

Hot Springs Eternal: Ancala's Evolution of HS Orka

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While renewable investment in Europe has been on a stunning trajectory in recent years, not all opportunities within the space are equal. Geothermal assets such as HS Orka are a rarity in Europe and do not frequently come up for acquisition.

However, in spring 2019, Ancala forged a deal with Jarðvarmi – an Icelandic pension consortium and incumbent shareholder in the 174MW geothermal energy producer HS Orka. This transaction saw Ancala [take a 50% stake](#) in HS Orka and marked the investment manager's entry into the Icelandic geothermal sector, which constitutes 8% of all electricity produced in the northern nation.

Since the deal, the partners have worked to realign the business towards its core focus – disposing of assets, implementing build-outs and new projects, and establishing mutually-beneficial relationships with industrial partners.

The net result of this has been a galvanising of the business' desire to place environmental considerations at its core, devising entrepreneurial and creative solutions to move towards a zero-waste society.



At the heart of HS Orka's transformation is the principle of circular economy, with the partners concentrating on optimising existing resources and ensuring all by-products are made use of. As energy efficiency becomes an increasingly pertinent topic, HS Orka's model could well be one that other producers look to replicate.

Ancala springs into action

Natural hydro and geothermal resources have made Iceland the world's largest green energy producer per capita.

Presently, the hydro and geothermal resources supply almost 100% of Iceland's consumption of electricity and around 85% of Iceland's total consumption of primary energy. Of the total primary energy consumption, roughly 20% comes from hydropower and 65% from geothermal sources.

This is the world's highest share of renewable energy in any national total energy budget.

HS Orka is one of 3 main energy companies on the island of Iceland, the others being Landsvirkjun (owned by the Icelandic state) and Orkuveita Reykjavíkur / Orka náttúrunnar (owned by municipalities). It was the first Icelandic energy company to be privatised in 2000.

The business then comprised 2 geothermal assets with a combined capacity of 174MW:

- [Reykjanes Geothermal Power Plant](#), 100MW
- [Svartsengi Geothermal Power Plant](#), 74MW

The Svartsengi plant comprises 6 powerhouses built between the 1970s and 2018. The most recently built Powerhouse 6 has 30MW of capacity.

The Reykjanes plant, meanwhile, consists of 2x 50MW double flow turbines with sea-cooled steam turbines. Both engines entered operations in 2006.

It also owns the [10MW Brúarvirkjun](#) run-of-river hydro project which was under construction at the time of acquisition and had other prospective renewable energy developments.

At the time of the takeover, the shareholding structure in the business was as follows:

- Innergex subsidiary Magma Energy Sweden – 53.9%
- Jarðvarmi – 33.4%
- Fagfjárfestasjóðurinn ORK – 12.7%

IJGlobal understands Innergex's acquisition of HS Orka was part of a deal wherein it acquired Swedish wind assets, though the Icelandic geothermal component was not core to its strategy. Innergex therefore decided to sell the business in 2018, with a process launched and later shelved.

Around this time, Ancala became interested in the asset. Ancala partner Lee Mellor explains the appeal: "At Ancala, renewables is something we've been investing in since inception. Our first investment was a hydro developer – Green Highland Renewables. We've always supported the energy transition, and ESG is at the heart of everything we do."

The prospect of investing in a rarer form of renewables also provoked interest. Mellor continues: "Until 2019 we had invested in solar, anaerobic digestion, hydro, many technologies. But a key interest for us has always been how can heat be decarbonised, and how do you get baseload renewable power. Geothermal ticks both those boxes, and so we were looking for an opportunity in that sector."

Beyond that is the inherent security of the business: "It's a stable cash generative business. As with most renewables investments, you have an installed asset base generating cash flows. In the Icelandic energy market you are entering into long-term, typically inflation-linked PPAs with highly credit-worthy corporate counterparties, which was another attraction for us."

Ancala presented itself to Jarðvarmi as an investment partner who shared its vision for HS Orka, spending many months aligning their approach and interests. The fruit of the discussions was a plan for a pure play energy company with the promise of meaningful growth.

"We saw a lot of commonality and alignment with Jarðvarmi, who was interested in growing and developing the business over the long term, committing capital to build out capacity at HS Orka. We spent a lot of time with them deepening our understanding of the business, and figuring out what we wanted to do," explains Mellor.

The pension consortium agreed to buyout the remaining shareholders which paved the way for a fresh shareholders agreement on a 50:50 basis. This solved a number of problems, including an inherited complex shareholding agreement structure, and plans for the sale of a 30% stake in Blue Lagoon Geothermal Spa and Resort – Iceland's leading tourist attraction – which Ancala and Jarðvarmi divested to Blávarmi to transition HS Orka into a pure-play renewable energy platform.

Mellor is enthusiastic about the local partnership with Jarðvarmi, saying: "The benefits of a local partner are numerous. When investing across Europe, we find each country has its own nuances, customs, and the way it does business. Being able to partner with a local has allowed us to get the most from businesses. Though Jarðvarmi is a consortium of pension funds, they are actively involved in the business and driving it forward with us."

Business heats up for HS Orka

Since its acquisition of 50% in HS Orka, Ancala has implemented and overseen a multitude of changes – both operationally and technologically.

Not only was Tómas Már Sigurðsson appointed as chief exec, but a new CFO, CTO, and general counsel were recruited. The entire project team was restructured, overseen by Ancala representative Adrian Pike who serves as chair of HS Orka's board.

In Sigurðsson's words, "we refocused the operational side, strengthening the infrastructure so as to both optimise operations and execute complicated expansion projects."

This restructuring was a success: operational performance has improved and become more stable.

As for the "complicated expansion projects":

- Brúarvirkjun Hydropower Plant, 10MW – already commissioned
- [30MW extension to the Reykjanes plant](#) – completion expected in Q1 2023
- [22MW extension to the Svartsengi plant](#) – scheduled for late 2022/early 2023

Once completed, the projects will together add another 62MW to HS Orka's 174MW of capacity at the time of Ancala's acquisition.

The fact that the 30MW extension has been constructed “on budget and with no complications” – amid a pandemic and various economic crises – is testament to HS Orka’s operational prowess, Sigurðsson says.

HS Orka’s mantra is ‘a society without waste’, and these extensions are manifestly cost-effective ways of maximising energy efficiency. As Mellor points out: “We’re generating extra energy without using any more resources – it’s just the waste heat created by the existing plant.”

These renovations require funding, which is one of the reasons why Ancala and Jarðvarmi made the decision to [refinance HS Orka](#) in February 2020.

Of the \$210 million financing, around half was used to refinance existing debt while the remainder was deployed as funding for the expansion projects.

The package comprised:

- a term loan
- a capex facility
- a revolving credit facility

The debt, priced at Libor +150bp and with a remaining tenor of 3 years, was provided by a consortium of 3 European banks – in contrast with the single Icelandic lender involved in the previous financing.

Mellor explains: “HS Orka was under levered for a renewables asset, which is consistent with our approach. We look to create value through operational improvement rather than financial engineering whilst retaining financial flexibility.”

With this refi, Ancala secured “a good-sized capex facility to support the ambitious growth plans of the company,” Mellor adds.

The earth is HS Orka’s oyster

HS Orka’s Resource Park – the crowning jewel of its circular-economy model – is a part of the business that has seen huge growth since Ancala’s investment.

The number of businesses in the park has swelled to 11, each of which has found a specific use for one or more of HS Orka’s many by-products – including but not limited to brine, heat, seawater, and CO₂.

Ancala has chosen carefully which businesses to partner with HS Orka. As Mellor notes, “one of the selection criteria for who we want to work with is who can use what resources.”

Businesses located at the Resource Park include Samherji Aquaculture – a salmon farm planning to invest more than ISK45 billion (\$33m) in total over the next 11 years to build up to 40,000 tonnes of aquaculture.

Another partner is international energy company Hydrogen Ventures, which will invest more than €100 million (\$102m) – in the first phase – into green methanol production. Both deals were announced last year (2021).

These are “long-term partners,” Sigurðsson says, with “good experience in their fields who will invest and grow” within the Resource Park.

Other geothermal facilities have been unsuccessful in their attempts to replicate the scale and diversity of HS Orka’s Resource Park – often hampered by complications.

Ancala’s plans for HS Orka’s power plants and Resource Park are ambitious, premised on the concept of circular economy and energy efficiency.

In addition to the 62MW increase in capacity since Ancala’s acquisition, Mellor predicts that there is “another 200MW+ that we could develop over time,” adding that “we’re not taking our foot off the pedal in terms of development.”

Operational improvements, too, are on the horizon – such as the refurbishment of outdated equipment at Svartsengi.

New customers are lining up for the Resource Park, with upcoming projects in the agriculture and cosmetics industries, as well as a recently-signed contract for an algae farm expansion.

Existing Icelandic energy projects such as HS Orka look to be more and more attractive to investors. Coupled with the energy shortage in

Iceland, there is an increasingly rigorous process through which approval is gained for new projects, thereby enhancing the appeal of existing assets.

As Mellor puts: “Iceland needs more power, and the options to generate that power are somewhat limited because there’s a very stringent process to go through to develop new capacity.”

Not only is there a limited supply of energy, but Iceland’s prices remain insulated from those that are currently sky-high in the rest of Europe.

Iceland also has “effectively 100% baseload green energy,” Mellor points out, increasing its attractiveness to investors keen to strengthen their ESG credentials.

Interest in the Icelandic energy market is growing “week on week,” according to Sigurðsson. With a 3-year head start, a diverse pipeline of opportunities, and a methodical approach to waste, Ancala and HS Orka look well-positioned to capitalise on this interest.

Advisers on the acquisition:

- Evercore – financial to Ancala
- Travers Smith – legal to Ancala

Advisers on the refi:

- DC Advisory – financial to the borrowers
- Latham & Watkins – legal to the borrowers
- Logos – legal to the borrowers
- Shearman & Sterling – legal to the lenders

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