North American Refinancing Deal of the Year 2001

01/03/2002

October 2001 saw Calpine Corporation scoop up almost $2.6 billion from a multi-tranche securities issue that included a debut in Europe. Five concurrent offerings of senior notes were made in the US dollar, Canadian dollar, Sterling and Euro fixed income market, with the amount overall increased 31% from its original target. In addition, $654.5 million of structured lease obligation bonds (SLOBS) were separately but simultaneously issued with respect to refinancing sale-and-leaseback transactions. These act as a pass-through certificate, allowing Calpine to bundle payments and pass them on to security holders as interest.

Funds raised from the senior notes refinance existing corporate debt, including $1.2 billion raised to purchase UK plant Saltend from Dynergy earlier in the year. The designated debt portfolio also included a number of Canadian plant acquisitions from Westcoast Energy and bridge loans. Saltend marked Calpine's first foray into European power and it was this high profile entrance that provided the impetus for appealing to Sterling and Euro investors. The rationale behind issuing all tranches at once was gauging relative appetites so that adjustments could be made if necessary. In the event, the US dollar tranche was upsized considerably and the Canadian dollar downsized slightly. It is stated that this had been anticipated. Canadian capital markets are the thinnest of those targeted and deal architects were just going for what they could.

Four of the five senior issues were issued through a Canadian subsidiary. Tax benefits were the reason behind this route, rather than a desire to spare the balance sheet. Calpine will be able to deduct interest expense in Canada and the US. Pricing was set directly by the secondary markets.

TD Securities led a C$200 million tranche, Calpine guaranteed and issued through wholly owned venture Calpine Energy Finance ULC. The notes held a coupon of 8.75%, had a maturity of 2007 and were priced at 99.18%.

CSFB, which advised Calpine on the Saltend purchase and on tax issues relating to the bonds, acted as arranger and underwriter on the remaining portion of debt. Through wholly owned subsidiary, Calpine Canada Energy Finance II ULC, £200 million senior notes in principal of 8.875% and Eu175 million in principal of 8.375% were snapped up in Europe. They were priced at 99.184% and 100% and due 2011 and 2008 respectively. Both boasted corporate guarantees.

In the US, a $530 million offering through Calpine Canada Energy Finance ULC in principal of 8.50% was priced at 100.1163%, guaranteed by Calpine and is due 2008. These were a reopening of senior notes issued in April 2001. In addition Calpine Corporation directly issued $850 million worth of notes in principal of 8.5%, priced at 99.8214% and due 2011. These were reopening of an issue made in 2001.

The SLOBS broke down into two tranches. $454.5 million in principal of 8.4% Series A Certificates are due May 30, 2012 and $200 million in principal of 9.285% Series B Certificates are due May 30, 2019. They are both priced at 100%. They freed up some extra cash as well as refinancing sale-and-leaseback transactions on three new natural gas fired plants in the US. The South Point plant in Arizona is 560MW, the Broad River Plant in South Carolina is 850MW and the RockGen plant in Wisconsin is 520MW. The former, which is the first leveraged lease financing of a power plant on native American land, is a combined cycle plant, whilst the other two are simple cycle peaking plants. Tyco Capital put up lease equity and the lease has a term of 36 years.

Calpine and advisers had been working together with rating agencies leading up to the transaction and on October 2, 2001 news of a Moody's upgrade hit the markets. Moody's joined Fitch in putting Calpine in an investment grade category. Ba1 was replaced with Baa3. Standard and Poor's retained its BB+ rating, one tick below investment grade. The split rating was seen as beneficial for an issue of this size. The funding base was broadened and diversified, appealing both to high yield and investment grade investors. Appetite amongst both was said to be keen, with Europe proving a good source to offload the high-yield notes.

The added attraction to investment grade investors of two investment grade ratings, though, was undoubtedly a bonus for the deal's architects. ?At the time Calpine was in the process of migrating from high yield to investment grade investors and this transaction continued the trend,? says one deal insider.

With all senior notes guaranteed, the deal is essentially corporate, which is in line with general Calpine policy over recent years. The company aims to finance on balance sheet and then run plants as a system, believing that this maintains maximum flexibility for creating value. It does not generally opt for project financing on merchant operations.

The healthy response Calpine received in the markets was seen by all involved as a real success. The amount raised and the multi-currency approach set a precedent, seen as particularly impressive given market conditions in the wake of September 11.

With the benefit of hindsight, as far as Calpine was concerned, timing was perfect. Shortly after the transaction Moody's downgraded it back out of the investment grade category and now the bonds are trading at slightly below par. In the post-Enron crisis investor confidence in all US power corporates has waned. They have all been tarnished by the same brush. Speculation might suggest that Calpine, which has maintained a relatively conservative financing strategy, has less to worry about than others. After all, in a display described by one observer as ?cheeky?, it sold $1 billion in convertible notes two days after the downgrade.

Calpine Multi-tranche Issue

Status: closed 11 October 2001

Size: $2.6 billion

Description: Multi-tranche bond issue refinancing existing corporate debt

Sponsor: Calpine Corporation

Senior bond tranches: C$200 million and $530 million through Calpine Energy Finance ULC, £200 million and Eu175 million through Calpine Canada Energy Finance II, $850 million direct by Calpine Corporation

Structured lease obligation bonds: $654.5 million, broken down into $454.5 million of Series A certificates and $200 million of Series B

Lead arrangers: CSFB and TD Securities

Lease equity provider: Tyco Capital

Legal adviser to the sponsor: Covington Burling

Legal adviser to the underwriters: Skadden Arps

Legal adviser to the equity provider: Dewey Ballantine