DisCo inferno

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Despite widely advertised capacity shortages and some ground-breaking deals in 1999, Latin power projects have been slow to come to the market in 2000. The reasons, much as last year, come down to a continued wariness in investor sentiment. When AES took over Venezuelan DisCo (distribution company) Electricidad de Caracas (EdC), most of the comment was fixed on the development of the country's nascent stock exchange, rather than the prospects for further foreign penetration of the local electricity market. The prospect of consolidation amongst regional distribution companies, and the continued progress towards creating acceptable financial enhancements might feed through to greater deal flow in the second half of the year.

Sponsors are now dealing with markets rushing headlong towards deregulation that do not have the sovereign rating to bring in the choosier US investors. Argentina is a case in point. As Dan Kastholm, from Fitch, explains, ?it's the most competitive electricity market in the world. No one player has dominance, and contracts falling by the wayside means that risk in the markets is increasing?. It is now over a year since the pace-setting AES Parana deal and new projects in the country are only now emerging.

Parana, the $448 million baseload plant sponsored by AES and PSEG Global, was to have provided a template for multi-sourcing funding and selling merchant risk. The Inter-American Development Bank (IADB) and JBIC were heavily involved with covering the debt, but the facility was not highly leveraged and the supply, at least, was heavily hedged. Those close to the deal were right to stress the strength of the sponsors in getting the deal through ? AES is a serious presence in the distribution market in the country.

The attention of sponsors may indeed have shifted closer to the consumer, both in Argentina and beyond. AES recently completed a refinancing of its distribution companies in the north and south of the country. It is, as yet, a rare example of an acquisition whose bridge finally left the cycle of roll-overs in which pre-crisis deals have been locked. It replaced a $280 million bridge taken out in 1997 with a $200 million structured loan spread across the two entities EDEN and EDES, as well as the holding company for the controlling stakes, AES Ocean Springs.

The deal, whilst arranged by seasoned players WestLB, BankBoston, Bank of America and Deutsche (as well as local Banco Galicia), was rated by Standard & Poor's. Its B+ rating for the holding companies was based in parts of the subordination of upstream cashflow, but also a strong perception of future uncertainty in the Argentinean electricity market. Argentina may soon follow the UK example of increasing re-regulation and mandated lower prices are just around the corner.

Where this leaves the generators is harder to gauge ? short of dramatic capacity failures, future support from the government will be limited. One project almost certain to get off the ground, however, is the Pluspetrol expansion. The plant is sponsored by a subsidiary of oil producer Pluspetrol Resources (55%) and Repsol-YPF subsidiary ASTRA CAPSA (45%). The plant, however, requires local currency funding since a dollar-denominated PPA is out of the question.

ABN Amro has used a mixture of a Coface-backed $131 million buyer's credit, to support the sourcing of equipment from

ABB Alstom, and European Investment Bank (EIB) support. The EIB contribution will provide political risk backing to local investors whilst leaving commercial risk with these lenders. The Coface element is comprehensive and signed in April 2000 whilst, at the time Project Finance went to press, the EIB was reviewing the project documentation.

The deal is for a capacity expansion from 115MW to nearer 357MW, with a mixture of spot market and contracted revenue streams. Edenor and a number of smaller offtakers have agreed to take around 60% of output, with the remainder sold on a merchant basis. The situation is almost the mirror of that in Mexico, where additional contracts are used to mitigate reliance on incumbent, and public, offtaker the CFE. Bilateral contracts, however cheap, are as much of a mitigator for generators as they were with the AES Ocean springs rating.

It's a wrap

With local banks still wary of extended tenors, the search is on for structures that can enhance long-dated debt to sell it abroad. Here the developments are more encouraging. The Inter-American Development Bank's partial guarantee product is one of the most talked about of these. Multilaterals like this because it strains the balance sheet less severely and can assist them in their stated aim of encouraging foreign direct investment in underdeveloped sectors.

The partial wrap is an inconvertibility tool above all, covering the risk of fund expropriation and transferability. From the sponsors' point of view it cuts down on a large chunk of the project analysis since the funders and ratings agencies examine commercial questions. Providing institutional appetite in the US and elsewhere holds up, the wrap could dominate cross-border financings from countries with sovereign rating constraints.

Its most recent appearance was in the San Pedro deal, where $144 million of the Dominican power project's costs were covered by the wrap. The WestLB-managed notes were placed in two tranches to commercial banks ($65 million in loans) and US Financial services groups ($72.2 million in bonds). The guarantee, however, backed a sovereign guarantee of a power purchase agreement ? the last time that this will happen there.

Those behind the deal say that the template could be used again, although the list of countries to which it is applicable is falling rapidly. Even if a more enthusiastic promise than the comfort letter (as solid as its name suggests, as far as Indonesian sponsors are concerned) can be extended, budgetary constraints and continuing enthusiasm for the privatization of distributors will make an exact copy of the product rare. Honduras, Nicaragua and possibly Peru have been mentioned, but these regions are all waiting for the killer project to present itself. The biggest one on the horizon is a mooted AES project in Honduras, currently going through the process of gaining local approval.

The wrap already has an imitator in Opic, however, which has just extended an inconvertibility guarantee to Argentinean gas distributor TGN's bond issue. The $175 million of notes are unsecured, and are based on TGN's robust and contractually underpinned revenues. Opic's deal carries conditions on US involvement, but the prospect of competition in offering these enhancements would be one way to kickstart the market.

The signs are, however, that countries with sufficiently developed capital markets will stay at home, especially if Chilean generator Gener's example is anything to go by. Gener, an initial user of non-recourse funds to support its cross-border ventures, has now gone into the US energy marketing with Transalta. About a year ago it completed an issue of $500 million in convertible securities with a domestic take-up of over 80%. Whilst they carry maturities of only up to six years, they yield only 6%, covering the bulk of Gener's requirements.

Interconnection

Where Gener, and international competitors, are most likely to approach the market is in Interconnection projects. Gener used interconnection to bring capacity over from its Salta project in Argentina to the Chilean Atacama region. Its local rival Endesa de Chile is planning an extension of its Argentina to Brazil transmission system, CIEN. The original CIEN, or Companhia de Interligacao Electrica, deal signed at the end of 1999 with BSCH and Credit Agricole providing most of the $315 million financing. The follow-up, which will increase the present 1000MW by 50%, has already confirmed original contractor ABB for the extension. Further projects in the pipeline include the Central Argentina/Chile Transmission Line, SING-SIC Interconnection, and Transmission Line in Central America.

An increase in interconnection can best be seen as an inexpensive short-term solution to the current deficit of investor confidence and lead-time for natural gas supplies to come on-stream in the region. Likewise for hydropower, still enjoying a surge in popularity, particularly in Brazil and Peru. Nordic developer Vattenfall is banking on further delays to the beginning of operations at the Camisea gas-fields in Peru, believing that the Peruvian government will have little option but to open up the Pativilca valley to a flood of BOT projects.

According to Bengt Vernmark, head of Vattenfall's Latin operations, however, ?Brazil is the important one. It's the third largest market for Swedish exporters and the hydro assets ? particularly in the interior ? are very promising? The bias in favour of generating is a departure from its move into distribution in Europe. ?We shifted our focus there because there was too much capacity. Here that's not the case. The assets we've been looking at are in good condition or semi-complete and we're looking to pick them up as part of closed tenders or disposals.?

Vattenfall, through its development subsidiary Nordic Power Invest, signed an agreement with NRG Energy in January to co-operate on Latin projects. The venture, known as COBEE, is concentrated upon the Bolivian market, but, as Vernmark admits, this is simply too small. Vattenfall's next move is likely to be on the next big dam tendered by Aneel in Brazil, for which it and NRG are currently negotiating.

And whilst Brazil's hydro projects are at most destined to be hindered by complex procurement laws and environmental scrutiny, gas projects are still waiting for an upsurge in market conditions. The only solution to the prohibitively high cost of imported gas following Brazil's devaluation is a huge increase in gasfield development.

The Uruguiana-Porto Alegre pipeline is one attempt to leverage the devloping Campos basin discoveries to bring gas further into the Brazilian interior, in particular a planned 500MW AES plant at Uruguiana. The plant is partially on-stream, and at present relying on Argentina for gas supplies, and is designed to increase in capacity according to the availability of fuel. By 2002 it should convert to a full-blown combined-cycle plant.

The second plant close to financing is the Cuiaba project in the West of Brazil. The 480MW plant, in Mato Grosso state, is sponsored by Shell and Enron and is reliant on a pipeline constructed over the Bolivian border, where excess supplies of gas are available. This facility is also destined to go into construction in stages, with Opic and the Kreditanstalt fur Wiederaufbau lined up to cover the lending.

One theory prevalent in financing circles is that multilateral and ECA funding will gradually head back south as the need for cover in Mexico diminishes. The surge of interest in Mexico's latest $1.5 billion sovereign bond issue has been driven largely by normally cautious investors acting as if an S&P investment grade rating is a foregone conclusion. If the Opic, Ex-Im and Coface backing that has been a feature of recent Mexican deals is less vital, other countries might take up more of their attention.

Aside from the fact that exposure rules would have to change, however, the fact is that there is little direct evidence of a sponsor shift in this direction. This leaves the more niche players pushing projects in second-tier markets. Andrew Aldridge, responsible for Latin America at CDC Capital Partners' power and infrastructure group, has made the conscious decision to concentrate elsewhere. ?People who withdrew from South America are now in Mexico, partly attracted by the new administration. But there are probably too many of them, and as a private equity player there's not too much left?.

Aldridge believes that the EdC take-over might establish precedents: ?There was a sense that it was cracking a market.

It's not a choice market, but the deal did call attention to it?. The Brazilian utility CESP Parana is up for sale in the fourth quarter, with AES (unsurprisingly) and Duke Energy front-runners as bidders. Cross-border generating deals, however, will be thinner on the ground. ?In the long term I'd expect to see that local tenors can be extended, and that international project finance deals will dry up. Whilst there may be a need to shake up the local banking sector, there are new institutions out there. Pension funds have been helpful in Chile, for instance?.

Nevertheless, local debt markets are still looking for small spreads over government securities, with project debt commanding spreads that make the bulk of regional investors wary. Refinancings, let alone greenfield projects, are equally victims of this culture. Latin America's capacity shortage will have to wait, therefore, on altered risk perspectives from both local and cross-border investors.