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InterGen TransAlta: Minor M&A?

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InterGen completed its acquisition of two Mexican independent power projects from TransAlta on 8 October 2008, for a purchase price of $303.5 million in cash. The assets are the Campeche and Chihuahua power plants, and constitute TransAlta's whole Mexican portfolio. The acquisition was financed with $261 million in bank debt provided by Calyon, Export Development Canada, WestLB, Sumitomo Mitsui Banking Corporation, and DekaBank, with the remainder in equity.

The financing comes during a period of acute market distress, and at a pivotal time for InterGen. Not only was it the last infrastructure operator to close a high-yield bond financing before the crunch hit, but one of its parents – AIG Highstar – recently sold its 50% stake in InterGen to India's GMR. The financing and the change in ownership promise a renewed focus on emerging markets for InterGen. But it still has a Eu405.6 million ($595.8 million) financing for its Rijnmond 2 project out to market, a deal with a much more aggressive structure than the TransAlta assets.

Campeche is a 252MW combined cycle gas-fired plant located in the state of Campeche on the Yucatan peninsular. Chihuahua is a 259MW combined-cycle gas plant located near to the Mexican border with the US at Ciudad de Juarez. Both plants have full power purchase agreements (PPAs) with the Mexican national utility Comisión Federal de Electricidad (CFE) under 25-year contracts, and began operations in 2003, Campeche in May, and Chihuahua in September. They were both developed under the CFE's IPP programme, which has awarded 22 PPAs since 1997. InterGen's La Rosita and Bajío projects were also awarded under the same programme.

The debt features one long-term tranche, with a 14-year maturity, and several smaller letters of credit. According to Martin Rees, chief financial officer at InterGen, the LCs are commonplace in this type of transaction in Mexico. They were required by the CFE to support the project's PPA obligations, and to support obligations to the suppliers of fuel to the plants.

WestLB and Calyon were mandated first, and were joined by EDC, SMBC and Deka in August 2008 when the financing was repackaged as a club deal. Rees says that the original intention was to syndicate the debt after financial close, but given the recent slow-down in syndications markets, a club deal was favourable. Rees also notes that the market was particularly tumultuous at the time of the financial close, and InterGen was pleased to be able to succeed in closing.

The debt providers are each committing to roughly equal portions of the facilities. The EDC has provided most of the LCs, with Calyon also taking a portion, but the lenders intend to restructure the LC part of the financing after the deal closes, so that each of the five takes an equal share. According to a source at one of the lenders, the pricing on the debt is competitive, in the high 100s, or low 200s, in basis points over Libor.

Rees believes that the TransAlta assets complement InterGen's other Mexican assets, which are also combined cycle gas-fired plants, though their technologies differ from plant to plant. He also says that, because of the existing contracts with the CFE, the assets have long-term appeal. Stephen Dowd, a senior vice-president at the Ontario Teachers' Pension Plan, which holds the remaining 50% stake in InterGen, reiterates this sentiment. Teachers' has traditionally favoured long-term contracts for its infrastructure investments, and Dowd says that Teachers' supports InterGen's prudent growth, in targeted acquisitions and in greenfield development. InterGen is currently looking at growth opportunities in Mexico and western Europe.

TransAlta decided to sell its assets under the recommendation of LS Power, which together with Global Infrastructure Partners (GIP), had jointly proposed to buy TransAlta in July of 2008, and had previously advised its shareholders to divest of non-core assets, including the Mexican portfolio. The TransAlta board rejected the takeover bid in August, as its members felt that the offer of $39 per TransAlta share (around $7.8 billion in total) undervalued the company's worth. LS abandoned its bid on 9 October, and TransAlta's shares have not moved above $25 since.

According to TransAlta, the sale of the Mexico portfolio was accretive to earnings. Based on the value of its Mexican business before the sale, TransAlta said it would take a charge of C$55 million to C$65 million (C$0.27 to C$0.32 per share) to its first quarter earnings, reflecting the difference between the purchase price and book value of the business. TransAlta said that it planned to use a significant portion of the proceeds to buy back its shares, but that buy-back has not yet happened.

Capping a busy three days for InterGen, in the company GMR completed the purchase of a 50% stake on 9 October, one day after the TransAlta deal closed. It bought the stake from AIG Highstar for $1.1 billion, or $360,000 per MW of InterGen's capacity. GMR funded the acquisition with a bridge loan provided by five Indian banks, and intends to have a long-term financing in place by the end of the year.

Highstar's decision to sell is not believed to be due to any market conditions, or AIG's acquisition by the US government in September, but part of an existing strategy to realise some of the gains on its energy portfolio. The sale had been approved in June 2008, and the period between agreement and sale was consumed with gaining regulatory approvals.

InterGen now has 12 power plants internationally, in the UK, the Netherlands, Mexico, the Philippines and Australia. Its total generating capacity is 8,086MW (6,231MW net, of which 428MW is under construction). After an unsettled period, and now with a settled ownership, InterGen is likely to step up its development efforts. TransAlta may be a foretaste, and a relatively straightforward one, of a larger pipeline of business. But Rijnmond 2 will be a better indication of banks' enthusiasm.

Energia Campeche/Energia Chihuahua
Status: Closed 8 October 2008
Size: $303.5 million
Location: Campeche and Chihuahua, Mexico
Description: Acquisition of TransAlta's Mexican portfolio, of two gas-fired power plants
Equity: $42.5 million
Sponsor: InterGen
Debt: $261 million
Mandated lead arrangers: Calyon, Export Development Canada, WestLB, Sumitomo Mitsui Banking Corporation, DekaBank
Lender legal: Shearman & Sterling
Sponsor legal: Paul Hastings
Sponsor financial adviser: JPMorgan