INTRODUCTION

It's a pleasure to be here. I am going to talk about project financing. My focus is on oil and natural gas projects; but the comments are relevant to other projects such as copper and coal mines, and aluminum, petrochemical, steel, and electricity generating plants.

First, let me establish Morgan's creditability. In the last two years we have managed oil and gas related project financings in Southeast Asia totalling $825 million. Currently, we and many others are actively pursuing several large projects in the region which aggregate $4 billion. Of this, approximately 60-80% could be financed on a project basis.

Why is Southeast Asia such an attractive area? We believe the ASEAN countries provide a receptive environment because of their high degree of political stability. Government leaders are committed to economic realism. The region enjoys substantial oil and natural gas as well as other natural resources. The upbeat economic tone provides expanding markets nearby.

PROJECT FINANCING

Morgan's view of project financing is the financing of an economic unit, i.e., an oil field, a mine, a petrochemical plant, where the lenders look primarily to the cash flow from that project. Once certain agreed upon tests of the project's technical viability have been met, the lenders have a limited, if any, direct financial recourse to the project's sponsors.

A project financing is characterized by:

- Its purpose, which is to finance development of natural resources of a process plant. Timing, the financing is usually set up so that construction expenditures are covered. The fact that debt repayment is limited primarily to cash flow from the project itself. I have stressed primarily because lenders do try to preserve the distinction between their debt and the equity of the projects' sponsors. The key to project financing is analyzing the various risk factors that affect the project's cash flow and reducing these risks. In some cases, this risk reduction includes sponsor support.

How Do Lenders Go About Project Financing?

My focus here is on non-U.S. projects. Much of what I say relates to direct experience with project financing in Southeast Asia. The basic risk factors include political risks both of a general nature and those related specifically to the project, which are primarily changes in the contract and the tax regime; technical risk, which includes the amount and recoverability of oil and gas reserves, operating costs, market risks, and, last, force majeure.

Lenders begin to analyze a project loan by trying to answer the same questions they would ask if they were lending directly to the country. What are its basic economics, natural resource base, balance of payments, monetary reserves? What is the amount and maturity schedule of the country's external debt? What is the internal and external political situation? How qualified are its economic ministers? How effective is the central bank?

Next, lenders focus on the specific contractual and tax arrangements which directly affect the project's cash flow. This is the area of many new developments in project financing and the majority of the learning experience comes from work on Southeast Asian projects. In the U.S.A., lenders usually have a direct security interest in the reserves and producing facilities. They also have the right to step in and replace the operator if the project's cash flows