

Floodgates open for investment in Russian hydro

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The Russian power sector is on the verge of an influx of foreign capital after the European Bank for Reconstruction and Development (EBRD) arranged the longest syndicated rouble loan on the market to date

Nine banks lined up to be part of the 6.3 billion rouble (US\$235m) deal that will provide financing to Russia's Hydro OGK for the modernisation of nine hydro power plants in the Volga-Kama cascade.

The cascade of power stations on the Volga and Kama rivers is one of the largest renewable resources in southwest Russia.

The facilities owned by Hydro OGK - a subsidiary of state-owned utility company UES - are more than 40 years old and in great need of renovation. The loan will extend their operating life by at least 25 years.

The deal is only slightly smaller than the Rub7.2 billion (US\$268.5m) syndicated loan that EBRD arranged in April 2006 for Mosenergo to refurbish its combined heat and power plants in Moscow.

Whereas the Mosenergo loan saw eight banks commit to a seven-year repayment schedule, this latest deal has nine banks signing up for either eight or ten-year terms.

Both deals were rouble-denominated - a new development and seen as a vital step towards an independently strong Russian economy.

The establishment of a transparent MosPrime rate in April 2005 was the precursor to European banks agreeing to provide Russian currency loans. The banks are showing confidence in the long term strength of the rouble as MosPrime is based on a three-month index.

The project

This is the first of what is expected to be a long line of loans needed by Hydro OGK to conduct a five-year upgrade of its ageing infrastructure.

The total cost for rehabilitating obsolete equipment - mainly turbines, generators and transformers - on the Volga-Kama cascade is estimated at Rub26 billion (US\$969.8m).

Hydro generation is the main source of renewable energy in Russia - providing more than 20 per cent of all power produced in the country.

The Russian government has now also charged Hydro OGK with the development of all renewable energy resources including wind farms, tidal and small hydro projects.

This benchmark deal was attractive to the European banks because Hydro OGK is highly underleveraged with only eight

per cent debt and strong cash flow.

Hydro OGK also offers low risk based on hydropower's strategic importance to Russia.

The government is expected to retain more than 50 per cent of the company and is unlikely to let it fail in its financial obligations because if these were impacted a major source of the country's power supply could be jeopardised.

Once the modernisation of the hydro plants is completed - and after a reorganisation that will consolidate a large number of hydro power plants - Hydro OGK will be the largest power generating company in Russia with an installed capacity of 23,127MW.

Financing

EBRD will be the lender of record for the full Rub6.3 billion (US\$235m) loan but Rub4 billion (US\$149.2m) has been syndicated to nine banks under an A/B loan structure.

The bank will hold the Rub2.3 billion (US\$85.9m) A loan priced at 365bp over MosPrime for 14 years.

EBRD sent out a request to banks for offers of syndication in June 2006 and based on the pricing of the responses worked backwards to derive their own rate.

The first of two tranches for the B loan provides Hydro OGK with Rub3.15 billion (US\$117.5m) at 305bp over MosPrime for 10 years.

The banks with a breakdown of their involvement:

- Standard Bank (Rub900m, US\$33.6m)
- Bank Austria Creditanstalt (Rub800m, US\$29.8m)
- ING Bank (Rub800m, US\$29.8m)
- Calyon (Rub325m, US\$12.1m)
- Fortis Bank (Rub325m, US\$12.1m)

The second tranche of the B loan is for Rub850 million (US\$31.7m) over an eight year period priced at 275bp.

The banks providing the second tranche are:

- Raiffeisenbank Austria (Rub220m, US\$8.2m)
- Citibank (Rub210, US\$7.8m)
- Banque Societe Generale Vostok (Rub210m, US\$7.8m)
- Credit Suisse (Rub210m, US\$7.8m)

According to EBRD's senior syndications manager Michael Delia there was a great deal of interest from a wide range of banks.

'We went to market in June and expected a fair amount of interest at eight years but not necessarily at the 10 year level,' he said. 'When the dust settled we had oversold on both tenders.'

Delia attributed this to the relative low risk involved in moving from an eight-year term to a 10-year term compared to the pricing benefit.

Conclusion

EBRD purposefully selected a large number of banks with a varied background so that Hydro OGK can build relationships for future transactions.

This will help when the company needs to find more loans for its massive infrastructure modernisation needs. One of those loans could be required as soon as next year.

This is expected to be the first of many deals in Russia's power sector which holds very little debt and needs extensive investment to maximise the efficiency of its current plants and build new generation facilities.

Russia's demand for electricity and heat is predicted to increase by 2.5 per cent each year exceeding that of other developed countries. Other banks will be looking at this deal to see if the water is warm before jumping into the investment pool.

There is undoubted potential in Russia's emerging free market economy still very much in its infancy 17 years after the fall of communism.

The project at a glance

Project Name	Hydro OGK modernisation project
Location	Volga-Kama cascade, southwest Russia
Description	Hydro OGK received a US\$235m loan - paid in roubles - to modernise hydro power plants extending their life by at least 25 years
Sponsors	Hydro OGK
Operator	Hydro OGK
Project Duration (Including construction)	5 years
Total Project Value	US\$969.8 million
Total senior debt	US\$85.9m 14 year A loan
Senior debt breakdown	First B loan tranche US117.5m for 10 years
	Second B loan tranche US\$31.7m for eight years
	A loan:
	EBRD (US\$85.9)
	First B loan tranche:
Senior debt pricing	Standard Bank (US\$33.6m)
	Bank Austria Creditanstalt (US\$29.8m)
	ING Bank (US\$29.8m)
	Calyon (US\$12.1m)
	Fortis Bank (US\$12.1m)
Mandated lead arrangers	Second B loan tranche:
	Raiffeisenbank Austria (US\$8.2m)
	Citibank (US\$7.8m)
	Banque Societe Generale Vostok (US\$7.8m)
	Credit Suisse (US\$7.8m)
Participant banks	A loan 365bp over MosPrime
	First B loan tranche 305bp over MosPrime
	Second B loan tranche 275bp over MosPrime
Legal adviser to banks	European Bank for Restructuring and Development
Date of financial close	Standard Bank, Bank Austria Creditanstalt, ING Bank, Calyon, Fortis Bank, Raiffeisenbank Austria, Citibank, Banque Societe Generale Vostok
	Gide Loyrette Nouel
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