Four years in the making, the Surgil financing features a number of unprecedented achievements in the industry – the first international oil and gas project financing in Uzbekistan, the largest project financing in Central Asia, the largest petrochemical project financing in the CIS region, and the first Equator Principles-compliant project in Uzbekistan, among others. The Surgil project sets the template and opens the door for future project finance opportunities in resource-rich countries of Central Asia.

Uzbekistan is one of only two double land-locked countries in the world, and is the only Central Asian state to border the other four (Kazakhstan, Turkmenistan, Tajikistan, and Kyrgyzstan). Historically, Uzbekistan has been a nexus for international trade between Europe and Asia, along the famous Silk Road. It is therefore fitting that the Surgil transaction has been one of the most internationally diverse financing ever seen – the first time that South Korean, Chinese, European and Uzbek lenders have all shared the same finance documentation, signed on May 19 2012 in Tashkent, Uzbekistan’s capital.

Critical role of South Korea
Perhaps less commonly known is the importance of historical and trade ties between Uzbekistan and South Korea. The project was developed through close co-operation between these countries, combining the gas-producing capabilities of Uzbekistan (the second-largest gas producer in the CIS) with the petrochemical expertise of South Korea, to develop an economically viable and value-enriching project.

The project received strong political support from the governments of Uzbekistan and South Korea, with the personal endorsement of each of their presidents (both of whom attended the project’s stone-laying ceremony). For South Korea, Surgil is one of the largest foreign direct investments (approximately US$800m) and the largest amount of South Korean financing ever arranged for an international project (from Kexim, K-Sure, KoFC and KDB), further demonstrating the strong commitment at the sovereign level.

Experienced sponsors and strong economics
The project is being undertaken through project company Uz-Kor Gas Chemical LLC, a limited liability company set up to develop, finance, build and operate an integrated gas-to-petrochemicals plant.

The company is 50% owned by Uzbekistan’s national oil and gas company, Uzbekneftegaz (UNG), one of the oldest producers of oil and gas in the world, and 50% by a South Korean consortium comprising Honam Petrochemical Corp (part of the Lotte Group), Korea Gas Corporation and STX Energy Co Ltd.

The project includes the development of the Surgil gas field, the construction of a gas separation plant, an olefins cracker and petrochemical downstream units with a design capacity of 387,000 metric tonnes of high density polyethylene and 83,000 metric tonnes of polypropylene, and all associated facilities and infrastructure (including 115km of gas pipelines). The polymers will predominantly be sold internationally to China, Turkey, Russia and Western Europe. The gas separation plant will strip out methane-rich gas, which will be sold to UNG. Additional value from gas sales is an important driver for the project’s position as a first quartile producer globally (as confirmed by Nexant).

The project is located in the Karakalpakstan region in north-western Uzbekistan. In the past, this region suffered severe environmental degradation as a result of Soviet agricultural planning. The Aral Sea, once the fourth-largest inland sea in the world, has shrunk to 10% of its original size, adversely affecting local industries such as fishing and farming.

The Surgil project has therefore been eagerly awaited by the local people, as it will create more than 5,000 local jobs during construction and over 1,100 jobs during operations. Furthermore,
Uz-Kor’s adherence to the Equator Principles and stringent Asian Development Bank environmental and social policies, and the involvement of international consultants such as Mott MacDonald (advising Uz-Kor) and Aecom (lenders’ independent consultants), set the standard for environmental and social protection in Uzbekistan and the wider region, which in turn will attract other environmentally conscious lenders and investors.

Legal framework
A specific framework was set up for the Surgil project in order to ensure the bankability of the scheme from an international perspective and to stabilise certain legal, regulatory and fiscal regimes for the duration of the project. The investment agreement, which sets out a number of privileges and benefits, in addition to certain undertakings from the Government of Uzbekistan, was negotiated with the Government of Uzbekistan and signed in February 2010, and set the financing process in motion. The investment agreement was followed by a supplemental investment agreement in April 2011 that crystallised a number of fiscal arrangements for the project.

Project structure
The project and commercial structure was developed to ensure the bankability of a long-term project financing. Figure 1 shows a simplified overview of the project documents entered into by Uz-Kor on a long-term basis. From the outset, construction arrangements were structured to avoid the requirement for full sponsor recourse. The project benefits from true lump-sum turnkey contracts for both upstream and downstream construction, significant committed contingency funding for cost overruns as well as construction all-risks insurance, including delay in start-up insurance. The construction risk is further mitigated by the proven technologies for the petrochemical plants (UOP/ORTLOFF, KBR, Mitsui), blue-chip South Korean EPC contractors (Samsung, GS and Hyundai) for the downstream and utilities packages and an experienced EPC contractor for the upstream work (UNG). As a result of this robust structure, lenders were able to accept capped completion support from sponsors, rather than full financial completion guarantees.

The gas supply agreement with UNG, a 50% shareholder, provides for feedstock supply to meet the plant’s operating requirements (beyond the supply already provided from the Surgil field). The agreement covers the sale of methane-rich gas to UNG following separation of natural gas and liquids in Uz-Kor’s gas separation plant. Both of these agreements are fundamental to the project’s viability. Finally the polymer offtake agreements for HDPE and PP product are contracted with experienced counterparties Honam, Samsung C&T and UNG, which are responsible for transporting the product from the polymers plant, and placing product into target markets.

Financing structure
Given the South Korean involvement in the project, it was expected that South Korean ECAs would provide strong support, and Kexim and K-Sure therefore participated in developing the financing from the very early days. The Asian Development Bank were also keen to be involved, despite never having done a petrochemical transaction, due to its growing interest in Uzbekistan and the beneficial socio-economic impact of this project. The role of the China Development Bank was also critical in completing the financing plan, with China being supportive of long-term economic development in Uzbekistan.

Uz-Kor’s financial and legal advisers, ING Bank and Vinson & Elkins RLLP, developed a very detailed financing term sheet that helped to secure the initial commitments of the South Korean ECAs and the ADB. The negotiation of this FTS took about nine months – a record for a pathfinder deal in a new market. It was agreed and signed in Seoul in September 2011. After this, financing for the project could be launched in the commercial bank market. The market had been introduced to the transaction earlier, in March 2011, during the bank roadshow held in Tashkent, attended by 19 financial institutions from Europe and Asia. However, at the time of launch in the summer of 2011, the market faced...
a renewed liquidity crisis – new commercial lenders were sought and the debt financing plan was adjusted in order to fulfil the US$2.54bn funding task. The debt financing plan eventually comprised eight tranches as follows:

- Korea Eximbank (Kexim) direct loan – US$700m;
- Korea Eximbank (Kexim) covered loan – US$300m;
- China Development Bank direct loan – US$250m;
- Asian Development Bank direct loan – US$125m;
- National Bank of Uzbekistan direct loan – US$100m;
- Korea Trade Insurance Corporation (K-Sure) covered loan – US$800m;
- EKN covered loan – US$140m; and
- Euler Hermes covered loan - US$124m.

The nine commercial banks that participate in the ECA covered facilities are the following institutions:

- Korea Finance Corporation, with a US$500m commitment;
- Korea Development Bank, with a US$300m commitment (K-Sure agent and offshore account bank);
- ING Bank, with a US$160m commitment (Kexim agent, intercreditor agent and hedging co-ordinator);
- Siemens Bank, with a US$75m commitment;
- Credit Suisse, with a US$75m commitment;
- Bayern LB, with a US$70m commitment;
- KFW IPEX-Bank, with a US$64m commitment (Euler Hermes agent);
- Nordea, with a US$60m commitment (EKN agent); and
- SEK, with a US$60m commitment.

The door-to-door tenor of the financing is up to 16 years, inclusive of a 3.5 year construction period, setting a record for the whole CEE/CIS region. The structure also allows a relatively long period before the long-stop completion date, allowing for the long ramp-up period of this complex project.

The financing has been structured to allow flexibility in repayments to accommodate cashflows weaker than expected in the base case, which makes lenders rely on future recovery in margins to catch up on repayments.

Surgil has a flexible repayment structure whereby in most scenarios a cash sweep operates such that repayments follow a more aggressive cumulative target repayment schedule (TRS). This allows lenders to capture some of the benefits of periods of good margins and in return requires that in periods of weak margins Surgil is only required to meet a mandatory repayment schedule (MRS). The MRS also allows Uz-Kor to start the repayment of the senior debt at a slower rate in the event of a prolonged delay in completion.

The senior debt is secured by a pledge of shares in Uz-Kor, mortgages over fixed assets, pledges of bank accounts and assignments of Uz-Kor’s rights under the project agreements and rights to receive insurance proceeds. The majority of the project accounts are domiciled in South Korea, and project revenues will flow through controlled accounts charged to lenders pursuant to a typical project financing cash waterfall.

A detailed due diligence process

In order to meet lenders’ requirements, the lenders’ due diligence process began early, with the following independent consultants being appointed:

- DeGolyer and MacNaughton – Upstream reserves consultant;
- Nexant – Technical and petrochemical product market consultant;
- Ernst & Young – Financial model auditor;
- AECOM – Environmental and social consultant (Mott MacDonald acted as Uz-Kor’s environmental and social consultant);
- JLT – Insurance consultant (Willis acted as Uz-Kor’s insurance consultant); and
- Ernst & Young – Euler Hermes’ independent adviser.

Norton Rose and Colibri acted as lenders’ international legal counsel and lenders’ local counsel respectively. Leges Advokat acted as Uz-Kor’s local counsel.