The Soro Dondar Project – B

A Case Study in Energy Project Financing under Adverse Market Conditions

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Abstract

Project financing is sometimes used by large energy companies as a means to mitigate project political risks. Such protection does not come without a cost. Project financing typically costs a premium of 2% or more versus the firm's normal borrowing cost. In risky locations, the premium can soar to 4% or more. Energy firms then struggle to determine whether the protection they obtain is worth the cost premium. This involves a comparison of "intangible" risk mitigation benefits and easily calculable, "hard" dollar costs. This case provides an opportunity for students to consider such tradeoffs. Students should calculate the hard costs, and then devise their best method for valuing the "intangible" protection gained by using project finance. The case for project financing is rendered more difficult by financial markets not being in a receptive mood for a Soro Dondar deal.

When evaluating Simonivar's political risks, students should review the account of recent developments there provided in the "A" case.

This case provides students with an opportunity to consider the specific risk-mitigating benefits of doing project finance with Export Credit Agencies (ECAs). Multilateral Agencies, such as the World Bank, garner most of the attention for performing a risk mitigating role. In practice, however, considerably more project financing gets done with ECAs. The case also introduces the concept of "co-lending." Under this approach, the project investor also acts as a project lender, usually alongside a syndicate of banks. Co-lending has been practiced by energy companies to achieve the best of both worlds, i.e. using project finance to mitigate political risk while doing co-lending to neutralize project finance's cost premium. The case discusses toe pros/cons of this approach. Students must decide whether Simonivar is a suitable venue for attempting co-lending.

This case is based upon a large petrochemical project which Mobil brought into ExxonMobil at the time of the merger. The existing finance plan reflects what First Boston had developed for Mobil prior to the merger.