A toe into uncharted waters

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Putting his hand up at the Power 2000 conference in Amsterdam in May 1999, [redacted] a senior African finance minister asked the question ?What is mezzanine finance?? The question, while reasonable, was greeted by a chorus of whispering from the delegates.

Surely this was proof that African governments did not understand the concept of privately financing power projects and were not prepared for a flood of foreign companies?

Despite the scepticism displayed by some at the conference ? and you have to ask why one development agency even bothered going to a conference on power in Africa if they have no inclination to invest in the region ? there are many who can see the potential. And there are already signs of change.

Independent power project finance in Africa is defined by three deals which have closed financing in the past few years ? Jorf Lasfar in Morocco, Azito in Côte d'Ivoire and Sidi Krir in Egypt. Financing for these projects has signed in the past two years and their sponsors have hailed these deals as the template transactions for Africa. However, despite their success, these privately-financed power deals remain the exception rather than the rule.

Africa has 12% of the world population but consumes a fraction of the total global energy consumption. African countries are still recovering from years of war, political upheaval and their governments are burdened by debt. Despite this a growing number of foreign investors are putting a considerable amount of time and effort into power schemes. Lenders are responding to this push with more scepticism.

Africa is rich in energy ? coal is abundant in South Africa ? and oil and gas is found across the continent. It has the potential to generate large amounts of energy through hydro power and solar energy and yet, as Said Mikhail, senior power engineer at the World Bank in Washington says, most people in Africa still continue to use subsistence forms of energy ? wood and kerosene. Says Mikhail: ?No country in the world has succeeded in shaking loose its subsistence life without access to modern energy.?

Speaking at the Africa 2000 conference in Amsterdam Tony Hanna, vice-president for Africa at Shell International Gas in London said: ?In some countries regional cooperation will help development. But some say that there is no money available for developing power ? the only way to break the cycle is to bring in foreign money. Independent power producers are the obvious solution. But African governments need to produce suitable fiscal and legal frameworks and multilaterals, lenders and export credit agencies need to come up with innovative solutions.?

Multilaterals and export credit agencies have already provided part of the solution. In Morocco, CMS Energy and ABB's Jorf Lasfar project ? lead arranged by ABN Amro, Credit Suisse First Boston and BNP ? sourced funding and guarantees from the World Bank, Italy's Sace, Opic, ERG and US Ex-Im. Financing for ABB, EDF and Industrial Promotion Services's Azito project in Côte d'Ivoire ? tapped funding from bilateral and multilateral agencies including the International Finance Corporation (IFC), the African Development Bank (AfDB), the Commonwealth Development Corporation (CDC), DEG and

FMO.

But there is a limit to the amount of financing multilaterals and development agencies are able to provide. Officials from PricewaterhouseCoopers in London, who are providing advice on projects and privatizations in the region, advocate the liberalization of the energy sector as a forerunner for private development.

The World Bank's Mikhail says that independent power producers are not a substitute for restructuring the government entities, utilities and economy of a country. A strong and regulated power sector is a prerequisite for private investors. Says Mikhail: ?Market liberalization is an essential ingredient to promote competition and increase efficiency.?

He adds that the World Bank has constraints ? tight budgets and limited human resources ? and it can only do business in countries where the governments have chosen to liberalize.

Other development banks have similar constraints. The AfDB, for example, did participate in the Azito project but it has limited funds. The UK's CDC is also keen to participate in African power schemes but, since its partial privatization, it has been heavily marketing its involvement as a mezzanine financier, whereby the institution either comes in with equity to kick-start the debt or variations on this idea. For many, however, the problem is not lack of equity but lack of debt and there is an ever-dwindling amount of debt available.

If the multilaterals are being cautious, commercial lenders are even more conservative.

Africa is perceived as too risky. Says Saadia Khairi, managing director for African project finance at Citibank in London: ?Most banks are unable to provide long-term finance for African countries. And you need to be able to provide at least 10 to 12 year-debt to make many of these deals viable. Therefore multilateral bank and export credit agency must be involved. But generally even the agencies are reluctant to lend unless there is considerable government support and this relates not just to macro-ecomonic reform but also to sector specific reform. It's not rocket science.?

Despite this Citibank has pursued power deals in Egypt and is involved in others in Uganda and Ghana. The message is that for the right project, commercial banks are prepared to take the risk. Banks involved in the Azito project include SG, Paribas, Dresdner, HypoVereinsbank, Dexia, Generale, Natexis and Credit Commercial de France.

Sponsors are even less willing to waste their time on risky projects. Speaking at the Power 2000 conference in Amsterdam, Ronald Spiers, regional director for southern Africa at National Power in London said that his company will always look for projects in which they have a competitive advantage. More than that, their deals often involve a partner and the government has to have compatible objectives.

Says Spiers: ?But we've ruthlessly weeded out bad projects at an early stage.?

Where a captive market is the best option
At Rolls-Royce Power Ventures the strategy has been slightly different. Rather than concentrating on the large 1,000MW power plants, Rolls-Royce has participated in small to medium-sized schemes in Africa which will be able to use its turbine equipment. But the company's strategy has other advantages. Says Paul Carey, vice-president for the Middle East, Africa, Turkey at Rolls-Royce Power Ventures in London: ?The company initially got involved in a project in Tanzania over a year ago. It was an opportunistic venture ? a power plant for a gold mine. We then decided that there was sufficient opportunity in Africa to make a more concerted effort and this coincided with a bid for a power plant for a mine in Mali.?

From a financing perspective these contained power projects, which supply electricity to a creditworthy western offtaker, offer various advantages. Says Carey: ?Rather than betting on the country, the credit risk in these projects has more to do with the gold market.? Too much exposure to one type of commodity can also be a danger.

Financing such small projects also allows the sponsors to do the deal on their own balance sheet with the view to bringing in further financing after the higher risk construction phase is over. ?In Mali our project is likely to be financed with 100% equity,? says Carey, ?with a view to bringing in partners and lenders, on a non-recourse finance basis, after construction?. However, Carey admits that this strategy is not appropriate for larger deals or for those in which power is sold to the state electricity utility ? the company hopes to participate in this type of deal in other parts of Africa.

The race is on ? where will independent power producers go next?

Good bets for investment in Africa, so far, have focused on north Africa. Egypt's Sidi Krir project, for example, is just the first of a series of privately-financed power plants planned in the country. A strong legal framework and strong support from the government, attracted many sponsors and commercial banks to the Sidi Krir concession.

[redacted] InterGen eventually won the mandate and the syndication of the deal was being wrapped up as Project Finance goes to press (see this month's Egypt Investment Guide).

And following in the steps of Morocco's Jorf Lasfar power plant, is PSEG, Sithe and Marubeni's Rades plant in Tunisia. Sanwa and Paribas concluded the first stage of financing for the project in June 1999. But beyond northern Africa there are other pockets of hope.

Law firm Cameron McKenna is advising on several projects in Africa including one in Uganda. According to Paul Biggs, partner and head of the Africa group at the firm's London office there are several reasons why Uganda is viewed as a good bet by power developers.

These include its good government, stable economy and demand for power. But pushing forward feasible projects is taking time.

Cameron McKenna has been advising AES on its bid to build the 250MW Bujagali Falls hydroelectric project in Uganda for the past four years.

Bob Chesnutt, project director for AES in London says that the Ugandan government was due to consider providing a guarantee for the project in July but approval has been delayed. He says that one of the biggest challenges for the project has been obtaining such approvals.

The project faces other challenges. For example, a Nordic-led consortium has plans to build a power plant at Karuma. But Uganda's donors, which include the World Bank, have advised the government that it cannot afford to pay for power from two independent plants and that the government has to choose one to go forward. Quite what will happen to the other plant is unclear but some sort of remuneration package may be required.

Neighbouring Tanzania is also attracting attention from power developers. Not only does the country desperately require power ? only 10% of the population has access to electricity ? but it also has gas ? 1 billion cubic feet. Ocelot Energy International and TransCanada Pipelines are sponsors of the Songo Songo gasfield and integrated power development project. According to Donald MacPhail, vice-president at Ocelot International in Guildford, UK, financing for the gas pipeline, the final link in the $350 million integrated gas and power plant, will be completed by the end of the year. Financing for the gas and power schemes is being provided by sources which include the European Investment Bank, the CDC, the World Bank, DEG and the IFC. Part of the deal tested the World Bank's partial risk guarantee which is used in the Azito project ? many see this as an advance on the bank's A-B loan structure.

Other small power projects in Tanzania connected to mines owned by Ashanti and Sutton Resources are also in progress.

But, while ministers speaking at the recent Power 2000 conference were optimistic about enticing investors into the country, there is one hitch. Independent Power Tanzania (ITPL), a company owned by Malaysia's Mechmar, and its co-sponsor Wartsila, are involved in arbitration proceedings linked to a technical issue in the power-purchase agreement for its 100MW power project. This legal case has hindered the progress of the Songo Songo deal and it could have tarnished the Tanzanian government's record but for the swift action of the government. Says MacPhail: ?The legal case has had an effect on the development of our project but there was not much we could do. But the government has taken steps to keep us interested. It has set up an account whereby we get our investment back should there be any significant problems. This is something we worked on with the government and which has been endorsed by the World Bank. It has allowed us to proceed.?

While Ocelot and TransCanada Pipelines may have had their interests partically protected, legal proceedings will deter other investors.

In this light, plans to build interconnector lines with Kenya, Uganda and Zambia, creating the East African Power Pool, could take some time to come to fruition.

South Africa ? loosening Eskom's grip

As governments struggle to establish who will be the ?power house' of Africa, one country stands out from the rest ? South Africa. In many ways South Africa has many of the right preconditions for growth. The problem is that with an installed capacity of 37,000MW, South Africa's state utility, Eskom has excess capacity, a situation which is unlikely to change at least for the next five years.

Despite Eskom's excess power capacity, plans to build independent power projects are being mooted. Curtailing plans to develop independent plants, however, is the extremely low cost of power supplied by Eskom. The company is able to produce power for as little as US2 cents per kiloWatt/hour ? this rivals many of the world's lowest cost producers and with relatively old equipment. Quite how Eskom is able to achieve such low cost power is not publicly revealed, but what is clear is that until there is a serious demand for power in the country, even highly efficient new plants will have problems competing with power produced by Eskom at present levels.

But even if other companies are finding it hard to compete for large power projects, Eskom has its own expansion plans. Speaking at the Amsterdam conference, Reuel Khoza, chairman of Eskom in Johannesburg said: ?Eskom is very serious about our expansion in South Africa.? The company hopes to export power in the next decade. ?I believe there is light at the end of the tunnel,? said Khoza. ?Eskom and others are commited to illuminating the proverbial ?dark continent'. We want to integrate the continent into the global economy.?

Khoza's plans fit well into the Southern African Power Pool model established in 1995 to trade power between 12 countries in east and southern Africa (see Project Finance, June 1999, page 34). So far the pool is only working in a limited sense. Power from the Cahora Bassa power plant in Mozambique, for example, will be channelled to South Africa and then back through the Motraco power lines to the Mozal aluminium smelter in Mozambique (see Project Finance, January 1999).

Discover how sponsors are making the most out of South Africa

But private power producers do have a chance to grab a slice of the action in South Africa on a smaller scale. Says Paul Biggs, partner and head of African project finance at law firm Cameron McKenna in London: ?The white paper for the development of the power sector in South Africa sees the break up of Eskom and some municipalities having their own licences.? According to the white paper: ?The entry of multiple players into the generation market will be encouraged. Initially this policy will be implemented by obliging the national transmission system to publish National Electricity

Regulator-approved tariffs for the purchase of co-generated and independently-generated electricity on the basis of full avoided costs.?

On July 9 1999 two consortia submitted bids for the first of these municipal power financings. An ABB-Pretoria Power Ventures-led consortium and a group led by Tractebel are competing for the concession to refurbish, own, operate and maintain the Pretoria West Power plant. If all goes to plan, negotiations will be concluded by December 1999. And following Pretoria West, will be similar concessions for plants in Port Elizabeth, Johannesburg and Cape Town. Says Simon Morgan from Standard Bank in London: ?One of the greatest challenges will be how to upgrade and refurbish the generation assets such that the cost of power is competitive with Eskom's.?

But if municipal power plant refurbishment does not interest your company, others are entering the game through another route. South Africa's Metrogas, a gas distribution company in the country, is out to tender. Says Standard Bank's Morgan: ?A number of international integrated power companies are also hoping to enter the energy arena in South Africa by getting their hands on the small gas distribution businesses currently out to tender by Greater Johannesburg Metropolitan Council. This should put them in the forefront of private sector involvement in energy with consequent superior positioning when the larger power/energy deals come along.?

The best credits ? which utilities are
power companies putting their money on?In southern Africa, three power utilities stand out from the rest ? South Africa's Eskom, Namibia's NamPower and Botswana Power.

Together some believe these three offer the best credits for an offtaking utility in the region. And all three are showing signs of progress.

In Namibia, ABB has recently obtained financing for a 400kV, $180 million interconnector line. Advised by Standard Bank, lenders on the deal include the AfDB, Sweden's Seda, SEK, the European Investment Bank and Agence Française de Developpement.

But NamPower is not just restricting itself to an offtaker role. The utility recently formed a joint venture with Shell, Eskom and National Power for the 750MW Kudu gas-fired plant in Namibia. The plant will tap gas from the extensive reserves in the country. Says Simon Morgan of Standard Bank in London: ?One of the reasons the Kudu deal did not get the go-ahead was because the cost of power exceeded Eskom's expectations.? But he adds: ?The sponsors of Kudu are still pursuing various development options including piping the gas to Cape Town for generation and industrial purposes.

Furthermore, gas-fired power plants can be efficiently used for peaking power purposes which may benefit Eskom generation.?

In comparison some utilities look less attractive. Zimbabwe's relative political instability, the power utility Zesa's uncertain finances and indecision over which power plant to build first, have dented investor confidence. The Zimbabwe press blame the World Bank for the slow made on the country's independent power plants. An article in the Herald in April 1999 said that: ?The World Bank, an arm of the United Nations, has refused to back both the 900MW extension of the Hwange Thermal Station and the building of the new 1,400MW Gokwe North Power Station. It does not believe Zimbabwe could service the loans required by both projects simultaneously...The Government believes that the World Bank's refusal to lend for both projects has a high political element, dating from the row over the selection of a Malaysian company as the partner for Zesa in the Hwange project. The developers want to go ahead with the programme but cannot do so without a guarantee from the World Bank.? The debate continues.

ABB ? two deals signed and more to come

ABB has been involved in both the Azito project in Côte d'Ivoire and Jorf Lasfar in Morocco. These pioneer non-recourse finance deals, however, are just the culmination of years of relationship-building by ABB.

According to Lennart Blecher, president of ABB structured finance in Zurich: ?For ABB it is not enough just to look at the equipment supply contract. Customers want total solutions. This means supplying equipment, equity, debt and advisory services. ABB is a one-stop-shop organization.? He adds that with a workforce which spans the globe, the company benefits from having people on the ground.

Blecher says that acting in so many capacities as developer and equipment supplier, for example, might create conflicts of interest for some companies but the key is to build up ?chinese walls?.

Crying for help ? western Africa waits for Nigeria

Marco Denes reports

Speakers at the Power2000 conference held in Amsterdam warned delegates to be prepared for emotional reactions to the gloomy situations in some west African countries. Said Solomon Gerber, permanent secretary at the ministry of energy and power in Freetown, Sierra Leone: ?At the end of my presentation, you will either cry or you will come out and help.? Sierra Leone is a country where only 10% of the 4.5 million inhabitants have access to electricity that covers only 2% of the national territory. Civil disruptions, considerable loss of logistics and dependence on erratic flows of imported fuels are real issues for war-torn countries such as Sierra Leone.

But the biggest absentee at the conference was the Nigeria government. Nigeria is the country with the biggest population in Africa, 110 million, and a key player for the political and economic future of west Africa. At the core of this development is Nigeria's large gas and oil reserves. Plans have been mooted to export this gas and oil to Nigeria's neighbours through the West African Gas Pipeline (WAGP). Benin, Togo and Ghana will all be linked to the pipeline which will then be extended to Côte d'Ivoire and other landlocked states. The future of power development in west Africa will be achieved through regional integration and the creation of a transnational pipeline system.

Said Gilbert Dokyi, chief executive of the Volta River Authority in Accra, Ghana is ?committed to the idea of WAGP?. Ghana needs $2 billion to build an additional 1,000MW to supply the country until 2003.

Tapping into this demand for power, CMS Energy of the US is developing a $60 million, 110MW power plant. Fuel for the plant will be supplied by Nigeria and Côte d'Ivoire.

But while Ghana and other countries urgently need the pipeline, the future of the project has been hindered by political uncertainty in Nigeria which has triggered its isolation from international politics. In May 1999, however, the new Nigerian president Olusegun Obasanjo, was sworn in and the first civilian government for years has been formed. Obervers are optimistic that Nigeria's transition to democracy will break its economic and political isolation.

But ?transition will not be easy?, says Stefano Tranchida, a France-based specialist on west Africa. ?Transition from a centralized military government to a working federal democracy will be painful and a quick, positive outcome is not guaranteed,? says Tranchida.

Others are being cautious. The country is ready for change since the death of General Sani Abacha, former ruler of Nigeria, a year ago. Konyin Ajayi, partner at Olaniwun Ajayi & Company in Lagos says that despite its potential, Nigeria ?still has to win back confidence?.

But Mamadou Ndiaye, senior editor of Revue Africaine de Banques in Dakar, is positive that Nigeria will have a ?very big impact in west Africa? and that strengthening of political and economic relations between Nigeria and other west African countries like Côte d'Ivoire and Senegal is already happening.

And there are signs of change in international politics. Old colonial powers such as France have been busy maintaining and securing their share of economic and political influence in west Africa. But France is coming under pressure from competitors mainly from the UK and the US.

French-speaking countries such as Senegal and Côte d'Ivoire are the top-scorers in term of their attraction of foreign investment in the region. French banks such as SG and Credit Commerciale de France (CCF) are active in both countries and look forward to strengthen their presence in the region. SG participated at the financing of 288MW Azito power plant in Côte d'Ivoire (see Project Finance, March 1999), a benchmark deal for the region while CCF arranged 50MW Cap de Biches power plant deal near Dakar (see Project Finance, December 1998). The International Finance Corporation (IFC) had a role in the two deals underlining the need for multilateral agencies when looking at project finance opportunities in the region. Azito and Cap de Biches attracted interest into the region and made international sponsors and financiers look at opportunities in west Africa at a time when a slow-down was felt in markets such as Latin America and Asia.

France will soon realise the degree of competition coming to west Africa. Senegal, Côte d'Ivoire and English-speaking Ghana are likely to be marked in red on the map of those interested to expand business in the sub-Saharan region beyond South Africa. Referring to the case of Ghana, Betrand Heysch de La Borde, vice-president of project finance at SG in Paris would like to see problems such as tariffs for independent power projects being tackled by the Ghanaian government. ?A stable supply of fuel for independent power projects would also be needed: something which could be solved with the implementation of the WAGP project,? says de La Borde. Looking at the resurgence of Nigeria, de la Borde is confident such an occurrence ?will not be detrimental to projects in neighbouring countries?. He stressed the case of Côte d'Ivoire being confident in its own regional role independently of what Nigeria or others will do.

Hubert Sueur, head of project finance at CCF in Paris is convinced of the opportunities west Africa holds for project financiers. CCF bid to advise the Senegalese government for the privatization of a 51% stake in Senelec, the country's state-owned electricity authority. Paribas won the mandate.

Johan de Mandt, account manager for power finance at ING Barings in Amsterdam says that in African deals it is ?not obvious you include commercial banks in the financing?. It follows that west Africa represents one of the most challenging regions project financiers can get into, but equally one of the most rewarding in terms of real need for projects to come online.