European Power Acquisition Deal of the Year 2003

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Italian generation companies (gencos) have tended to avoid raising anything but short-dated debt - until now. The deal backing the acquisition and repowering of Tirreno Power is the first time an Italian genco has secured medium-term financing from the start - in this case in an especially challenging climate for power deals. It is also the first project financing structured on a full merchant risk basis, without explicit shareholder support. At Eu1.19 billion ($1.4 billion) in size, it is also Italy's largest non-recourse power acquisition financing.

Mandated lead arranger BNP Paribas, with Barclays, Credit Agricole Indosuez, Banca Intesa, Banca Monte dei Paschi di Siena and Banca Nazionale del Lavoro led the financing on the Eu900 million debt portion of the deal.

Interpower is the third and last generation company to be spun off by incumbent Enel, through Italy's power market liberalization plan.

The sponsor group backing the deal is made up of EblAcea (50%), a joint venture between Electrabel and Acea, and Energia Italiana (50%), controlled by the CIR/De Benedetti Group, Verbund and Italian municipal utilities. With a total capacity of 2,600MW, Tirreno power is the fifth largest electricity generator in Italy.

The deal is a quasi-acquisition and quasi-project finance deal, incorporating elements of both. Although the tenor, at seven years, is by no means exceptional for power deals in general, the option to go out on a longer-term basis is also important since it represents a vote of confidence for a deal in a nascent and as yet uncertain market.

Moreover, it also highlights the willingness of ever more wary power project banks to back assets in the Italian market. The seven-year maturity provides a 3.5-year tail beyond the expected repowering completion date.

The financing is structured to allow the initial acquisition to be funded on a 50:50 debt to equity basis. At the same time, the package will fully fund the repowering plan on a 60:40 debt to equity basis, also drawing on the cash flow generated as well as sponsor equity.

Underlying the structure of the deal is a view to leading Tirreno Power to an investment grade profile, without tolling agreements or other electricity price hedging instruments. It will also allow a smooth refinancing at maturity, at which time about 68% of the total debt should still be outstanding.

Juergen Fryges, Electrabel's Italian CFO, says: "At the time of the acquisition it was not a very sound idea for us sponsors to do it as an 18-month tenor and then go out to the market to refinance."

So the group tested the banks market and saw an opportunity for raising longer-term money. "In the market the question for lenders is still: can we trust the sponsors or not? In our case, the banks backed us."

"It was the strength of the sponsors that clinched the deal," says Barclays' James Mckellar.

Indeed, the quality of the sponsors proved vital, especially against the background of a depressed market for power project financings elsewhere. To add to general worries, TXU, the embattled utility, was declared bankrupt the day before signing. "Getting seven years in those conditions was exceptional," says Fryges.

"It would have been expensive to go on a short-term basis, and it is simply impossible to go for a two- year deal, so the final analysis was that seven years worked best," says Emmanuel Rogy at BNP Paribas.

"When you look at the amount of equity and the tenor, you might think it's quite conservative," says a banker. But, says Fryges, "we simply weren't expecting a 85%- 95% leverage."

The price the consortium paid for the deal is also lower than the previous Enel divestment deals, because they came when the outlook was particularly gloomy, and all the traditional players had shown little interest in bidding.

Enel accepted the Eu874 million offer in November 2002, and the arrangers signed with the sponsors on 17 January 2003.

The financing splits into five tranches, a Eu141.6 million acquisition facility, a Eu13 million interest revolving credit facility, a Eu282.9 million intercompany facility, a Eu415.5 million repowering facility and a Eu47 million working capital facility.

Launched last February, the deal is priced at 125bp over Euribor years one to two, 130bp years three to four, 140bp years five to six, and 170bp thereafter.

One of the most important pieces of security for lenders lies in the incentivized equity injection mechanism. Shareholders are encouraged to put in new equity on a monthly basis, under threat of default. So given the sponsors' obligation to make up the shortfall, in effect the only instance in which the banks are exposed is in the event of a sudden and rapid downturn.

Since lending banks are taking merchant risk across a portfolio of plants with no significant sponsor support, the deal was not the easiest to sell. "We knew from the beginning that syndication would not be easy. We knew it would be a case of convincing people. But the banks that came in understood and in the end it went out fairly well," says Fryges.

"The most important success factor for this deal was the common view of the market shared by sponsors and participating banks - they all understood its strengths."

So can this deal get done again? "It has set a new benchmark," says Fryges. "It's a milestone in continental European financings, and it may be an approach our competitors might choose for their own refinancings."

"One of the things that everybody agrees on is that there will be a viable electricity market in Italy," says Rogy. "The uncertainty is how quickly you'll go from the high prices of today to more moderate, stabilized prices."

The basic principle underlying the deal - of medium-term financing with an element of refinancing risk - seems a robust approach for future deals. "The structure makes a lot of sense for portfolio deals, but it may not be easy to replicate for single asset deals," says Rogy. "This is a market with a lack of capacity. Tirreno power has given us the opportunity to enter the market with a portfolio of plants, which give us a strong foothold."

Tirreno Power

Status: closed 17 January 2003

Size: Eu1.9 billion

Location: Italy

Description: Deal backing the buyout of incumbent Enel's third generating portfolio

Sponsor: EblAcea (50%), a joint venture between Electrabel and Acea, and Energia Italiana (50%), controlled by the CIR/De Benedetti Group, Verbund and Italian municipal utilities

Lead arrangers: BNP Paribas, Barclays, Credit Agricole Indosuez, Banca Intesa, Banca Monte dei Paschi di Siena and Banca Nazionale del Lavoro

Legal adviser to sponsor: Milbank Tweed Hadley & McCloy

Legal adviser to lender: Clifford Chance