term interest rates set by the US Federal Reserve
- As banks have failed, other banks have become less willing to lend at low rates and thus new historically wide TED Spread levels have been reached in '08

TED Spread - January 2007 to date

Libor 3m vs. US Treasuries 3m
January 2007 to date
How we got to this point….

- A global financial crisis, coming up to its second anniversary
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How we got to this point….

- An unprecedented drop in global commodity prices, following an unprecedented commodity bull run
  - In six months we saw the loss of several years of average commodity price increases
  - The drop demonstrated the relative euphoria of certain markets, seen in recent years
  - This loss of value exacerbated the contraction of liquidity contraction and competitive thinning out
During the subprime crisis, demand collapsed while commodity prices rallied!
Commodity prices start dropping after summer-08

Oil Prices - June 2007 to date

Natural Gas Prices - June 2007 to date

Corn Prices - June 2007 to date

Aluminum Prices - June 2007 to date
Recent commodity performances start to diverge

Commodities correlations suggest investors were not selective during the de-leveraging process.
How we got to this point....

- A global financial crisis, coming up to its second anniversary

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How we got to this point....

- Fundamental changes in the way banks are regulated
  - For major money center banks, particularly true in Europe, the implementation of the new Basle 2 capital regulations
    - Provides sensible risk-base capital allocation
    - It is however highly pro-cyclical.....
  - Sovereign capital injections will stabilize bank capital but will invariably affect governance
    - We have seen it in relation to executive compensation
    - Should expect to see it in how capital is deployed
  - Expanded bank regulations are likely
Where does this leave us?

Commodity Prices

Access to financing

What has changed? What can borrowers expect?
Commodity prices

In Q1 09, commodities appear to have found a floor although the economic news flow has remained disastrous.
Producers will struggle rebalancing the market in 2009 but should eventually get the return in 2010.

Thanks to OPEC, the oil market should be rebalanced much faster than markets where the rebalancing comes only from a cost curve adjustment.

Stock in days forward consumption – 100 rebased in 2003

Source: SG Commodities Research
Recent trading conditions resemble very much to “post-bubble” conditions.

S&P GSCI Spot Monthly Average

Financial bubble bursting

“Fair value” trading range?

Factoring in the recession

LT trend

Source: SG Commodities Research
Despite the steep contango, SG research expects future prices to outperform current forwards.

Commodity Forward Curves as of 25/02/09 – 100 Rebased on the 1st Nearby

Source: SG Commodities Research

Short-end time-spreads just reflect the actual and expected stock-build.
Where does this leave us?

- Commodity Prices
- Access to financing

What has changed? What can borrowers expect?
Global Project Finance in 2008 – Snapshot View

The chart shows the growth in global project finance from 2002 to 2008, categorized by loan, bond, and equity. The y-axis represents the value in billions of dollars ($bn), and the x-axis represents the years from 2002 to 2008.

- **Loan** (gray) shows a steady increase each year, with a significant rise in 2008.
- **Bond** (red) starts small in 2002 and grows gradually, becoming more prominent in 2008.
- **Equity** (light gray) is relatively small but shows a slight increase each year.

The line graph depicts the global year-on-year growth percentage, indicating a steady increase from 2002 to 2008.
Project Finance in 2008 – Global Volume Analysis

**Global Sector Share 2008**

- **Energy**: 35%
- **Infrastructure**: 26%
- **Oil & Gas**: 24%
- **Petrochemical**: 10%
- **Industrial**: 3%
- **Mining**: 1%
- **Telecom**: 1%

**Global Sector Volumes**

Source: Dealogic
Latin American Energy Financings – Project and Corporate Finance (# of deals)
Where does this leave us?

- Commodity Prices
- Access to financing
- What can borrowers expect in 2009?
Implications for the Project Finance Market

- Strong capital constraints - liquidity continues to be scarce
- Underwriting appetite is now non-existent
- Club deals have replaced syndicated loans

- Credit committees remain cautious, rigorous and selective, resulting in a “back to basics” approach with more conservative facility structures and appropriate pricing
  - Loan tenors have been reduced
  - Required equity investment by borrowers has increased
  - Financial covenants are becoming more restrictive
  - Credit spreads in the sector have widened
  - Libor has not been reflective of actual bank funding costs
    - Market disruption language required in credit agreements

- Credit market disruptions have increased the costs of new financing
  - Cost of funding for banks has been going up
  - Fees required by arrangers have increased
What can borrowers expect?

- Structures and pricing will reflect limited liquidity and risk aversion
  - Mini perms
  - Tighter structures; deals structured with higher ratios and lower gearing
    - There are clear signs that investors require longer “tails” between final maturity and expiry of offtake/supply agreements
    - Robust credit fundamentals and stringent downside testing are required
    - Realigned risk return, albeit in a favourable interest rate environment

- Club versus Underwriting
  - Club deals are and will remain the norm until there is clear evidence that retail liquidity is returning to the loans market
  - Even club deals can be challenging because of constrained liquidity
  - Even generous flex provisions will not provide sufficient comfort to get banks into offering underwriting
What can borrowers expect?

- Good deals continue to get done
  - Long term bull view on energy
  - Capital investments continue largely unaffected.... as the industry expects a drop in costs
  - Very few abandoned or cancelled projects
  - Across industry sub segments, including select renewables
- Fundamental risk analysis is back
# Rankings & Awards in Natural Resources

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<th>Commodities Finance</th>
<th>2008</th>
<th>2007</th>
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<td>Best Arranger of PF Loans (7)</td>
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<td>Best Africa Project Finance House(8)</td>
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<td>Best Export Finance Arranger (2)</td>
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**Sources:**
(1) Euromoney July 2008
(2) Trade Finance June 2008, 2007 and 2006
(3) Euromoney, September 2007
(4) Asia Risk May 2008 and 2007
(5) The Asset Magazine 2008
(6) Project Finance International December 2008
(7) Euroweek Syndicated Loan Awards, February 2009
(8) emeafinance 2008 Project Finance Awards, April-May 2009
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