M6 Budapest-Dunaujváros wrapped bond refinancing

Simon Ellis

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After the political wrangles and hasty re-nationalisations of the last decade, Hungary's road privatisation programme finally seems to have come of age.

If the market needed a symbol of maturity, it is the refinancing by Dexia and FSA of the M6 availability-based PPP road scheme, sponsored by Bilfinger Berger, Porr and Swietelsky.

The deal saw the first eurobond launch by a Hungarian SPV and the first wrapped-bond refinancing in central Europe.

The refinancing also closed on a tight three-month timeline that echoed the original M6 financing in 2004.

The market's pedigree is shown by the deal's tight spread with the combined commercial financing and monoline premium coming at a very competitive all-in cost.

The project

The Hungarian government's initial attempts to procure highways through project finance were marred by disputes over real tolling -the M1-M15 which was renationalised in 1999 and the M5 which was restructured to remove tolls in 2004

However the government learned from these mistakes to tender the M6 deal in January 2004 on a simple availability-based payment mechanism.

The M6 was tendered as 22-year DBFO of a 58km two-lane motorway stretching south from Budapest to the M8 motorway at Dunaújváros. Instead of bearing commercial risk, the consortium would secure a performance based payment of around €55 million per year.

After a competitive tender, the M6 concession was won by M6 Duna Autopalya Koncesszios - a consortium of Bilfinger Berger, Porr and Swietelsky - and reached financial close within a year of the tender in December 2004.

The deal was financed by a €411 million syndicated loan provided by BayerLB, Commerzbank, KBC, KfW, K&H and Magyar Kulkereshedelmi Bank, priced at Euribor plus 115 bps, stepping up to -124 bps.

Despite the relative tightness of the initial financing, the sponsors were encouraged by depth of the banking market shown by the 2003 refinancing of the nearby M5 toll road (which cut pricing from 312.5bp to 120-160bp) and the chance to take advantage of the resurgent European monoline market.

In Summer 2005, the SPV approached banks and monolines through two separate competitive processes.

Market response

The competition to secure both mandates was fierce as banks and monolines tried to get a foothold in the prized eastern European market.

In December 2005, Dexia was mandated to put together the financing for the deal while its subsidiary FSA won the competition to wrap the funding.

Meanwhile the European Investment Bank, which had attempted to fund the first M6 deal in 2003, also secured a mandate.

As well as dealing with the EIB and consortium, the new funders would have to deal with some of the banks of the original syndicate which remained in the deal through the VAT facility and the equity bridge loan.

Politically the deal faced severe time constraints as Lionel Epely, a Senior Project Manager at Dexia, explains,

'There were a few challenges because it was the first financing of this type. But the first challenge was timing, due to the election that just took place. We wanted to go to the market by the end of March so there was a lot of pressure on the execution.'

In fact the financing closed on 31 March 2006 just over a week before the first round of elections for the Hungarian parliament.

The refinancing structure

To cut the already low margin on the debt, Dexia had to bring something special to the table. Originally the bank had also contemplated the use of wrapped bank debt but the bond route was finally preferred to take advantage of hungry Eurobond market.

Epely explains that the bank was faced with a choice between one innovative method over another,

'Even if it is the first wrapped bond deal in central Europe, there is still more experience generally in wrapped bonds than in wrapped debt so it was adjudged to be safer to go the bond route,' he says.

But the option was not risk-free. It would be the first bond launch by a Hungarian company on the Luxembourg stock exchange and it had to be achieved to meet the end of March deadline.

The sponsors decided to raise €212 million of the financing through the bond issue (see bond launch below).

In addition, he EIB agreed to provide a conventional €200million loan.

To ensure flexibility to the SPV, Dexia also provided an FSA-wrapped €19 million revolving letter of credit facility priced at a similar rate to the bond.

Interest rate risks were hedged by an interest rate swap with BNP Paribas.

Construction risk is borne by the contractor which receives a fixed sum - an early hurdle as the interim completion date has been delayed by 6 to 8 weeks to May 2006.

The bond launch

On 31st March the M6 consortium launched the FSA-wrapped floating rate €212 million Eurobond on the Luxembourg Stock Exchange with a coupon of 6-month Euribor plus 27 basis points.

The amortising securities have an average maturity of 9.5 years with a final maturity date of March 2025.

The issuer has a call-option from March 31 2011 to buy the bonds back at 101 per cent of nominal value in year six, 100.05 per cent in year seven and any time thereafter at par.

The bond was three times oversubscribed by a range of banks and institutional investors in six European countries (see charts below).

Despite the low pricing, Epely believes the launch offered good value for investors as well as the sponsor,

'While it was quite competitive for the sponsors, I don't think the pricing was overly aggressive from the investors' standpoint. It was very well received. The only similar incomes you would get are in the UK PFI market but that is fixed rate, sometimes inflation-indexed bonds and that is usually longer tenors of 30 years plus.'

'Here you are talking about less than 10 year average life, it's Eurobond and there is a lot of appetite in the Euro market so people are very hungry for that kind of paper. There are very scarce opportunities in terms of central European paper.'

Conclusion

Despite the clear international demand for the financing market, the outlook for the Hungarian roads will be uncertain as the government completes its ongoing restructuring of state highways agency AAK.

The extension of the M5 project has stalled and there are strong rumours that the government will procure future deals through sub-contracts on the AAK's balance sheet.

However, the participants can draw satisfaction from the refinancing itself. The sponsors more than halved their financing costs and yet easily secured financing from institutional investors and commercial banks.

The deal also signalled a double for Dexia - which won both the refinancing mandate and the monoline mandate through subsidiary FSA.

After arranging a wrapped bank debt deal earlier in the year as an MLA on the Golden Ears bridge transaction, Dexia has put itself at the forefront of innovative monoline-backed financing techniques.

As monolines reach the height of their cycle, these will be powerful weapons in any bank's repertoire.

The project at a glance

Project Name	M6 Duna Autópálya Koncessziós Zártköruen Muködo Részvénytársaság ("M6 Duna")
Location	Hungary
Description	Design, build, operation, maintenance and finance of a 58.6-km stretch of new motorway, starting south of Budapest near Érdi and ending at the intersection between the M6 and the M8 motorways near Dunaujváros, under a 22-year availability-based Concession Agreement with the Hungarian Minister of Economy and Transport.
Sponsors	Bilfinger Berger BOT GmbH (40%), Porr Infrastruktur GmbH (40%) and Swietelsky International Baugesellschaft mbH (20%)
Operator	Duna-Intertoll Rt, a subsidiary of South African international road operator Intertoll
EPC Contractor	M6-Autópálya Építési KKT., which is jointly owned by Bilfinger Berger Baugesellschaft mbH, Porr (Budapest) Kft. and Swietelsky Építö Kft.

Project Duration	20.5 years left under concession agreement
Total Project Value	Approx. € 485m
Total senior debt	€ 412 m
Senior debt breakdown	€ 212 m Floating Rate Notes due March 2025 € 200 m EIB Loan due March 2025
Total bonds	€ 212 m
Bond pricing/ tenor	6mEuribor + 27 bps, 19-year maturity
Bond ISIN number	XS0245906150
Debt:equity ratio	90:10
Mandated lead arranger(s)	Dexia Capital Markets Sole Lead Manager and Bookrunner
Monoline provider	Financial Security Assurance, a Dexia Company (wrapped all facilities)
Participant banks (account bank/ bookrunner/ facility agent/ insurance bank/ co-arrangers)	Dexia Banque Internationale à Luxembourg listing agent, principal paying agent and calculation agent
Pre-refinancing debt pricing	Euribor + 115-124 bps
Pre-refinancing debt maturity	March 2025
Legal adviser to sponsors	Freshfields Bruckhaus Deringer
Financial adviser to sponsors	BNP Paribas
Legal adviser to financiers	Clifford Chance LLP
Legal adviser to government	Linklaters
Financial adviser to government	ING
Date of financial close	31/03/2006