Exeltium Virtual Power Project Financing

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April 2010 saw financial close of one of the most innovative infrastructure financing deals of recent years - Exeltium - conceived by the French government in 2005 as an elegant way of killing two birds with one stone.

First the country, in common with much of Western Europe, was becoming less and less competitive for labour and electricity-intensive industry to operate in, as first Eastern Europe and then, among others, China had become viable alternative locations.

Secondly EDF, which was planning a huge new nuclear power unit at Flamanville (Brittany) and in the era of European rules over state aid and open markets, was struggling to see where the up-front funds for construction would come from.

The solution that the various parties hit upon was to allow a consortium of France's biggest electricity users to come together and raise funds for a discounted forward purchase of power from EDF - money which EDF could then use to build Flamanville 3.

However, a question mark remained, over where the money would actually come from. Banks were not immediately keen to get involved in a project finance deal with no physical assets. Additionally project financing of nuclear power plants is something project financiers have tended to shy away from. But the level of political will behind the deal made the participation of France's biggest banks - Natixis, which took the financial advisory mandate, BNP Paribas, Crédit Agricole and Société Générale - unavoidable.

Simon Ratledge, a partner at Linklaters who was advising the lenders, said, "the deal was effectively a virtual power project based on a hybrid structured corporate/project finance facility, but was run out of the PF desks of the four main French banks, which are used to physical assets and having security over those assets. So the challenge was to try to replicate a structure that resembled the classic project finance model as far as possible."

Project financiers, however, are always keen to point out that the security in a deal is not the physical asset but the contracts associated with it - and Exeltium was to have a fixed, 24-year take-or-pay contract for EDF-supplied electricity. That was, until the European Commission got involved.

Rethinking the deal

The four banks started working on the deal in early 2007. Not long after that, in July 2007, the Directorate General for Competition in the European Commission indicated it was unhappy with what was taking shape.

The DG of Competition was worried about a foreclosure of French power markets - taking the biggest consumers of electricity out of play for 24 years, meaning new entrants to the supposedly liberalised market would have a far smaller pool of customers to play with. It also asked that resale restrictions be removed.

A year later, Commissioner Neelie Kroes welcomed changes made to the agreement and green-lighted Exeltium - but the changes meant that the deal would need a new borrowing structure.

The main difference under the new formulation of Exeltium was that member companies could now opt out of the deal after year 10, and every five years thereafter - "decreasing the potential foreclosure effect of the framework in the medium to long term", according to Kroes. Resale restrictions were also lifted.

Bertrand Andriani, Ratledge's colleague at Linklaters, says, "The principle imposition from the commission was that the deal was a long-term commitment from the clients of Exeltium to take-or-pay for the electricity for the duration, without any possibility to get out of the deal. So the commission imposed an opt-out for the clients at year 10 and every five years thereafter. This opt-out obviously makes a big risk for a big project like this one, which had to be mitigated."

The knock-on effect for the deal's lenders, and for EDF, was that they could no longer have security that the deal would last any more than 10 years - though it was still theoretically to be signed for 24 years.

The 2008 financial crisis was then thrown into the mix, which made all but the very best and most obvious deals impossible to finance. Exeltium would have to wait.

Fine-tuning the deal

It is important to note that Exeltium, as it has ended up, is not purely as a 'pass-through' entity, sending power one way and money the other. It is a 'for-profit' company, charging its members for power, paying EDF, paying off its debt and retaining a debt service cover ratio of around 1.45x at base case. It will also pay its members dividends if it runs up a cash surplus.

In order to provide EDF with more assurance if - as was the case with the first European Pressurised Reactor project in Finland, and appears to be happening at Flamanville - the cost of its project was to overrun, a mechanism was incorporated into the deal to share some of that risk with the Exeltium consortium.

According to Exeltium itself, the company provides its shareholders with access to prices offering them "visibility" over the longer term.

"This price is subject to significant risks directly linked to the structure of the financing and the hedging provisions, and, on the other hand, on the industrial risks associated to the development and operation of EDF's nuclear park, which will be shared by Exeltium within the framework of the Industrial Partnership Agreement," it adds.

Emerging from the crisis

The deal was originally intended to be around €4 billion, but the continuing lack of liquidity in the market, which is still today not back to 2007-levels, meant the consortium and its lenders found it prudent to split it into two phases.

The recession which followed the financial crisis also took its toll on the deal in another way: many of the Exeltium shareholders found their power needs reduced due to scaling back their commercial operations. Another driver for shrinking the deal slightly was that other power purchase agreements had been put in place while Exeltium was delayed.

At the end of 2009, the four banks decided to take phase one to the market to syndicate out some of the €1.7 billion debt that the €2 billion deal needed. The four of them committed to €300 million each, meaning €500 million needed to be found on the bank markets. The €300 million shortfall would come from Exeltium members' balance sheets.

In its final incarnation, the deal also benefited from €233 million in mezzanine bond financing from French state financing institution CDC, with €175 million in equity from Exeltium funded by a share increase subscribed by the members.

That meant the total bank lending was reduced to €1,592 million, split between the four initial MLAs, plus three further MLAs and three other participant banks, as follows:

- BTMU (MLA)
- Intesa (MLA)
- Santander (MLA)
- Dexia (Lead Arranger)
- Banesto (Arranger)
- ING (Arranger)

Around €600 million was syndicated to the six later arrivals, leaving the four initial MLAs with tickets of around €250 million each.

The banks lent on a 9.5-year mini-perm, for two reasons. A 24-year debt is still hard to come by in the current market, and refinancing in the next few years could yield a more advantageous deal.

Also, with the first drop-outs from Exeltium possible after year 10, it is doubtful the banks would have wanted to lend longer with that uncertainty. It remains to be seen whether a re-finance will yield a longer tenor. The lending is priced at 250bp, rising through 300bp to 400bp - with the step-ups coming every two years.

A cash sweep begins in year three and incorporates step-ups to 100 per cent before the lending reaches maturity - but the structure will still leave a bullet at the end of the term. The deal is structured with a debt service cover ratio (DSCR) of around 1.45x - a relatively high figure which reflects the level of risk inherent in the deal.

In the event of a consortium member opting out of the deal, Exeltium will first endeavour to sell the excess power to other members at the contracted rate. If that fails, the surplus will then be sold on the open market - as per the European Commission ruling.

The commercial lenders can take heart, however, from the mezzanine first-loss funds put in by state-owned CDC - underlining the French government's support for the deal.

Exeltium, and beyond

The €2 billion deal is around half of what Exeltium - and EDF - originally hoped to raise, and a phase two is in the works. By all accounts it is likely to be structured similarly to phase one - and the financing could incorporate a refi of the first instalment.

Gildas Barreyre, head of operations at Exeltium, says, "We should refinance [Phase one] as soon as we get the opportunity. We got today's market, and today's credit conditions; our shareholders might want to review that through a re-financing. Combining that with phase two is a possibility."

Finding the same amount of money all over again could prove challenging in what is still seen as a controversial, or at least somewhat weird, deal. However, syndication of phase one was encouraging - suggesting phase two should be a success.
Perhaps more interesting will be whether the deal is replicated in other markets. As far as EU regulations are concerned, the French have done the heavy lifting for this deal - putting in place a template which could be used again.

The new government in the UK, for instance, is trying to square the circle of encouraging new nuclear build with not providing a state subsidy - and providing a go-between to ensure nuclear new build has a market once it's built is likely to be the minimum a government can get away with.

Exeltium could not have happened without political support. As Linklaters' Bertrand Andriani says, "The structure is simply one that has never been tested before. It relied on specific legislation to implement the project, which shows the support politically that the project has benefited from.

"The legislation has been amended a number of times to take into account the Commission's rulings, which shows the political importance for the French industrial network. These are very large, labour-intensive industries and it's important that they have access to long-term affordable electricity."

Conclusion

The deal remains an elegant killing of two birds with one stone - and the European Commission's intervention ensured collateral damage to Europe's free market in power was minimised.

The importance of the deal is best exemplified by the fact it overcame so many obstacles on its route to financial close. Political will and imaginative financing methods got it over the line - and ended up making it an attractive deal to the banking community.

As much of Europe is now looking at ways of catching up to France in its use of nuclear power, and scratching its head over how to finance it, Exeltium could well provide a template which is replicated elsewhere.

