Captive Finance: Off the cuff

01/02/2000

Incest is illegal in most societies ? not, it seems, in the energy sector. While it is usual for energy project sponsors to provide the largest chunk of equity and for energy buyers to provide equity as well. Now, outside investors are buying in with an equity stake, with financing subsidiaries of some energy firms becoming equity holders and debt providers.

Neither is the scope of participation constrained by company size. As well as the mega-deals of multibillion-dollar conglomerates, smaller transactions abound. The nature of relationships also varies greatly. Idacorp subsidiary Ida-West Energy Company ? a developer, financier, owner and operator of independent power generation facilities ? has been a 50-50 partner with TransCanada, an energy firm focused on natural gas pipelines, power generation and marketing services. The two are co-developing an Oregon power plant whose energy buyer is the Californian independent power producer Calpine Corporation. Closing on the deal is due this month, with construction of the $300 million facility billed to start this summer and operation set to start summer 2002.

For its part, Calpine entered into a deal mid-January to buy a 50% interest in the $280 million Aries Power Plant near Pleasant Hill, Missouri. Vendor is Merchant Energy Partners, a subsidiary of Kansas City-based Aquila Energy Corporation. Calpine will oversee construction, and operate and maintain the plant.

Stephen Moore, vice-president in the global project and infrastructure finance group at Moody's, said: ?There is no difference between investing equity in another company's project and putting your own company's money in another company's corporate bonds.?

In fact, the injection of equity into a deal sponsored by a lesser entity may give strength to that project. A project run by an inexperienced sponsor may be buoyed by the confidence demonstrated by an investment from a major player, Moore said.

Curt Spillers, project finance analyst at Duff & Phelps in Chicago, claimed major energy providers in the US rarely deviate from their core competencies which are usually confined to building and operating plants.

?Major energy producers will only look to put a slug of equity in deals where they have an operational stake. However, they may invest in private placements in the secondary market.?

GE Capital deviates from that narrow focus, investing in projects in which the company is not a sponsor. In fact, GE invests in more projects as a passive minority investor than it does as a sponsor. GE Capital Structured Finance Group is a stakeholder in the global energy, commercial and industrial, communications, and transportation sectors. In the past five years, the company has structured and financed more than 200 transactions worth more than $8 billion and has $10 billion in assets. The group draws on the strength of GE Capital ? a global, diversified financial services company with assets exceeding $300 billion ? and General Electric Company, a diversified manufacturing, technology and services company with operations worldwide. However, many of the projects in which GE takes an equity position require the purchase or lease of the company's equipment, such as turbines.

?We are a leading equity investor and financier in projects regardless of whether we are connected with the project in an operational sense or whether the project even uses GE equipment,? says Ken Koprowski at GE's structured finance group. ?We are not limited by industry either, although our investments fall within the broad scope of energy, commercial and industrial, communications, and transportation sectors.?

Koprowski pointed to a recent telecom deal in which GE was a debt provider. Crown Castle, an infrastructure company in the telecom sector, received a $200 million infusion from GE in exchange for 8.25% convertible preferred stock and warrants to purchase shares.

Last May, GE and partners closed financing on the second phase of the $1.87 billion Dabhol power project, in Maharashtra state, India. The deal, led by Enron, represented the largest-ever energy infrastructure project financing in India. The deal included the financing arms of project sponsors GE, Enron and Bechtel, as well as an international consortium of banks.

The $1.87 billion financing includes five loans totalling $1.414 billion and an equity investment by the sponsors of $452 million. Indian financial institutions, with Industrial Development Bank of India (IDBI) acting as lead arranger, provided rupee loans equivalent to $333 million. Those involved in the rupee loans are IDBI, ICICI, State Bank of India (SBI), the Industrial Finance Company of India, and Canara Bank.

Commercial banks, acting as global co-ordinators for a $497 million syndicated loan are SBI, ABN Amro, Credit Suisse First Boston, ANZ Investment Bank and Citibank. Canara Bank, Bank of America, Development Bank of Singapore, and Credit Lyonnais acted as senior lead arrangers for this loan.

The Overseas Private Investment Corporation also provided $60 million in project finance loans.

An export credit loan of $433 million was arranged by the Japanese Export Credit Agency (ECA) providing $258 million and commercial banks providing $175 million. The Japanese Ministry of International Trade and Industry insures the commercial banks. Fuji Bank is agent for the $433 million loan from the Japanese ECA. An export credit of $90.8 million was also provided by a syndicate loan from commercial banks. The loan is insured by Office Nationale du Ducroire, Belgium, with ABN Amro acting as agent for the commercial bank lenders. Both export credits were provided guarantees by Indian financial institutions.

The first phase is a joint venture among affiliates of Enron (50%), MSEB (30%), Bechtel Enterprises Holdings, (10%) and GE Capital Structured Finance Group (10%). Partners in the second phase and their current ownership interests are Enron (80%), Bechtel Enterprises Holdings, Inc. (10%), and GE Capital Structured Finance Group (10%). MSEB has the option to buy 30% of the second phase from Enron's 80% stake.

PP&L Global, a subsidiary of Pennsylvania-based PP&L Resources, has various energy interests and in July, the company entered into a joint venture with Duke Energy North America (Dena), the developer of North American power projects for Duke Energy. The deal involved the joint completion of a gas-fired, combined-cycle power plant in Arizona.

As part of the deal, PP&L Global transferred a 50% interest in the venture ? the Griffith Energy Project ? to Dena, with Dena funding 50% of the capital cost of the project. PP&L Global also routinely takes an equity position in existing projects, some of which involves an operating role. In late August, its transfer of a 50%-stake in Bangor HydroElectric Company (in Maine) to Penobscot Hydro, a PP&L Global subsidiary, was approved by state regulators.

The Arizona transaction is unusual for Duke, says company spokesman Paul Mason. ?Duke Capital is essentially a legal entity and does not invest in projects outside of Duke Energy. It is just a legal entity under the holding company.?

He said Duke Energy's equity investments are only ?financial vehicles, not investments? adding that it would be possible ?some way down the road? for Duke to take an equity position in other projects. ?Will we ever take on debt for another project? That too is possible,? says Mason.

Says Thomas McDaniel, president and CEO of Edison Capital: ?We are not a senior debt provider in projects. We do mezzanine debt and structured finance. We look at the market through a variety of glasses.?

In equity stakes, Edison Capital recently took a $95 million position in a wind energy project at Storm Lake, Iowa, (an Enron project), as well as investing $15 million in three other wind projects. Within that, Edison Capital injected $243 million in mezzanine debt through Edison Mission Energy into the Fiddler's Ferry and Ferrybridge projects in the UK. Edison Mission Energy specialises in the acquisition and construction of power production facilities. For just over $2 billion it snapped-up the two PowerGen UK plants. The cash injection was used to upgrade pollution controls.

As of the third quarter, 1999, Edison Capital had invested $137 million in energy/infrastructure projects and had forward commitments of $297 million.

Among its stakes in US projects are: a 25% investment in the Beaver Valley Unit Two nuclear power plant; a 24% stake in Vidalia Hydroelectric; a 38% stake in the Huntington Waste-to-Energy biomass power project; and a 75% interest in the Buffalo Ridge wind power project.

Edison Capital has also committed $125 million to the $525 million AIG Emerging Europe Infrastructure Fund. The private placement fund invests in infrastructure projects in central and eastern Europe, the Baltic countries, and possibly the former members of the Commonwealth of Independent States. Edison Capital, American International Group Inc, and ABN Amro are co-sponsors.

Through participation in the $1 billion AIG-GE Capital Latin American Infrastructure Fund, Edison Capital has closed investments in various regional projects. Edison Capital also co-invested in other projects, including an electric distribution system in Bolivia and a methanol plant in Trinidad.

In Africa, Edison Capital has invested $372 million in three coal-fired units near Johannesburg, South Africa. Eskom operates the power plant. In Asia, Edison Capital sunk $100 million in the AIG Asian Infrastructure Fund II. The $1.7 billion fund was created to focus on water, power, natural resources, transport and telecom projects throughout the region, including China, India, Thailand, South Korea, the Philippines, Taiwan, Indonesia, Malaysia, Vietnam, and Pakistan.

In an unusual cash cross-pollination, energy services provider Avistar Inc, a wholly owned subsidiary of the Public Service Company of New Mexico, bought a significant stake in Amdax.com, a business-to-business e-commerce firm in San Diego, California. Amdax has developed a proprietary, internet-based energy auction platform, ?PowerBid? which efficiently brings together electricity buyers and sellers in the newly deregulated electric power market. Through PowerBid, multiple energy suppliers actively compete for the energy contracts of commercial, industrial and governmental customers, based upon terms and conditions selected by clients. The proposed contracts, together with the customers' energy usage profiles and credit ratings, are electronically posted on a secure website. Pre-qualified energy suppliers logon to the system to review the available contracts and submit bids. As well as managing the auction process, Amdax will offer a range of extra customer services, either directly or via strategic alliances with leading providers in the industry. These services will include energy audits, billing, meter installations and solutions, meter-reading and demand-side management. The company hopes to start its first auctions next month.

Under the deal, Avistar is buying three million shares of Amdax convertible preferred stock, roughly representing a 25% interest in the company. As well as its investment, Avistar is to help the company in regulatory proceedings in states now engaged in energy industry restructuring, and the two firms aim to joint market operations.

Such unusual agreements may become the norm as energy companies continue to diversify, particularly in the telecom sector.

Maryland-based Allegheny Energy subsidiary, Allegheny Ventures, actively invests in and develops energy-related and telecom projects. For its part, Enron may be taking the idea to the next stage, by establishing alliances with Cisco Systems, Ciena and Sun Microsystems to develop a nationwide fibre-optic network.

Enron proposes to trade excess bandwidth capacity on the open market. The arrangement calls for the use of cutting-edge technology allowing data to be transmitted over a network more efficiently, meaning more data over less fibre.

Speculation is that Enron may tap other companies in the energy sector to bankroll this capital-intensive venture.