

Calpine: over-paid and over here?

01/08/2001

Months of strenuous speculation have surrounded Calpine's intentions with regard to the European market. The generator, whose stock market fortunes have often seemed the reward for an exclusive focus on the US market, has been uncharacteristically coy when asked about its wider ambitions. With the acquisition of the Saltend plant it has signalled its intentions to storm the European market. But is this the right time?

Saltend is a 1200MW combined cycle natural gas-fired plant located at Hull, in East Yorkshire in the United Kingdom. Its current owner is Entergy, which financed the plant, along with BP Amoco, in June 1998. Arrangers then were UBS Warburg, Dresdner, Bank of America, NationsBank, Toronto-Dominion and Barclays Capital. The deal was described as a merchant first, although 10% of the plant's output was taken by a nearby chemicals facility. Total project cost was £790 million (at the time about \$1.3 billion) and the financing was broken down into a £646 million 17-year loan and £72 million sub-debt piece, with an equity facility provided by Barclays. Pricing at the time was an extremely tight 115-130bp over libor.

The UK power market has changed rapidly in the years since financial close, mostly because of the New Electricity Trading Arrangements (NETA). Here, wholesale prices are set by bilateral bids rather than on a marginal cost basis, and should drive prices to the consumer down. Moreover, the introduction of NETA was preceded by a number of aggressive moves against generators from the sector's regulator, OFGEM.

IPP financings, both retrospective and prospective, have been affected by the situation. Edison Mission Energy was burnt by its large investment in the Fiddler's Ferry and Ferrybridge plants, which were older coal-fired facilities. It has said that the troubles with the investment have materially affected its earnings (at a rather sensitive time) and wants to sell up. Two National Power divestments, Killingholme and Eggborough received markedly different receptions in the market. Eggborough, led by Barclays Capital closed earlier in the year after various market-friendly tweaks, but Killingholme, led by Bank of America, came in without too much trouble, albeit with a margin of 130-175bp over libor.

Calpine is at pains to point out that the quality of the asset should make it immune to many of the shocks that have hit generators elsewhere in the UK. Saltend is a combined-cycle plant with steam recovery technology and uses advanced versions of the Siemens 701F turbines, the 701F2, built by Mitsubishi. Even in the Humber region, location for much of the country's gas-fired capacity, Calpine says that the plant will be one of the most efficient on the grid.

There are some worries about the time it took to bring the plant online, and operations were delayed considerably beyond its planned start date. Raytheon Engineers & Contractors were forced to delay the acceptance date of the plant and pay \$52 million in liquidated damages to Entergy. The start date was delayed from January 2000, first to June 30, and then to a final start date of November 2000. Entergy wisely decided to hold on to the project until both the plant's and the market's future could be ascertained.

Calpine intends to market the output of the plant itself, and has indicated that Saltend could be the start of a European strategy involving other gas-friendly markets such as Spain and Italy. The bedrock power purchase agreement (PPA) with BP remains in place, for around, 85MW, or 10% of output, and 250,000 lb of steam per hour. The contract was signed in 1994, lasts for 15 years, and is indexed to the consumer price and oil prices, although it was signed at very favourable

rates.

Calpine has already given some guidance as to how the plant will be financed, and project financiers with a dominant place in the sterling market should not be holding their breath. A single asset, non-recourse facility or bond issue is not on the cards. Instead, Calpine has gone back to its sturdiest relationship banks, Credit Suisse First Boston, Bayerische Landesbank and Scotia Capital, for a bridge loan. This \$1.2 billion bridge is expected to close in the next two weeks, is of a corporate nature, and is larger than the purchase price because Calpine says it has a few other acquisitions up its sleeves. Bayerische and Scotia are existing lenders under a corporate revolving credit facility and CSFB was the financial advisor on the deal.

The take-out of the bridge loan depends to a large extent upon the efforts of Calpine to reach investment grade. Despite a protracted, and apparently very frank, exchange of views with the major ratings agencies, Calpine is still at Ba1/BB+ (Moody's/S&P). It says that the fact that it has now completed several plant developments and that it has a relatively healthy balance sheet should count in its favour. Several market observers have suggested that Calpine's avowed preference for corporate debt is unusual for a company with such a short operating history.

What Calpine wants to do is issue two corporate bonds, the first of which is a £275 million issue with a 10-year maturity, to establish itself in the European capital markets and roughly match projected revenue from Saltend. The second will be a C\$250 million issue of between five and seven years, depending on market conditions. Both bonds will use a double-dip structure by registering holding companies in two different jurisdictions to capture both sets of tax benefits. Calpine's last bond \$1.5 billion issue through its Calpine Canada Energy Finance vehicle, used a similar tax play, and this vehicle is also expected to be expanded by \$500 million. Finally, the developer will look to re-price its \$2.5 billion shelf registration, under which \$1 billion is currently available.

CSFB took care of the last issue, and given its advisory role looks like a hot favourite to pick up the underwriting mandate. And Calpine can start to become acquainted with the intricacies and peculiarities of the UK power market.

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