European IPP Deal of the Year 2003

01/02/2004

AES Cartagena was not an easy power deal to get away. Its first attempts at syndication failed - partly due to bank misgivings over its struggling sponsor AES, its initial high 90:10 debt-equity split and its record size for the year and geographic market.

But when the deal did finally close on 8 August 2003, what emerged was not the first Spanish independent power plant (IPP) deal - that accolade was taken in April by ESB's Bizkaia Energia - but certainly the first Spanish IPP with a realistic template for future Spanish financings.

Through its use of a mini-perm - still a rarity outside the US power sector - the AES Cartagena structure has an in-built incentive to refinance 5.5 years after project completion. If no refinancing occurs, a full cash sweep mechanism enters into force from June 2011 to prepay the facility (final repayment then occurs in 2018).

Consequently the mini-perm appeals to the sponsor in that it potentially enhances early project internal rates of return, and is attractive to more wary lenders through its shorter-term tenor.

Furthermore, lenders are first in the repayment queue with dividends payable only after the debt has been fully serviced in accordance with the semi-annual repayment profile of the mini-perm.

Although secondary syndication of the Eu665 million ($782 million) project finally came in oversubscribed when it closed on 22 December 2003, it was only after reducing the 90:10 debt equity split to 80/20 that the deal took off in August.

Given AES had just failed to negotiate peace with its creditors on the UK Drax plant, that the banking market was (and still is) IPP averse, and that lending capacity had reduced, the initial leverage was too aggressive. The equity injection boosted interest but meant that the deal closed four months later than expected.

ABN Amro, Credit Agricole Indosuez and SG arranged the Eu665 million of project debt - comprising the Eu493 million mini-perm and Eu172 million in ancillary facilities, including a VAT tranche, working capital tranche, cost overrun tranche, letters of credit and three performance bonds.

Spanish development bank, Instituto de Credito Oficial (ICO), was granted mandated lead arranger status as a result of its substantial commitment to the project, while ANZ, ING, WestLB and BBVA came in as senior lead arrangers and CIC as arranger. Citibank joined the banking group as manager post signing.

Mandated lead arrangers were offered tickets of Eu80 million minimum; senior leads, Eu75 million with a target hold of Eu65 million; and leads, Eu60 million with a target hold of Eu50 million.

Pricing on the deal is a respectable 140bp during construction and 130bp-180bp during operation: 130bp to140bp within the eight-year loan period followed by a 170bp to 180bp premium rate if the deal is not refinanced within this.

In addition to the financial engineering, lenders also took comfort from the project being fully contracted for up to 24 years under the terms of a long-term tolling agreement with Gaz de France - the fourth biggest gas buyer globally and the biggest LNG player in Europe - signed in July 2002.

Failure to secure such contracts is the prime reason why many US developers have abandoned their planned CCGT plants in Spain. Gaz de France also has an option to take some equity in the project in the future.

AES Cartagena is a very competitive plant relative to existing Spanish generation facilities, with proven and environmentally friendly technology. The DBFO project involves development of a 3 x 400 MW combined cycle gas turbine (CCGT) power station to be located at Escombreras, Puerto de Cartagena, in Murcia province. The plant is in construction and should be onstream by 2006.

Initec Energia, a Dragados unit, and Mitsubishi Corp were appointed as EPC contractors in July 2000. The technology is tried and tested but there is also a long-term services agreement with Mitsubishi for scheduled and unscheduled maintenance of the gas turbines.

Land for the project has been concessioned out to AES for 23 years by the Spanish ports authority. The concession was signed in 1998 and runs until November 2021. If the concession is extended to 2028 - which looks likely - and Gaz de France comes in as an equity holder, AES's refinancing prospects should be significantly improved.

Although Cartagena is the second IPP to close in Spain, it was for much of the time the frontrunner. Consequently Cartagena faced all the same documentation hurdles as Bizkaia in Spain's recently liberalized gas and electricity markets.

The fact that the project is being built in Spain also lends investors some comfort. The market was successfully liberalized in 1998, there are no economic or political risks and there is a high demand for electricity in Spain. Demand is forecast to increase by 3.75% a year until 2011, which will lead to a capacity gap in the short to medium term.

But the Spanish market is not without pitfalls. In addition to the lack of access to reliable tolling partners - from which Cartagena does not suffer - a number of issues have slowed development of new projects.

The market is dominated by cash-rich incumbent utilities that have been largely successful, to date, in barring new entrants. The permitting process for new plants is also very slow, and the forward market lacks liquidity, preventing developers from putting effective hedges on power revenues. So the likelihood of a Cartagena look-alike appearing in the market in the short term is at best slim.

However, when the next Spanish IPP deal does eventually appear it will look very similar to Cartagena.

And the very least that can be said of Cartagena is that it is an example of structuring and pricing a record deal volume in a very adverse lending market and for a struggling sponsor.

Could it have been done without Gaz de France? Probably not. Will it be done again? Certainly.

Energia Cartagena

Status: closed 8 August 2003

Description: Non-recourse facility for Spanish independent power project

Sponsor: AES Corp

Debt: Eu665 million

Mandated lead arrangers: SG, ABN Amro, Credit Agricole Indosuez, ICO

Senior lead arrangers: ANZ, ING, WestLB and BBVA

Arranger: CIC

Manager: Citibank

Fuel tolling: Gaz de France

Legal advisor to the sponsor: Uria y Menendez (Spanish law) and Norton Rose (English law)

Legal advisor to the lenders: Allen & Overy (London and Madrid)

Legal advisor to the supplier: Freshfields Bruckhaus Deringer

EPC contractors: Initec Energia; Mitsubishi Corp