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Export financing in international construction: Case study of Siemens power division in Oman

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Abstract

Many construction and technological firms grew beyond borders of their countries since their market size couldn't absorb their growing production capacities. Similarly, orientation to certain market segments forced these firms to go abroad in order to sustain their revenues, further improve their specialization and expand shareholder value. Due to increasing competition in the world market, traditional prerequisites do not necessarily have to lead to success in international bids. In addition to technological excellence, long-lasting experience, quality and cost leadership, securing project financing can play a crucial role in project bids. International Joint Venture (IJV), led by Siemens, gained an order with an international bid for delivery of two power plants with combined cycle to Oman, due to securing project financing for multinational investor. Project financing, arranged by German state-owned KfW IPEX-Bank, proved to be the turning point in this international tender. Siemens and its Korean partner successfully delivered both power plants in full conformance to investor's requirements. Despite uneasy market conditions and financial markets recovering from financial crises, German and Korean government export credit agencies (ECAs) opened new export opportunity, in order to support their home economies. Whereas jobs in Germany were secured, Siemens as a leading contractor improved its market position within the region of Middle East. At the same time, Sultanate of Oman gained access to highly efficient power sources with low impact on environment. This reference study demonstrates increasing and necessary role of government export-oriented agencies and banks for reaching exporters' success in international business. The main objective of this paper is to contribute to identification of exporter's key success factors, when delivering project on export financing principles. In order to clearly introduce key aspects of this advanced export financing concept, case study as a research methodology was selected.

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1. Introduction

Exporting is considered by governments around the world as a central strategy for economic prosperity in the new global landscape. The focus on exporting, as an engine of economic growth, has taken hold in almost in every country, even in nations with large domestic demand. This focus is not surprising since national governments have discovered that outward-bound international activities generate jobs and taxes at home and that export revenues are instrumental to the enhanced welfare of its citizens [1]. Although many studies have sought to discover the main aspects of export performance, export risks and their hedging, far less attention was given to sources of competitive advantage or the way to build up competitive advantage at export markets. Several studies came to conclusion that essential for export success is access to financial resources [2,3,4]. Other study argues that the working capital and financial liquidity requirements of export operations mean that access to financial resources is essential [5]. Recently, there were just few studies focused on gaining access to export financing [6].

For running business in international context, there must be a large degree of mutual trust and support. Such a trust is giving confidence to exporter, that buyer will pay for the goods and services received. In addition to that, exporters are recently forced to assist buyers in getting access to credit with competitive credit terms. Delivering project construction together with secured project financing proved to be the key success factor in developing markets which enables these firms to succeed in highly competitive international bids [7]. Other study investigated how public insurance schemes could be used to serve trade-related or other objectives [8]. In many OECD countries, the political risk of default associated with export credits is usually covered by ECA which is owned and supported by the government. The analysis emphasizes the role of government export financing and insurance programmes when exporting to less developed and risky markets, while private insurers still limit their activities to relatively safe markets.

2. Case Study – Construction of Barka III and Sohar II - combined cycle power plants in Oman

2.1. Sultanate of Oman

The Sultanate of Oman (Oman) is one of the most progressive countries in the Middle East. The country has achieved remarkable growth in all sectors of economy during the past years and is well on course for excellent growth. Crude oil remains the single most important source of the state revenues and it's expected to make the growth and development process of Oman more sustainable in the long run. The Sultanate encourages foreign capital that will enhance the overall development of the country. It should supplement local investment in utilizing its untapped resources, facilitate transfer of technology, know-how, managerial skills, and getting benefit from the worldwide connections of multinational corporation in opening new markets for Omani products.

Oman is committed to a policy of open market economy based on free competition in which the private sector is encouraged and facilitated to play the leading role. Developed infrastructure, incentive packages, attractive corporate tax and tax holidays and simplified business procedures made Oman to become an attractive destination for investment. The government is continuously engaged in making the investment climate as conducive and investor-friendly as possible. Oman's foreign capital investment law has been liberalized, permitting 70% foreign participation in companies automatically in most of the sectors and even 100% foreign capital investment is permitted for projects of national importance.

The country's economy has shown ability to counter and confront the consequences of the large decline in oil prices. The country's economy depends on oil market prices, which suffered from high volatility during the last years. Despite the market situation driven by development of the world economy, the country reported solid GDP growth of 5 % in 2012, resp. 5.4 % in 2011. Together with economic growth, even power consumption is dramatically rising. The less efficient power technologies are penalized through very high gas prices. Efficiency is thus the key leading to success in this market in order to meet environmental criteria. In addition to that, limited

natural gas resources have to meet increasing power demand in the country. Oman's power consumption is growing at nearly 10 % a year, which is a driving force for building new power sources.

2.2. *KfW IPEX-Bank*

The KfW is a German government-owned development bank. It was formed in 1948 after World War II as a part of the Marshall Plan. KfW is dedicated to the sustainable improvement of economic, social and ecological living conditions. Its statutory functions are those of a promotional bank for the domestic economy and a development bank for the developing countries [9]. Nowadays, KfW banking group covers over 90 % of its borrowing needs in the capital markets, mainly through bonds that are guaranteed by the federal government. This allows KfW to raise funds at advantageous conditions. Together with its exemption from corporate taxes due to its legal status as a public agency and unremunerated equity provided by its public shareholders, KfW is able to provide loans for purposes prescribed by the KfW law at lower rates than commercial banks.

KfW IPEX-Bank GmbH (KfW IPEX), as a largest subsidiary of KfW is in charge of project finance and corporate finance related to German or European exports. Its prime focus is on medium and long-term lending to boost the export economy, develop economic and social infrastructure and support environmental and climate protection projects. It also promotes foreign investments in Germany. Unlike KfW banking group itself, it is in direct competition with commercial banks. Therefore, and in response to concerns voiced by the European Commission concerning unfair competition, IPEX Bank has become legally and financially independent in 2008. IPEX Bank's main sectors of activity are ports, airports, toll roads, bridges and tunnels, railways, ships, planes, telecommunications, energy and manufacturing. It plays a major role in fulfilling the promotional mission of KfW. It is represented in the key economic and financial centres around the globe. In 2012 the volume of new commitments generated by KfW IPEX-Bank totalled EUR 13.4 billion.

2.3. *Euler Hermes – Export Credit Agency (ECA)*

Export Credit Agencies continue to play a vital role in supporting international trade. At a time when banks are adjusting to the increasingly stringent capital adequacy and liquidity requirements imposed by Basel III, the availability of ECA support, particularly in the form of buyer credit cover, has been a key factor in facilitating long tenor debt finance by commercial banks for many capital intensive project finance transactions.

Euler Hermes AG and PricewaterhouseCoopers AG manage the German official export credit guarantee scheme on behalf and for account of the Federal Government. Euler Hermes acts as leading partner in this consortium, which explains why these guarantees are widely known as Hermes Cover. Hermes Cover protects companies from the risk of bad debt losses in connection with export transactions. These export credit guarantees are mainly targeted at exports to developing countries and emerging markets. Budgetary responsibility is borne by German state. The two companies, Euler Hermes and PricewaterhouseCoopers, support the government in implementing and managing this scheme. The Federal Republic of Germany provides guarantees against commercial and political risks in connection with export transactions and against the political risks of foreign direct investments as well as political risk cover for projects which secure the supply of raw materials to Germany. With Hermes Cover government supports the activities of German companies abroad by means of its foreign trade and investment promotion scheme and in doing so maintains their competitiveness, contributes to job security and promotes exports thus acting as an important growth factor. In such circumstances German exporters are able to build or maintain their market position with the assistance of state export credit guarantees. Export credit guarantees support firms in their efforts to open difficult markets and expand in traditional markets in unfavourable times.

By taking out Federal guarantees, German exporters and banks protect themselves from the country and buyer risks involved in export transactions. In addition to non-payment risks, which exist also at home such as insolvency or unwillingness to pay, political non-payment risks also loom abroad, which may result in a complete loss of the trade receivables in extreme cases. These risks include for example the confiscation of goods or the unfair calling of

contract bonds. Economic or political reasons may even force an early stop during manufacture. In such a case the exporter will normally be left with the production costs incurred so far on his hands.

Hermes Cover includes commercial and political risks:

- Political risks
 - Bad debt losses due to legislative or administrative measures, war, civil commotion or revolution abroad (the general political risk)
 - Losses due to non-conversion and non-transfer of amounts paid by the debtor in local currency due to restrictions in the international payment system (in the past the most frequent cause of loss)
 - Loss of the right to receive payment due to frustration of contract for political reasons
 - The loss of goods before the risk has passed to the foreign buyer due to political circumstances (e.g., the goods were confiscated, destroyed etc. before reaching the buyer).
- Commercial risks
 - Loss of receivables due to non-payment after a certain period (protracted default)
 - Loss of receivables due to the bankruptcy of the buyer, a composition settlement in or out of court, an unsuccessful judgment execution or suspension of payments by the buyer.

2.4. Siemens in Oman

For the German export industry, particularly the construction and energy sector, the Arabia represents a fast growing region important market. German agencies and institutions such as Deutsche Gesellschaft für Internationale Zusammenarbeit (GIZ), Euler Hermes and KfW IPEX monitor the region and maintain contact with governments and economic institutions to identify business opportunities for German exporters. Siemens takes advantage of cooperation with these institutions as a channel for gaining access to the bids. Siemens has played an important part in many of Oman's key infrastructure projects since it entered the market in 1974 and remained further committed to the region's economic progress. In 2011, Siemens set up its branch and Oman became one of its home markets. Due to increasing power consumption in Oman, government was seeking new power sources in order to satisfy growing demand. GDF Suez is the leading power generator in Oman. This multinational company holds the dominant position in the entire Gulf region with overall operational capacity of 25,000 MW. In June 2009, the consortium of investors led by GDF Suez, authorized by the Oman government, opened tender for delivery of Barka III and Sohar II, two gas-fired power plants with combined cycle and total annual capacity of 1,500 MW. For Oman's sustained economic development, it was crucial that new plants are commissioned on time before the hot summer season when electricity demand soars. Siemens already delivered several facilities for GDF Suez in the past and thus had necessary know-how and a number of related reference projects. There are just a few firms able to design and build such complex facilities with high requirements on technological excellence, innovation, quality and reliability. Besides Siemens, companies from United States, France, Saudi Arabia and Japan joined the bid. International tender for delivery of both plants had multi-criteria ranging from project price, technological solution as well as delivery terms. In order to offer a turnkey solution, Siemens as a purely technological firm entered into an IJV with Korean GS Engineering & Construction Corp.. Project financing facility was structured by KfW IPEX jointly by the two national ECAs - German Euler Hermes and Korea Eximbank (KEXIM). Both government agencies arranged syndicated buyer's credit with appropriate credit cover under attractive terms in order to support the IJV of Siemens and its Korean partner. In case of project failure, Oman would be suffering from shortage of power, thus the projects of Barka III and Sohar II reached strategic character and gained political support. Oman Ministry of Oil and Gas made a committed in terms of secured gas supplies for both plants in the future. Similarly, Oman Power and Water Procurement Company (OPWP), single wholesale buyer of electricity in the country, signed long-term purchase agreement for plants' production capacity with operator of both power plants, represented by GDF Suez. These

contracts became a cornerstone for the whole project and substantially increased the trust of financing banks, and participating ECAs. For project scheme see Fig.1.

In March 2010, Siemens submitted its advanced technological solution together with the offer for project financing. Due to subsidized loans from the German KfW IPEX, consortium came out with attractive conditions for investors. Proposed technology, delivery terms, financing offer with interest rates below commercial market level were finally evaluated by investors as excellent. In June 2010, as a result of joint effort, the consortium led by Siemens won this lucrative bid for delivery of the two 744 MW green-field power plants. GS Engineering & Construction Corp. was responsible for civil construction work, supplied the heat recovery steam generators, electrical transformers as well as equipment installation. Siemens supplied the main components comprising two gas turbines, one steam turbine and three generators.

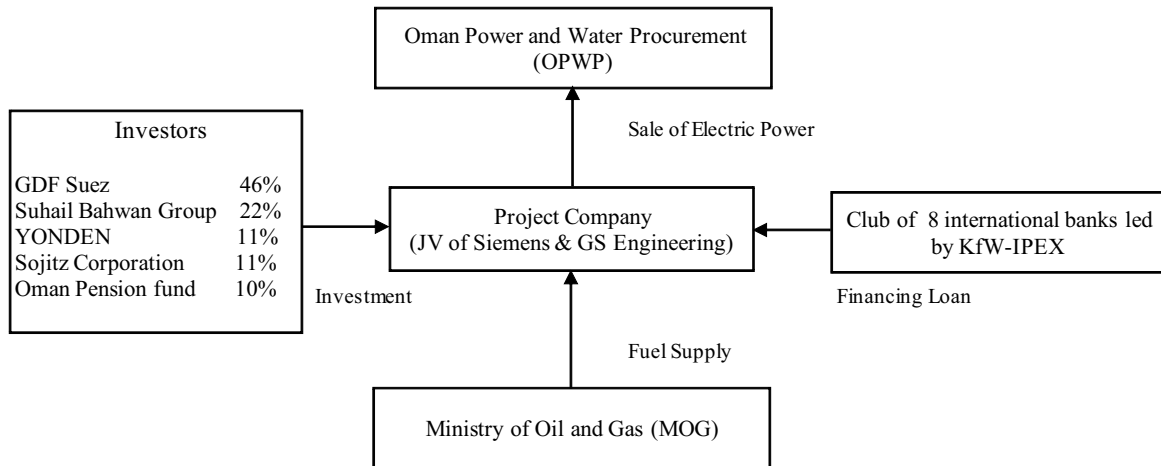


Fig.1. Project scheme

2.5. Financing Structure

The financing facility was structured and negotiated at the bid submission stage of 2009 when financial markets were still recovering from the financial crisis. IJV partners strived to bring competitive financing and attractive financing conditions, which finally led to granting of this power project. The project was financed through a blend of equity, early generation revenues and a senior debt facility involving ECA's Euler-Hermes and Korea Eximbank (KEXIM), and a club of eight international banks: Natixis, KfW-IPEX, Credit Agricole, HSBC, Bayerische Landesbank, Europe Arab Bank, CIC, and Standard Chartered Bank. KfW IPEX contributed around \$ 380 million to the total investment volume as well as part of the interest rate hedging. The bank provided fixed-interest loans on CIRB basis (Commercial Interest Reference Rate) over a 17 year period at attractive conditions as part of the promotion of German power plant technology. KfW IPEX was mandated lead arranger and Euler Hermes main coordinator of the financing agreement. In connection with this transaction, credit guarantees against commercial and political risks were issued by Euler Hermes and KEXIM. The share of their involvement was equal to engagement of Siemens and its Korean partner. Insurance covered 95 % of credit volume, uninsured portion was shared by exporters and banks. For export financing model see Figure 2. Due to the volume of financing equaling to \$1.3 bn, exceeding limits of KfW IPEX, also other banks were also invited to participate in this transaction. Another motivation was to pool banking know-how, different product specialization and experience with such large transactions. Besides investment credit, wide range of banking products were required such as issuance of performance bonds, warranty bonds, letters of credits, FX transactions, interest rate hedging, FX hedging, etc. All these services were provided by members of the bank syndicate. This transaction marked the first involvement of the

German ECA in Oman's power sector projects. Euler Hermes provided comprehensive credit cover of more than USD 600 million for both projects. German KfW IPEX has continued support of the region's power sector spanning almost a decade.

2.6. Project and transaction overview

Project:	Combined cycled power plants, Barka III and Sohar II, 2x 744 MW
Territory:	Sultanate of Oman
Importer/Investor:	Consortium led by GDF Suez S.A. (46 %)
Exporter:	IJV - Siemens AG and GS Engineering & Constr. corp. (South Korea)
Role:	EPC Contractor
Technical advisor:	Mott McDonald
Financing banks:	A club of 8 international banks – KfW IPEX (Lead Arranger), Natixis, Credit Agricole, HSBC, Bayerische Landesbank, Europe Arab Bank, CIC, Standard Chartered Bank
Insurers / ECAs:	Euler Hermes, KEXIM
Term of delivery:	09/2010 – 04/2013 (full operation as of 06/2013)

Structure of financing:

Contract price:	\$ 1700 million
Exporting buyer's credit:	\$ 1300 million (76.5 % of contract volume)
Investor's equity:	\$ 400 million (23.5 % of contract volume)
Drawing period:	30 months
Tenor:	17 years, 6 months grace period
Technology:	Siemens AG (gas-fired combined-cycle turbines)

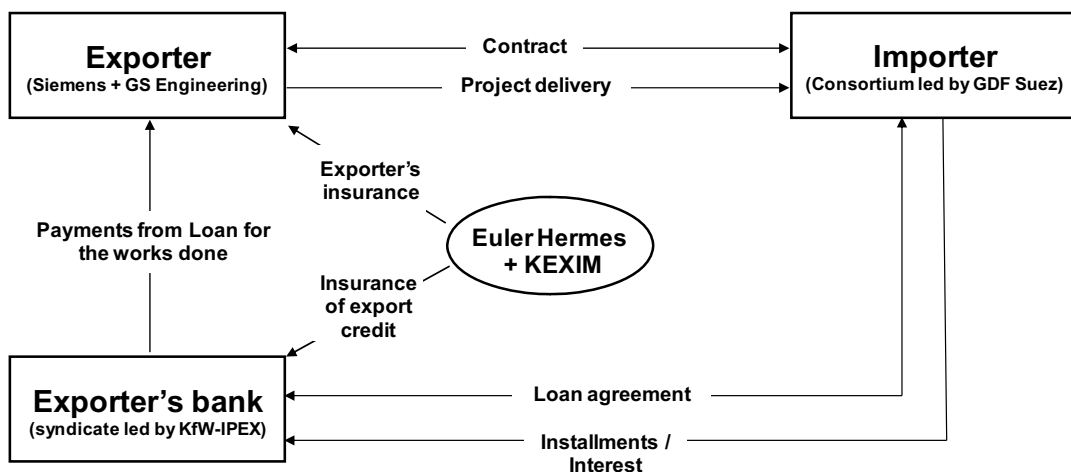


Fig. 2. Syndicated Buyer's credit with Hermes and KEXIM insurance

Characteristics of export financing: Syndicated buyer's credit with signs of project financing – the whole project is assessed and evaluated according to the risk related to importer itself, as well as the stand alone project.

Hypothesis:

Based on literature review, current state of academic knowledge and case study presented, the following hypothesis were formulated:

H1: Strategic character of project and support of foreign country government are essential for successful project execution.

H2: Participation of export credit agencies increases confidence and mutual trust among project stakeholders.

3. Conclusion

The Siemens turnkey combined-cycle power plants Barka III and Sohar II were delivered on time and ahead of peak summer demand in accordance to agreed price and required quality measures. Exporting program of German KfW IPEX enabled advanced Siemens' power technologies to be exported, ensured that vast majority of supplies, services and equipment installed came from German contractors and thus jobs and employment in the home country were secured. This mechanism enables to tap into new markets. Germany further profited through project contribution to country's GDP growth and taxes being paid there. On the other side, with 57.6 %, Siemens executed construction of Oman's most efficient combined-cycle power plants, reflecting the country's focus on advanced technologies with low lifecycle costs. Thanks to advanced German technology, millions of tons of carbon dioxide will be saved. Such projects lead to the firm's further technological improvement and access to other power-engineering bids worldwide and thus drive German export-oriented economy forward. Without state guarantees, neither investor nor financing banks, wouldn't have enough confidence for participation in the project.

Based on above mentioned case study, we identified exporter's key success factors when delivering the project under export financing concept:

- Cooperation with institutions and agencies monitoring market opportunities in the region
- Close cooperation with national export bank and ECA
- Strategic character of the project – national export banks support power sector as well as projects for infrastructure development on the long term basis.
- Guarantees and support of foreign country government due to projects' strategic character for the country, leading to increase of confidence of all project stakeholders.
- Possession of advanced and highly efficient technologies
- Wide range of related reference projects and international experience
- Entering IJV with experienced foreign partner
- Cooperation with foreign investor on the long-term basis

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