Paiton

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Asia Pacific Refinancing Deal of the Year 2002

Paiton Energy

Paiton, the massive, and complex, financing of a coal-fired power plant in Indonesia, garnered widespread praise when it closed in 1995. This $2.6 billion deal involved three export credit agencies, a 144A bond issue, and the co-operation of the Indonesian government. But then the Asia crisis hit. How Paiton managed to step back from the brink, and renegotiate its options with creditors and counterparties is a must-read story for power developers.

Paiton's financing relied heavily on dollar-denominated debt ? including $506 million directly from the Japan Bank for International Cooperation (JBIC), $338 million covered by NEXXI political risk insurance, a $508 million covered loan from US Ex-Im (to be taken out by a direct loan upon completion), $200 million from Opic, and a $180 million bond issue. Both the tariff paid by state-owned offtaker PLN and the fuel supply contract were in dollars.

This arrangement worked well until the wave of devaluations and defaults that hit the region in 1998. The crisis severely hampered demand in affected economies, led to capital flight and, ultimately, led to the fall of the Suharto government. More immediately, it racked up the cost to PLN of honouring its dollar obligations. By 1999, a nasty war of words had developed between the sponsors and the Indonesian government, and the abandonment of the project was highly possible.

If there was a time for the sponsors ? Edison Mission Ennergy, Mitsui and GE Capital ? to walk away, it was this period. But below the surface the fundamentals, that the 1,230 MW Paiton accounted for about 10% of the country's load and was a low-cost plant, were solid. At the heart of the restructuring was the renegotiation of supply and offtake contracts, and following this the creation of a capital structure that would match the new contracts.

The situation had moved on, and very much in the project's favour, in the intervening period. Like many infrastructure projects caught by a violent change in government, Paiton initially made an attractive target for corruption allegations. What made Paiton different from CalEnergy's assets in the country, or the Dabhol project in India, was that its economic fundamentals were in place.

When the project was first mooted, lenders wanted Paiton locked into a secure, but highly-priced coal contract. Back then the country's coal industry was in its infancy, and the Adaro mine produced about 2 million tonnes per year ? half of Paiton's yearly needs. Addaro now produces 20 million tonnes and has far better infrastructure, so that coal costs have dropped from 1.6 cents/kWh to 1 cent. This is in line with PLN's own fuel costs

This means that the project can produce electricity that is inside 5 cents/kWh. The new rate, 4.93 cents, is inside the PLN's cost of power, and higher up the dispatch curve, meaning that the plant now becomes central to grid reliability. The task for the lenders was to adapt the capital structure to this less lucrative contract.

The key principle for all parties was that there would be no haircut to debt or equity. There would be an extension of maturities, and Edison and the other sponsors would need to accept a lower rate of return, but would cover their cost of capital. Indeed, the sponsors injected a further $240 million to fund the plant's completion, and this has also been incorporated into the capital structure.

The loans were originally to be repaid by 2011, but some lenders have had to extend their tenors, in particular, the JBIC, Opic and Ex-Im direct pieces. Ex-Im, which at the time did not provide loans before completion, uses acceptance and operations to decide when a plant is completed, and wanted to reduce its exposure. It therefore developed a risk-sharing tranche, where $308 million comes from its own books, and the banks, which bought into all tranches on a pro rata basis, keep $127 million. The direct loans now mature in 2013.

Another area where the sponsors had to tread carefully was with bondholders. A controlling position in the $180 million issue came into the hands of hedge fund Farallon, which has made headline moves into Malaysia, and saw an opportunity to pick up the bonds cheaply. The outcome will be reassuring to other developers with hedge funds at the gates ? Farallon was supportive of the restructuring, although since the bonds accounted for about 10% of the plant's debt it had little choice.

This ability to keep a hedge fund happy means that the Paiton finance team has developed a unique and useful skillset. No doubt several of their US counterparts may find themselves in a similar situation soon. In general, however, all parties agreed to share the burden of the refinancing, which included a back-ending of the amortization on some of the direct ECA loans. The long-term trend downwards with the Libor will also have reduced the project's debt service burden.

As Rob Edgell, Edison Mission's president for the Asia region, says, ?you need to assess early on whether you can get through the process, and whether there are enough benefits to all parties from doing it. We're among the first investors in the country, have been behind the early PPA model and understand the PLN team professionally. Everyone realised the importance of Paiton, so we worked backwards from the new tariff to get a financing that would protect the equity.? Edison, with a 40% stake, led negotiations with the Indonesian parties, assisted by financial advisor ABN Amro, while Mitsui, with 32%, led talks with the Japanese parties.

Paiton has gone far towards restoring confidence in Indonesia as an investment destination. Demand there is growing at over 8%, and per capita usage is still low. Future investors, as well as other developers locked in negotiations with the PLN, would do well to follow Paiton's lead.

PT Paiton Energy

Status: Restructuring closed December 2002

Size: $2.6 billion

Location: Indonesia

Description: tariff and debt restructuring for 1,230MW coal-fired power plant

Sponsors: Edison Mission Energy, Mitsui, GE Capital

Debt: $1.742 billion

Lead arrangers: JP Morgan Chase, Mizuho, Credit Lyonnais

Providers: US Ex-Im, JBIC, Opic

Financial advisor: ABN Amro

Independent engineer: Mott MacDonald

Fuel advisor: JT Boyd

Lawyers to the lenders: Latham & Watkins

Lawyers to the borrower: Skadden Arps

Lawyers to JBIC: Milbank Tweed

Back to contents