Finding the debt for Indian power

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The vast construction programme of new power plants in India has the domestic banking system at full stretch, including state-owned banks, private sector commercial banks, and specialised infrastructure lending entities such as Power Finance Corporation and India Infrastructure Finance Company Ltd (IIFCL).

The ultra mega power projects (UMPPs) will each generate 4,000MW, and at a cost of around $4 billion apiece are some of the biggest power projects being built globally. In addition there is a long list of plants in excess of 1,000MW, as India moves aggressively to address its electricity shortage and keep economic growth on track.

Fortunately for sponsors, Indian retail and institutional equity investors are enthusiastic about the power sector. But there is also strong renewed interest from international equity investors attracted by the rise of over 50% in the Bombay Stock Exchange Sensex Index since the beginning of 2009. This has allowed power sector companies to tap the equity market for fresh capital.

"Following the collapse of Lehman Brothers in September 2008 there was an outflow of international funds from the Indian stock market, but part of those funds have now returned, attracted by the stable political environment following the elections, and the growth potential of the Indian economy," comments Ivan Palacios, Analyst at Moody's Investors Services in Singapore.

"In July Sterlite Industries raised $1.5 billion via an offering of ADRs, part of which will be used to finance its power projects. Also in July, Tata Power Company raised $335 million through a GDR offering. We have also seen sizeable domestic IPOs, such as Adani Power in August," adds Palacios. "This highlights the investor appetite for the Indian power sector, which is currently able to raise the equity needed to support its expansion plans."

Adani Power had originally planned an IPO in 2008, just after Reliance Power had raised $2.9 billion in the biggest ever Indian IPO. But Adani held off because of market conditions, as the BSE indices fell sharply back from their January 2008 record highs. The $630 million IPO finally came in August 2009, and was twenty times oversubscribed. The offering was led by SBI Capital Markets, DSP Merrill Lynch, Enam Securities, IDFC-SSKI, JM Financial, Kotak Mahindra Capital Co, Morgan Stanley and ICICI Securities.

Also in August, state utility NHPC raised $1.25 billion in a heavily oversubscribed IPO, and more Indian power company IPOs are planned for the coming months: Indiabulls Power will raise Rs15-20 billion through a soon-to-be-launched IPO and has just dropped plans of raising Rs4 billion through a pre-IPO placement to avoid delay in its public issue. It is working on power projects with an aggregate capacity of over 10,000 MW and a few months ago, achieved financial close for its 2,640MW Amravati thermal power project.

JSW Energy is also looking at raising Rs40 billion ($823 million) from an IPO. The company, which is setting up a 3,200MW power project at Ratnagiri in Maharashtra, is aiming to become a major power producer with over 12,000MW by 2012.

Minimal foreign lending

Foreign equity investors may have already returned to India, but on the debt side the involvement of foreign lenders remains at a low level.

In 2008 BNP Paribas arranged $1.7 billion of foreign covered and uncovered debt for Tata Power's Mundra UMPP. At that time there were high hopes of bringing in foreign debt tranches on a series of upcoming power projects, with various arranging mandates signed. But the financial turmoil following the collapse of Lehman Brothers in September dented the probability of syndicating foreign tranches and some mandates were renegotiated.

For example, in March 2008 Standard Chartered Bank signed a $500 million fully underwritten 12-year dollar loan agreement with Adani Power in relation to its Mundra Phase III power project. The post-Lehman environment made it very difficult for Standard Chartered to find international banks willing to come in, even at margins of 325bp rising to 375bp. In May 2009, Adani Power agreed with Standard Chartered to a reduction of the facility from $500 million to $250 million. But in July the loan was replaced with a 13.5-year rupee facility priced at 50bp under SBI PLR from SBI Capital and Power Finance Corporation.

Entities such as IIFCL are helping with direct loans to projects, providing both domestic debt and foreign currency tranche loans via its UK office. There is also speculation that the market may increasingly see IIFCL taking out some of the existing bank debt on power projects. The banks have exposure norms for a given sector or a particular borrowing group, so if IIFCL can provide this kind of refinancing facility it will make room on bank balance sheets for new project lending. In addition, some deals might initially get signed up with Indian banks, but with an option for some of that debt to be refinanced at a later date by international lenders.

The significance of IIFCL lending via both its Indian and UK offices is that the loan via the UK is denominated in dollars. The government has set out a programme under which the Reserve Bank of India can buy up to $5 billion worth of bonds issued by the UK subsidiary of IIFCL, which can then use these proceeds to finance overseas capital expenditure of Indian companies in the infrastructure sectors.

IIFCL was integral to getting Reliance's 4000MW Sasan UMPP to financial close in April. Standard Chartered had been mandated to arrange an international debt tranche, but given the upheaval in the global debt markets this did not materialise and the deal went domestic with additional IIFCL UK involvement.

The estimated cost of the project is Rs194 billion funded on a 75:25 debt-to-equity basis. Lead arranged by SBI, lenders include IIFCL (UK & India), Power Finance Corporation, Rural Electrification Corporation, Punjab National Bank, LIC, Axis Bank and IDBI Bank. Sasan still has the flexibility to try to put some foreign commercial banks debt in place if market conditions improve.

In June, the IIFCL UK also put up the foreign debt on Sterlites Energy's long-term dual-currency take-out facility on the bridge loan for its 2,400MW Orissa plant: The deal comprises $140 million of 15 year debt and Rs55.69 billion ($1.14 billion) of 13 year local debt lead arranged by SDBI, SBI Capital and Deutsche Bank. The debt priced at 25bp discount to SBAR (then 11.75%).

Local funding gets cheaper and bigger

To date, at least, concerns over domestic bank capacity appear misplaced as the vast deal volume continues to get financed. In a period of just two weeks in July four Indian power projects reached financial close: Lanco Hydro Energy's Phatabyung hydroelectric project in Uttarakhand; Essar Power's 1,200MW Mahan project in Madhya Pradesh; and Reliance Power's 300MW Butibori plant and the second phase of its 600MW Rosa Power project.

One of the strengths of the Indian banking sector is its strong deposit base, giving local lenders a relatively cheap and stable source of funding. External borrowing by Indian banks has also been quite limited. Thus the global crunch in bank liquidity has had very limited impact in India. This is in contrast to the GCC region, where many regional banks had relied heavily upon tapping the international syndicated loan market. As this source of funding dried up, so did their capacity to lend.

In contrast Indian private sector banks are well placed to continue lending. Reliance Power's 300MW Butibori Project, which is a captive coal fired plant for large industrial customers in Maharashtra, reached financial close with a purely domestic bank line-up: Axis Bank lead managed the Rs15 billion ($300 million) project financing, with a consortium including SBI, Union Bank of India, United Bank of India, South Indian Bank, Syndicate Bank, UCO Bank, Allahabad Bank, Dena Bank, Life Insurance Corp of India, Corporation Bank, Karur Vysya Bank and State Bank of Hyderabad.

The same is true of Essar Power's 1,200MW Mahan coal-based plant in the Madhya Pradesh. The Rs48.6 billion project is being funded via a consortium of four lenders: ICIC (lead arranger), Power Finance Corporation, Rural Electrification Corporation, and Punjab National Bank. ICICI Bank.

Some Indian lenders are also willing to provide subordinated debt, and in the case of Adani Power's recently financed Mundra Phase IV debt package, State Bank of India, Punjab National Bank, Bank of India and UCO lent Rs4.5 billion on a subordinated basis: The financing for Mundra Phase IV was signed in late June, with Rs67 billion of 13 year debt being provided by a consortium of lenders comprising State Bank of India, Allahabad Bank, Punjab National Bank, Bank of India, Canara Bank, Union Bank of India, Corporation Bank, Life Insurance Corporation of India, and UCO Bank. The deal priced at par to SBAR (11.75%).

The cost of local debt has also become more competitive as margins at the international banks have increased. Local banks are also typically lending at interest rates at a discount to SBAR and many of the deals closed this year have benefited from a 50bp cut in the SBAR rate in July to 11.75%. For example, the Rs145 billion Sasan project debt priced in April at a 50bp discount to SBAR (then 12.25%) and is consequently enjoying a further 50bp drop in interest.

Will foreign lenders make a comeback?

As the global financial markets stabilise foreign banks may find an appetite for Indian power project lending – particularly as Indian power projects typically feature long term Power Purchase Agreements (PPAs) with a small merchant element, a comfort to lenders as long as the offtaker is solid.

Furthermore, as the market matures and Indian sponsors, many of which are relatively new start-ups, establish track records, international lenders will also be better able to assess sponsor performance and the ability to get projects completed on budget and on time.

Take Adani Power as an example. It has a big name in Indian power but it has no operating history in the power sector for lenders to look at, and as of 1H 2009 had no operating cashflows to analyse. It is also quite aggressive with its debt:equity ratios, and is proceeding on an 80:20 basis with most of its projects.

That said, Adani has had little trouble funding its project programme domestically. The first 330MW unit of the Mundra Phase I and II Power Project was commissioned in July 2009, and the company expects that the power project will be fully commissioned by February 2010, comprising four sub-critical generation units of 330MW each.

In January Adani Power also reached financial close on the 1,320MW phase I of its Tiroda Power project, with Rs49 billion being provided by a consortium led by State Bank of India. And the smaller phase II already has banks lined up to participate.

If international lenders do return to the market they may face stiff competition – although not necessarily from domestic banks. Were the growing pipeline of Indian power projects to be financed domestically it would leave Indian banks vastly over-exposed to the sector, and at some point lending capacity must hit constraints. However, competition may come from Chinese lenders on the back of the growing Chinese construction input into Indian power – for example on Adani's Mundra Phase II and III, the EPC contractors are completely Chinese led by Shandong Electric Power. Although the long-term reliability of Chinese equipment is under scrutiny, the growth in Chinese EPCs signals the potential entry of China Exim into the market and the debt pricing implications thereof.