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Elcho: PSEG breaks into Poland

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Syndication of both the $193 million and PLN345 million tranches for Poland's landmark Elektrocieplownia (ELCHO) deal, sponsored by PSEG, has launched, with both portions sole lead arranged and underwritten by Dresdner Kleinwort Benson.

The funds will fuel the construction of a 560MW cogeneration heat (360MW) and coal-fired power (200MW) plant in the town of Chorzow, Upper Silesia, Poland. Financing splits into three tranches of which one, at PLN7.5 million, will not be syndicated. The tranches in syndication sport terms of 18.5 years apiece. Margins on the loans start at 115bp during construction, ratcheting down to 110bp at the end of construction and commissioning, and then notching up stepwise to 175bp.

Dresdner Bank is currently offering participation on the two tranches in the following amounts. On the dollar tranche, co-arranger commitments pull in at $25 million, with a 50bp participation fee; the lead manager level claims a commitment of $20 million with participation fees at 45bp; and the amount for the managing banks is $15 million and a 40bp participation fee.

Co-arrangers for the Zloty tranche will commit PLN90 million at a 45bp participation fee; lead managers are to provide PLN70 million at 40bp; and managers come in at PLN50 million, with participation fees of 35bp. BNP Dresdner Bank Polska acts as the Zloty Facility Agent and security agent. Dresdner Bank suggests sizeable international market interest in the syndication.

The new plant will be set up adjacent to an existing facility owned by Elektrownia Chorzow (EC Chorzow), one of the country's oldest established heat and power generators, to be replaced by the new facility. The old generator will, however, continue to operate during construction. Commercial operation is slated for 2003. The EPC contract for the project was awarded to Polish and Finnish subsidiaries of Foster Wheeler at the beginning of February this year ? the company plans to employ its advanced circulating fluidized bed boiler technology. Construction is also expected to create around 1150 local jobs.

There are 20-year Power Purchase Agreements with the Polish National Power Grid for the electricity, and PEC Katowice, the district heating company serving the city of Katowice and its surrounding communities, for the thermal energy. The power will be delivered into the GZE local distribution system.

A fuel supply agreement was hatched with a subsidiary of coal company Nadwislanska Spolka Weglowa (NSW) SA in April for the delivery of 1 million tons of coal a year, for 20 years, from the Janina and Ziemowit mines in Upper Silesia. NSW is Poland's largest coal producer with a 19% share of the market and, although having recorded damaging losses last year, is expected to have rebounded this year.

Commenting on the deal's success, PSEG cites unprecedented cooperation from a wide range of individuals - government, lenders, lawyers, unions, and its strategic partner, Elektrownia Chorzow. PSEG Global holds a 93% interest in ELCHO with EC Chorzow holding the remaining 7%.

PSEG, although shortlisted for the privatization of between 10% and 25% of the southern Poland electricity distributor

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GZE, recently lost its bid to Swedish Vattenfall AB. German energy firm RWE, also unsuccessful, was also short-listed by the Treasury. GZE hopes to focus on building medium and low-voltage lines to assist regional development. With a market share of 12%, the firm is the largest of over 30 energy distributors in Poland.

The Elcho deal, however, is at the crest of the recent surge in generating asset sales. In contrast, power project financing activity in Poland had been negligible in recent years, primarily owing to the slow pace of growth in electricity demand throughout the country. Hence, only a handful of new plants were commissioned, with virtually no investment in upgrading and expanding existing plants.

But now, with the strengthening of Poland's macro fundamentals, industrial growth rates are increasing and a determined privatization program is well under way. These factors have boosted investor confidence in the Polish power sector and many heavyweight power project developers are eyeing the sector with interest.

As the power sector becomes more competitive, the cost of producing power is expected to reduce. But the sector's future is very much dependent on the success of the privatization program. Poland has no integrated electricity enterprises and all 33 regional distribution companies are separate corporate entities, their only activities being distribution. Power production is controlled by 34 enterprises whilst PSE owns and operates the grid, acting as the de facto single buyer of electricity from the generators. Apart from the few shareholdings in generation that have already been sold, the sector remains entirely state-owned. Minority stakes in each distribution company will also be sold off and trade unions will be awarded up to 15% of the shares, while the State Treasury will keep the residual share.

The privatization process is essential for the government as it will bring competition and best practice to the industry and move the burden of future capital spending for these plants to the private sector.

A major barrier for investors, however, still remains the lack of sufficiently modernized laws to regulate the production, distribution and pricing of energy, with industry restructuring still in its infancy.

Nonetheless, most suggest that the process is largely on schedule and, as such, future power generation and distribution sales will have little problem courting investors. Elcho, it seems, bears out this point.

Plans are also underway to privatize Elektrownia Belchatow, a 4,360 MW lignite powered plant. Belchatow needs $1 billion to upgrade 6 of its 12 units, local equity and bank loans are expected to cover $800 million of this, and a possible flotation on the Warsaw Stock Exchange may be an option to raise the additional $200 million.

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