North American Portfolio Power Deal of the Year 2007

01/02/2008

EIF Calypso: Flex and flexibility

Another buyout but not another B loan – EIF Calypso demonstrated that, for the right deal, hybrid corporate/project debt could fill the void created by the B loan flight from US power acquisition finance. The deal also enabled sponsor Energy Investor Funds (EIF) to get a quick financial close, and with a structure that gives it unprecedented financial flexibility.

The $850 million debt financing backs the acquisition from Goldman Sachs of an 80% interest in 14 plants (total 2,231MW) in the Cogentrix Energy portfolio (Goldman Sachs bought Cogentrix in December 2003 for $2.4 billion for stakes in 24 plants). Cogentrix/Goldman Sachs retains a 20% interest in the plants and will continue to operate them and work with EIF to maximize the value of existing contracts.

The deal is structured primarily through EIF's US Power Fund III (USPFIII) which raised $1.35 billion in commitments in July 2007. Participants in the fund include ABP Investments, Contra Costa County Employees Retirement Association, Howard Hughes Medical Institute, John Hancock Life Insurance Company, Mayo Clinic, New York Life Investment Management, and University of Toronto Endowment Fund and Pension Plan and a further 37 smaller investors.

The buyout was EIF's largest to date and a significant departure from its track record in small portfolios and single asset sales. But according to EIF senior partner Andrew Schroeder the portfolio was "a perfect fit and we felt good with the certainty of its history. The predicted base case meets our long-term ROI expectations and there are a number of added-value creation opportunities."

EIF had a number of key requirements of the deal: It needed to provide a full payout of the acquisition debt over the loan term; the structure had to allow dividends to flow back to shareholders and provide the appropriate flexibility for EIF to make acquisitions, divestitures, PPA restructuring and optimizations, while still providing an ample degree of protection to the lenders; the deal also needed to capitalize on traditional bank lenders' appetite for well-structured transactions, while avoiding the unnecessary pricing and structural impediments that the B Loan market would have imposed – notably boilerplate type B Loan characteristics (cash sweeps, prepayment penalties and balloon payments) that would have constrained EIF's strategic flexibility.

All those requirements were met – and at speed.

The financial engineering uses a holdco structure, not unique in the US – for example the Northern Star Generating assets sale was similar – but with flexibility on multiple levels: Not only can EIF raise more debt to acquire the remaining 20% of the portfolio, it can restructure and optimize the projects' PPAs and concurrently refinance those projects; it can also divest projects under certain conditions, provided minimum proceeds are generated from the asset sale.

Sole arranged by Calyon, the deal was structured from the outset to appeal to the bank market. Calyon had significant insight into the portfolio having been agent bank on the original financings for the majority of the projects and was willing to sole underwrite.

EIF was also willing to put in a lot of equity and had the option for a bridge financing for the remainder of the funds in a "worst case scenario" says Schroeder (both Goldman Sachs and EIF wanted a quick sale). The final debt-to-equity split is 46/54 –

"Calyon could do more debt but we went with the conservative leverage option," adds Schroeder.

The $850 million debt financing comprises a $650 million term loan and a $200 million revolver. The term loan is split between a $260 million seven-year tranche, initially priced at 225bp over Libor, and a 12-year $390 million tranche at 262.5bp. Pricing has since been flexed up slightly – more a reflection of the lending climate than the deal.

The deal comes with strong coverage ratios – 1.5x ADSCR – and lenders can take comfort from the diversified portfolio with strong cashflows. More than 90% of the portfolio's output is sold via power purchase agreements (PPAs) or tolling with investment grade offtakers – average remaining contract life across the portfolio is 15 years – and when the final tranche of financing matures in 12 years, 70% of the generation will still be contracted.

The deal structure is a hybrid between corporate and project financing. The loans have a sculpted amortisation profile schedule based on cashflows and full payout by maturity. The project-style elements include minimum and average DSCRs and traditional project-style distribution tests.

The debt is taken out at the holding company level and the corporate-style elements include financial covenants (both for holding company leverage as well as debt service) and all the financial flexibility that EIF demanded of the deal from the outset.

The deal launched to syndication on January 22 in New York and got a good response with around 30 institutions at the bank meeting. Calyon came to the meeting with pre-commitment from seven banks – Mizuho, TD Securities, Natixis, Union Bank, DZ Bank, Sumitomo, ING Bank – with takes ranging from $60 million to $30 million. Given the pricing, lender security structured into the deal and predictable cashflows, syndication should be fairly short.

Lenders also benefit from the partnership between EIF and Cogentrix/Goldman Sachs. Cogentrix is incentivised to maximise returns form its remaining 20% stake prior to a full buy-out by EIF and both sponsors have several contract optimization opportunities that were conceptualized or initiated before the sale.

EIF
Calypso
Status: Financial close December 2007, in syndication
Debt: $850 million
Location: USA
Description: Power portfolio acquisition financing via project debt
Sponsor: EIF
Sole lead arranger and underwriter: Calyon
Participants to date: Mizuho, TD Securities, Natixis, Union Bank, DZ Bank, Sumitomo, ING Bank
Sponsor legal counsel: Milbank Tweed (debt), Bingham McCutchen (equity and regulatory)
Lender legal counsel: Simpson Thacher & Bartlett
Financial adviser and equity syndication: Lehman Brothers
Insurance consultant: Moore-McNeil
Independent engineer: E3

EIF/Cogentrix portfolio
Logan: 100MW coal-fired plant located in New Jersey and selling power to Atlantic City Electric
Rathdrum: 270MW gas-fired plant in Idaho that sells power to Avista
Indiantown: 330MW coal-fired plant in Florida that sells power to FPL
Carney's Point: 262MW coal-fired plant in New Jersey with a contract with Atlantic City Electric
Selkirk: 345MW gas-fired plant that sells power to two New York utilities
Cottage Grove: 245MW gas-fired plant that sells power to Xcel Energy
Whitewater: 236.5MW gas-fired cogeneration plant located in Wisconsin, and selling to WE Energy
Morgantown: 62MW coal-fired plant located in West Virginia that sells power to Monongahela Power
Rocky Mount: 120MW coal-fired cogeneration plant in North Carolina that sells power to Dominion
Richmond: 208MW coal-fired plant in Idaho that sells power to Dominion
Scrubrass: an 85MW waste coal-fired plant in Pennsylvania that sells power to Penelec
Northampton: 110MW coal-fired cogeneration project located in Pennsylvania and selling power to Metropolitan Edison

Plains End: 113MW gas-fired peaking project located in Colorado and selling power to Xcel Energy
Ouachita: 789MW plant located in Louisiana, that sells power to Dynegy