Killingholme: NRG's merchant beachhead

01/07/2000

Syndication is underway on the £390 million ($560 million) acquisition financing for the Killingholme power station. The deal is NRG Energy's first 100% owned venture in the UK, and marks the end of a near six-month hiatus in the UK merchant market. NRG have been looking for a large scale entrance into generating since it sold 25% of the 396MW Enfield station to El Paso Energy.

The Minneapolis-based energy concern has been bidding tenaciously since the start of the recent wave of divestitures by UK incumbents. NRG is known to have been a short-listed bidder for the Drax sale, losing out on the £1.9 billion sale to AES. In November 1999, at roughly the same time as the Drax deal was closing, however, NRG was in talks with National Power about two of their other facilities.

Killingholme and Blyth are about as far removed as conventional fuel-burning stations can get. Killingholme is a 650MW combined cycle gas-fired turbine (CCGT) power station located in North Lincolnshire on the River Humber, which was commissioned in 1994, and accounts for about 1.4% of England and Wales' capacity. Blyth, on the other hand, is a coal-fired station, one of the oldest in the country. Its inefficiency is such that little of its potential 2,000MW is dispatched. Conventional wisdom has it that the plant has two years to run at most.

NRG could have attempted to bring the plant up to scratch using flue-gas desulphurisation technology and other additions (much as AES has done with Fifoots). The sweetener on offer from National Power (now inching towards its new identity as npower) to take on both as a job lot, at £20 million, was not enough to make a project viable. npower will keep Blyth on its hands for the time being.

It is Killingholme that is the jewel in National Power's crown, since the six-year old plant has one of the best availability records in the country. For the last six years, whilst technically a mid-merit plant it has been operating in a baseload capacity. It is not difficult to sympathise with the forced divestment, the more so when the sums raised are not far removed from the write-downs that National Power has had to swallow over investments such as the Hub project in Pakistan.

NRG has picked up a prime asset, therefore, albeit a few less than necessary to achieve the genco strategy it has long pursued. It has also, despite the experience of putting in an uncontracted bid for Drax, decided to operate the plant on a merchant basis. From November up to the close of the sale in February 2000, Bank of America advised NRG on a structure that could accommodate the two complementary aims.

The financing has been arranged to maximise investor comfort and provide NRG with a structure that can easily be taken out at a later date. It resembles most closely the ?mini-perm? structures used for single assets in anticipation of the development of a portfolio financing. The deal, for one, is not highly leveraged by comparison, with a 60:40 debt/equity split, leaving a term loan of roughly £294 million, arranged by Bank of America again.

The tenor of the debt is 19 years ? slightly, but not significantly, lower than recent deals, Yarmouth, and Coryton amongst them. The term of the loan is less significant than the added protection provided to the bankers in the form of a cash sweep. The term loan has two tranches, the second of which contains a cash sweep of 90% at the end of year six, rising to 100% if the debt is not repaid by then. This element represents about 20% of the loan, the remainder acting as a conventional amortizing loan.

The cash sweep tranche is a powerful spur to refinancing and virtually guarantees a sizeable chunk of repayment within a relatively short period of time. Further covenants exist, including distribution lockups and look forward tests, to a far stronger level than would normally be expected for a CCGT. Average Debt Service Coverage Ratio is 2.10x, with a minimum of 1.82x, and the average life of the loan is 10.5 years.

Crucially, the plant is backed by a low-cost, fixed price gas contract that can take advantage of the Humber's terminals. Whilst not index-linked, the supply deal gives Killingholme a crucial competitive advantage. The trading operations, which NRG uses to enhance the value of its generating capacity, have their obligations backed by a full corporate guarantee, rather than the artificial vehicles often created by large sponsors.

It is not difficult to see why the task of building up comfort is so crucial. Some plants in attractive areas, such as Fifoots, should be able to flourish, but Fiddler's Ferry and Ferrybridge (the £1.25 billion acquisition sponsored by Edison mission Energy) are believed to have suffered from faster than expected falls in pool prices. To compound Edison's woes, regulator Ofgem is investigating withdrawls of capacity at one of the plants.

NRG has not been included within Ofgem's remit since, unlike other recent acquisitions, Killingholme will not take its share of the UK market much higher than 2%. And it must be hoping that most of Ofgem's energies go towards cajoling generators that have signed up to the market abuse clause or referring those that have refused to the competition commission. This is not likely to continue if NRG succeeds in its usual aim of becoming a top three operator in any particular market.

Bank of America is now in the process of selling on the debt to a mixture of merchant savvy international institutions and NRG relationship banks. Responses should be good given the volume of business the sponsor will put their way on the near future. The prospect of an instant genco did not materialise, but NRG will make a fresh attempt to exploit the next phase of divestments. Here TXU (for its coal assets) and Fortum with a stable of CCGTs in the same neighbourhood as Killingholme, will join PowerGen for the sell-off.