

power finance & risk

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Cogentrix Plans Ahead

Cogentrix Energy has opened talks with its lenders about renewing a \$250 million credit line, even though the facility doesn't mature until October. The move is emblematic of the jittery U.S. power market's increased focus on financial liquidity.

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EXELON SEEN REKINDLING DQE ACQUISITION TALKS

Exelon reportedly has relaunched acquisition discussions with its smaller Midwest utility neighbor DQE barely two months since their last round of talks bit the dust over price, says a New York investor in touch with one of the parties. The pair failed to strike a deal in November because of haggling over price, but both companies have softened their stance and are committed to merging, explains the investor. A successful conclusion to the talks would create an approximately \$18.1 billion energy concern, given their respective stock market valuations of \$17 billion and \$1.1 billion. **Joe Balaban**, a DQE spokesman, denied it is in talks with Exelon and **Donald P. Kirchoffner**, an Exelon spokesman, declined comment.

Another New York banker says picking up DQE would be a strategic acquisition for Exelon as it would fill "the hole in the doughnut." He explains that buying DQE, which is

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CALPINE LOOKS TO HALT FIVE PROJECTS IN BID TO SAVE \$700M

Calpine is looking to mothball five plants that are under construction in the U.S. to avoid making a \$700-800 million equity contribution that is required under the terms of the projects' non-recourse loan covenants, but creditor opposition could undermine the move.

The five plants are funded primarily via the \$3.5 billion brace of non-recourse construction revolvers that Calpine arranged two and three years back and the loans' covenants require the San Jose, Calif., IPP to get lender approval to halt construction, says financiers. It is seeking creditor approval to amend the loans by Jan. 10, they add. Calpine spokeswoman **Katherine Potter** says the company is in talks with its banks about various facilities, but declined to elaborate. The specific plants and their size could not be determined.

The move is aimed at cutting cash injections from the corporate level. Under the terms

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2003 PREVIEW

The \$90B Question

MARKET AWAITS MONSTER REFINANCING WAVE

The U.S. power sector heads into the jaws of a refinancing wave this year that over the next 36 months could top \$90 billion. The bulk of the debt mountain comprises bank loans. In the near-term maturing corporate-level facilities will take center stage, but later this year the market must begin tackling the problem of maturing non-recourse mini-perms. Refinancing mini-perms is going to become an increasingly more important feature of the power sector financing landscape over the next few years.

Echoing the views of many financiers, **Andrew Mathews**, managing director at **HypoVereinsbank** in New York, says, "The bellwether is going to be **Calpine**." The San

(continued on page 4)

Check www.iipower.com during the week for breaking news and updates.

Tractebel Lands Turkish Financing

Tractebel has sealed a EUR475 million (\$475 million) 13-year project loan refinancing the construction costs of a Turkish power plant. The deal was structured as a club deal between ABN AMRO, BNP Paribas, Credit Agricole Indosuez, Fortis Capital, ING, Société Générale and Westdeutsche Landesbank, which each took equal stakes (PFR, 11/25). Pricing ranged from 12 basis points over Euribor on a portion guaranteed by Ex-IM Bank to a 167 basis point spread on a tranche with political cover from the World Bank's MIGA arm. The deal also offers up front fees of 60 basis points across the board and commitment fees ranging from 15-37.5 basis points.

The deal refunds the construction costs of a 763 MW CCGT plant that Tractebel is building on the outskirts of Ankara.

NordPool Feels The Strain

A sharp rise in volatility, widening bid/offer spreads and a dearth of players willing to take a market-making role are putting strains on the once robust Scandinavian power market. One London trader who declined to be named says his firm has pulled out of NordPool because liquidity has dried up and he fears the situation could deteriorate further with three of Nordpool's five market-makers recently announcing plans to quit the role by next spring.

NordPool's troubles emerged this fall as power prices spiked in the wake of low rainfall and sharply low water reserves to run the region's hydro plants. As prices rose so bid/offer spreads widened and volume plummeted, notes the trader. When volume falls it becomes increasingly tough for market makers to hedge their positions, he explains.

The three market makers that have decided to exit the market

are BKK Produksjon, Adger Energi, and Norsk Hydro. Helge Stiksrud, a spokesman at Norsk Hydro, notes the firm became a market marker in February on a trial basis and announced last month it will not be renewing the role come next March. He said several factors contributed to its decision, but declined to elaborate. Calls to BKK and Adger were not returned.

Sweden's Vattenfall and Oslo-based Hafslund are the only remaining market makers left on NordPool. Heine Ronningen, chief power trader at Hafslund, says it would like to see more players enter the market to make it easier to lay off risk, but adds it has no plans to quit the role.

Cogentrix Starts Ball Rolling On Renewal Of \$250M Loan

Charlotte, N.C.-based Cogentrix Energy has started preparatory work with its bankers on renewing a \$250 million corporate revolver, even though the deal doesn't mature until October. "Companies don't want to leave it to the last minute. If they can get it done early, they're trying to do it," says one financier, who attended a bank meeting at Cogentrix's headquarters early last month. Calls to Jeff Freeman, spokesman at Cogentrix, were not returned.

Despite being jilted at the altar when Aquila's own problems led to the termination of a takeover agreement, the Cogentrix story is a strong one, say financiers. It has a large fleet of assets under long-term contracts, generating a healthy cash flow, and its merchant exposure is limited, says one banker. The problem for the company is more to do with wider industry lending trends: the rating agencies are factoring in the possibility deals will not be rolled over and banks are increasingly looking to turn unsecured loans into secured facilities, notes one lender.

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Alliant Set To Close Club Deal

Alliant Energy Generation has finalized terms for a \$72.7 million eight-year non-recourse facility funding its acquisition of a 390 MW plant in Neenah, Wis., from **Mirant**. The deal will likely be wrapped next week, says one market official, and it will be a three-bank club consisting of **CoBank**, **ANZ Investment Bank** and **HypoVereinsbank**.

The financing, which has a 60:40 debt-to-equity split, was briefly conceived as a four bank group until **National Australia Bank** dropped out (PFR, 11/18). Still, given the deal's size, which resulted in \$23 million tickets for each lender, the need for a fourth player wasn't very pressing, says another market official. Typically on club deals banks seek internal credit committee approval with the rider that one lender may drop out, he adds.

The plant has six years remaining on a power-purchase agreement with **WE Energies**. While the PPA does not cover all of the eight-year loan, the loan has a number of cash traps, meaning the bulk of the debt will be amortized by the time the merchant tail is reached. Calls to **Mark Condon**, cfo at Alliant Energy Generation, were not returned.

Corporate Strategies

Illinois Power Bulks Up Issue Size

Illinois Power increased the size of a bond offering on Dec. 20 by \$150 million to \$550 million as distressed credit and high-yield investors flocked to the utility sector. **Karen Anderson**, an analyst at **Fitch Ratings** in Chicago, says, "It's heartening that Illinois Power was able to get it done because it originally tried to launch the deal in July." She explains that it put the deal on hold because it didn't get very good terms in light of downgrades from the rating agencies. The 11½% B3/BBB bonds due in eight years, were priced at 360 basis points over equivalent Treasuries. Officials at Illinois Power referred calls to **David Byford**, a spokesman at parent company **Dynegy**, who declined comment.

According to Anderson, Fitch assigned a BB minus rating to the mortgage bonds because of IP's relationship with Dynegy. She says that IP relies on a \$2.3 billion intercompany note from Dynegy's **Illinova** for a large portion of its operating cash flow and in the event that IP would not receive payments on the note, its financial condition would be adversely impacted.

IP is using the proceeds from the issuance partly to refinance some mortgage bonds due in 2003 and repay a portion of a \$300 million term loan, also maturing this year. Anderson says, "It was crucial that they get this money to finance these debt maturities because they don't have access to capital or liquidity."

Merrill Lynch and **Credit Suisse First Boston** co-led the deal.

TXU Sub Increases Bond Offering

Oncor Electric Delivery, a regulated utility unit of TXU, increased the size of a recent senior secured note offering by \$150 million to \$850 million because of strong demand from fixed-income investors. **Carol Peters**, a TXU spokeswoman, says, "There was such a strong appetite for the deal that we thought we'd sell even more notes and [earmark] the remaining \$150 million for general corporate purposes."

Peters notes that Oncor plans to use \$700 million of the issuance to pay off a similar amount of first-mortgage bonds coming due on March 1, April 1, and June 15.

The bond deal was divided into two tranches of \$500 million and \$350 million. The larger tranche has a 13-year maturity and 6% coupon, yielding 360 basis points over equivalent Treasuries. The smaller offering has a 30-year maturity, a 7¼% coupon and was priced at a similar spread. **Merrill Lynch** and **Credit Suisse First Boston** co-led the deal.

Alliant Goes Private For Speedy Execution

Alliant Energy Resources recently pocketed \$288.8 million from an issue of 9¼%, 10-year notes and chose to tap the 144a market to wrap the deal speedily before year-end. "The timing is quicker," says spokesman **Chris Schoenherr** of the reason for choosing a private placement over a wider public offering.

With demand strong at the 10-year part of the curve, the non-regulated arm of **Alliant Energy Corp.** ditched its original idea to also issue some five-year paper as well because it wanted to bulk up its medium-term debt to balance exposures along the curve, he adds.

The \$300 million issue is being used to repay short-term debt. The company was looking to execute the deal quickly in part because it wanted to demonstrate its access to liquidity, particularly in light of its Nov. 22 strategic plan to strengthen its financial profile, says Schoenherr. As part of that plan, Alliant Energy unveiled a number of initiatives, including asset sales and a proposed equity issue, both aimed at reducing debt by \$800 million to \$1 billion over 12 months.

On Dec. 6, **Standard & Poor's** lowered Alliant's corporate credit ratings to BBB+ from A-, reflecting its inability to achieve financial targets. "Alliant's credit-protection measures have shown some improvement in 2002, but the company still falls short of the measures Standard & Poor's expected the company to reach in order to maintain its rating," the agency noted at the time of the downgrade.

The private placement, led by **Merrill Lynch**, was also upsized from an original \$250 million. "The appetite was there for it," Schoenherr says.

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MARKET AWAITS

(continued from page 1)

Jose, Calif.-based IPP will be looking at both the corporate market with a \$1 billion secured revolver maturing in May and the project finance field to refund its trailblazing \$1 billion mini-perm construction revolver, which matures in November.

In terms of dollar refinancing needs for this year, Calpine doesn't make the top five in a recent analysis by **Standard & Poor's** (see table, at right). Financiers argue that behind the headline figures there is a positive undertow, and again many cite Calpine: the company has already started to lay the groundwork for taking out the mini-perm and is looking at a partial bond market takeout of the deal (PFR, 11/11).

On the corporate refinancing front, bankers are less sanguine and many are surprised that bankruptcies were avoided last year, particularly with the protracted stuttering at **PG&E National Energy Group** and **NRG Energy**. "People have been patient," says one financier.

Pat Kunkel, v.p. at **Erste Bank** in New York, expects bankruptcy filings to proceed this year. "I think you are going to see a couple of corporate-level deals that will force companies into bankruptcy because I think the lenders won't

be able to see a way out," he says.

While the roughly \$30-50 billion figure for mini-perm refinancing looks daunting, some commentators appear to have overlooked the fact that shorter-term project loans give lenders another chance to look at deals and alter the structure. "The benefit of the mini-perms is that the banks will have the

option to re-look at structures," says **Jay Worenklein**, global head of project finance at **Société Générale** in New York.

HypoVereinsbank's Mathews also notes that the maturing facilities are staggered over the next three years and don't hit the market in one shot. "The conclusion has been drawn, for some reason, that all the mini-perms have to be done in six

months. That's not correct. They are going to be spaced out over '04, '05 and '06," he says.

The impact of skidding power prices and sponsor instability is still going to be felt. "We will see a number of projects going into bankruptcy," says Worenklein. He adds that on a case-by-case basis, there may be opportunities for banks to profit because in some cases it will be sponsor problems undermining a financing, while the project is fundamentally strong. This situation may actually create some opportunities for banks to become equity investors, he reflects.

—Peter Thompson

Largest U.S. Debt Maturities	
Company	Total Debt Maturing in 2003 (\$ Mil) *
Reliant Resources	5,900
American Electric Power	4,463
TXU Corp.	2,966
Dominion Resources	2,650
Duke Energy	2,350
* includes commercial paper outstanding	
Source: Standard & Poor's	

Changing Of The Guard

Mid-Tier Banks Set To Benefit As Flows Thin

The roster of lenders atop the U.S. power project finance landscape this year is set to shift away from the traditional heavy hitters **Citibank**, **Credit Suisse First Boston**, and **Société Générale** toward the mid-tier commercial banks that are proving more willing to accept the slimmer pickings as deal flow dries up.

With the mega deals of yore expected to be thin on the ground, the move toward the smaller banks is likely to become ever more apparent, says **Mike Pepe**, head of project and export finance at **IntesaBci** in New York. "The big deals attracted the big banks. Those players have a high overhead, so the economics have changed against them," he explains.

The decision of **CSFB**—the 900 pound gorilla of the project loan market over the past few years—to scale back its project lending operations last fall (PFR, 11/4), underlines the changing landscape in project land.

But despite some lenders sounding the retreat, several large-ish deals came to market last year. The largest, trouble-free pure power deal of the year was **Tenaska's** \$497.2 million project financing for **Tenaska Virginia Partners** (PFR, 10/28). The selection of **DZ Bank**, **HypoVereinsbank**, **Bank of Tokyo-Mitsubishi**, **Credit Lyonnais** and **Dexia Credit Local** to arrange the financing highlights the changing market. While consistent players in project finance, the quintet have traditionally been outside the top three in terms of dollar flows.

Bankers say the deal's success lay in its solid structure, notably the backing of a strong tolling arrangement, but they also see the syndication of the deal's risk among 23 participants

2003 PREVIEW NORTH AMERICA (cont'd)

as crucial and a signal for the future. "Clubs have started to replace the single underwriter approach, particularly for larger deals," reflects **Didi Lacher**, senior v.p. at **Helaba** in New York. She adds that because of this, players outside of the top tier may take on more prominence.

Another deal cited by many as a prototype for the slimmed down future is the \$72.7 million loan for **Alliant Energy Generation**, which refinanced the acquisition of a plant from **Mirant** (PFR, 11/18). Its small size allowed three mid-tier players—**CoBank**, **HVB** and **ANZ Investment Bank**—to wrap up financing on a club basis and avoid syndication.

With a dearth of big-ticket plant construction programs, small project loans not only are becoming the order of the day, but also are peculiarly attractive to small and mid-sized lenders. First, the smaller shops don't require the fees embedded in a

large deal to cover the overheads of running a big syndication team. At the same time the easy digestibility of these deals mean small banks don't need to employ a syndicate desk to distribute the paper. "I think syndication is on life support because there are only a few mega deals on the horizon," reflects **IntesaBci's** **Pepe**.

The emblematic example of this shift is probably **Calpine**. After trailblazing with a pair of billion dollar-plus construction facilities led by bulge bracket banks in the last four years, the San Jose, Calif.-based IPP has shifted focus to the single asset financing approach. It wrapped a \$106 million deal for its Blue Spruce plant in Colorado via a small club led by **Credit Lyonnais** (PFR, 12/16) and has plans afoot for similar construction financing for a 600 MW plant in Wisconsin this year (PFR, 11/25).

U.S. Project Finance

New Flow Dries Up As Mart Faces Overbuild, Tight Spark Spreads

Last year's *annus horribilis* for the North American power project finance may be topped by even greater misery if bankers' bleak forecasts pan out. Financiers are expecting little if any new deal flow associated with plant construction as sponsors grapple with liquidity issues and also the fact that the construction boom of recent years has resulted in an oversupply of plants across much of the U.S. and tight spark spreads.

"Certain energy companies were encouraged by the markets to talk up growth," says **Mike Pepe**, head of project and export finance at **IntesaBci** in New York. That led to aggressive construction plans. Now, except in the West, there is no shortage of supply. "The push for growth was unsustainable,

just as it was with the dot-coms," **Pepe** reflects.

Pat Kunkel, v.p. project finance at **Erste Bank** in New York, argues that with so much capacity coming on line, "Two thousand-and-three will be a low point for spark spreads."

The gloom is pervasive for the short-term, but the long-term fundamentals for the market are strong. There is an inevitability to prices increasing, and for demand to eat up the supply, argues **Jay Worenklein**, head of project finance at **Société Générale** in New York. "The only issue is when it will happen." Worenklein puts that recovery in the five- to seven-year timeframe.

Many players are still grappling with the aftermath of 2002, when reverberations from **Enron's** collapse and the power crisis in the West continued to hang over the market. That was compounded by bearish investor sentiment and plummeting wholesale power prices, resulting in flows of project loans lower than most lenders envisioned 12 months back.

2002 Largest U.S. Energy Project Loans

Sponsor	Amount (\$Mil)	Launched	Project	Lead Bank(s)
MidAmerican Energy	875	May	Kern River pipeline expansion	CSFB, Commerzbank, Union Bank Of California
Tenaska	497.2	Aug	885 MW plant in Va.	DZ Bank, HypoVereinsbank, Bank of Tokyo-Mitsubishi, Credit Lyonnais, Dexia Credit Local
Progress Energy	440	Jan *	2,500 MW in new capacity	J.P. Morgan Chase
FPL Energy	425	Jan	535 MW plant, Johnston, R.I.	Citibank
Conectiv	365	May	1,100 MW, Bethlehem, Pa.	CSFB
Note * Significant structural changes unveiled Jan. 18				

Source: **PFR**

2003 PREVIEW NORTH AMERICA (cont'd)

"The big issue has been the complete collapse of power prices," says Worenklein. That became evident during the drawn out syndication for one of the bigger deals of the first half of last year; **FPL Energy's** \$425 million financing backing the construction of a 535 MW gas-fired plant in Johnston, R.I. Originally pitched as a merchant deal, the sponsor had to add an offtake guarantee in the face of lender skittishness about taking on exposure to spot prices (PFR, 7/8).

There is little argument over what were the standout deals launched and wrapped last year, in part at least because there are so few to pick from (see table, previous page). The Kern River deal attracted some 28 banks (PFR, 7/1) and is seen as one of the strongest deals of the year. Part of its success was down to its rarity value as a pipeline credit, but the backing of a strong rating and the high-profile support of **Warren Buffett's MidAmerican Energy Holdings** also ensured success.

Rating agencies proved another drag on the sector. Pepe discerns a change in approach at the agencies, which shifted their long-held stance that IPP businesses were investment-grade entities when the negative impact power price volatility would have on sponsors

became clear. While agreeing that the agency downgrades have hit the sector hard, another banker adds that lenders should have been more on the ball about the impact of rating triggers.

Bankers say one of the tougher questions to call is whether project developers are through the worst. "What will make a difference to the market is sponsors stabilizing. Let the guys who are going to file [for bankruptcy], file. That will reduce uncertainty but the ones that remain will have to improve their financial condition," says **Didi Lacher**, senior v.p. at **Helaba** in New York.

Despite the protestations of borrowers, lenders' concerns about shaky sponsors resulted in tightened credit terms. Bankers say the clearest sign of that is the two mega-deals that have been kicked around all last year but don't look like closing anytime soon: **Tractebel's** \$1.6 billion program deal (PFR, 11/25) and **FPL Energy's** planned construction revolver. The proposed size of the latter has shrunk over the year from a \$2-2.4 billion range to the sub-\$2 billion (PFR, 6/17).

In **Tractebel's** case sub-market pricing stalled syndication and **FPL** lost co-lead **Citibank**, reportedly because of its insistence on below-market terms (PFR, 5/6).

M&A

Merger Activity Set To Pick Up As Bargains Emerge

Merger and acquisition activity in the U.S. generation market could pick up pace this year as embattled power companies are forced to lower the sale price on power plants they're divesting in order to guarantee a quick sale.

Edward Tirello, managing director and senior power strategist at **Berenson Minella** in New York, notes that merger activity was undermined last year by the wide disparity between buyers' and sellers' valuations of power plants and other assets, but this could change. Sellers "are going to have to budge soon because it is estimated that about \$90 billion of

mini-perms are coming due over the next couple of years," he estimates.

Another New York banker adds activity was stymied by European utilities' reluctance to make good on earlier plans to invest in the U.S. They were unwilling to spend money for fear of weakening their own liquidity and nervousness about potential targets in the wake of **Enron's** rapid demise. "They're scared...because of the uncertainty. They're not going to come here anytime soon," forecasts the banker.

When prices come down the trickle of deals witnessed last year could turn into a torrent. "The assets we've seen to date have just been the tip of the iceberg," says **Tirello**. He notes that likely sellers include **Williams** and **El Paso**, which are still on the lookout to divest assets, and **Enron**, which plans to

2002 Largest U.S. Energy Mergers

Date Announced	Target Name	Acquiror	Deal Size (\$mil)	Target Advisors	Acquiror Advisors
7/29/02	Northern Natural Gas	MidAmerican Energy	1878.000	Merrill Lynch	Lehman
6/27/02	Sithe New England Holdings	Exelon	1693.000	Merrill Lynch	CSFB
4/29/02	CILCORP	Ameren	1344.938	Lehman, Lazard	Goldman Sachs
3/7/02	Kern River Pipeline (Williams)	MidAmerican Energy	960.000	Lehman	CSFB
4/15/02	Seabrook Nuclear Plant	FPL Group	836.600	JP Morgan, Jefferies	Merrill Lynch

Source: **Thomson Financial**

2003 PREVIEW NORTH AMERICA (cont'd)

offload the bulk of its U.S. and Latin American utility assets in short order.

While last year saw a handful of pipeline and plant sales, big-ticket corporate mergers were rare. This could change in 2003 if the utility sector stabilizes. "There was no time for big mergers because companies were too busy examining their balance sheets and making sure there were no skeletons in the closet. But if the sector settles down it might be a focus this year," forecasts Tirello.

Another New York banker speculates that similarly sized electric utilities with contiguous service territories are likely to tie the knot this year. "Utilities aren't in a growth mode because so many of them are in terrible shape so an easy way for them to get bigger is to team up with each other," he says.

In contrast to last year, 2003 will see the end of panic sales. Deals will be well thought out, rather than knee-jerk responses to credit rating downgrades, says Tirello, adding that buyers

also will be reluctant to make snap purchases. "Companies are scared to death now so they're going to buy assets with caution," he explains.

In terms of buyers, financial players such as **Kohlberg Kravis Roberts**, **Madison Dearborn Partners** and **Warren Buffett's Berkshire Hathaway** will continue to invest in the utility sector, Tirello says. "They have billions of dollars to spend and are looking to make investments in a solid industry. Utilities are a perfect fit because they're real. You can touch them," he says.

Tirello speculates that over the next 12-18 months there will be a whole slew of sales involving financial players. He adds that they will probably team up with industry players since they are not in the business of operating utility assets. Just last month, **AIG Highstar Capital** teamed up with **Southern Union** to buy **CMS Energy's CMS Panhandle** for \$662 million in cash and nearly \$1.17 billion in debt.

Traders See Light (At The Far End Of The Tunnel)

New entrants, in the form of banks and hedge funds, and the restructuring of debt overload through bankruptcy filings, will provide a much-needed fillip to power trading this year, but few market officials see a short-term rebound for the battered energy-trading business. "I think 2003 will be a continuation of the bad times," says **Dave Freeman**, president of consultancy shop **Team Power & Associates** in Plano, Texas.

As a swathe of trading outfits slashed headcount or exited the business last year, one of the few bright spots was the entrance of financial players into the sector, from hedge funds such as **Citadel Investments** (PFR, 10/21) and **D.E. Shaw** (PFR, 11/14) to Street blue-chip firms such as **Goldman Sachs** (PFR, 8/19) and **Bank of America** (PFR, 7/24). "They are a start," reflects **Nanch DeSchane**, president and ceo of **Duke Energy Services Trading and Marketing**, on the impact the new players will have on liquidity.

The liquidity they can bring is much needed. "People don't have the credit to buy or sell forward," says Freeman, a veteran of **Panda Energy** and **Aquila**. While that impacts the more speculative position-taking end of the market, it also hits the marketing end. DeSchane says marketing has held up relatively well, but without a deep trading market, players don't have as much freedom to lay off risk. "Today, with limits on liquidity, our focus is on products synergistic to our [generation] portfolio," she notes.

Creditworthiness will remain at the heart of the issue this year. The new financial entrants have it, but some of the more

beleaguered power players may attain it by filing for Chapter 11 and wiping the slate clean. "The creditworthiness of market participants will come back. In part because the indebtedness will get cleared by bankruptcies," reflects Freeman.

Information Flow

Sometimes lost amid the torrent of negative news are the fundamental rationales for being in the business. Freeman argues information flows, for one, are compelling reasons for players—from generation-owners to banks—to be in the business. "Trading is an information rich business and it complements other parts of an organization," he says, explaining that, for example, banks can get early information that will be useful to their lending operations in the sector. There is also a straight profit rationale, particularly on the marketing side. "We believe there is value to the customer in providing flexible and structured energy products," says DeSchane, noting that Duke's interest is in receiving compensation for that service. "It's nothing more complex than that."

One phenomenon that will gain pace this year—and will probably stay under the radar—is trading shops picking up power contracts from rivals looking to exit the business and wind down their trading portfolios. **Aquila** and **Williams** are two of the firms that have been offloading contracts, but buyers are unlikely to crow about the deals they're securing. "There are great contracts to be had. They are being bought quietly because of the expected capital markets reaction to such moves," says Freeman, explaining quoted companies don't want to be tarred with the continuing negative connotations of trading.

2003 PREVIEW LATIN AMERICA

Project Finance

LatAm Bankers Prepare For Another Bleak Year

The Latin American project finance market is set for another barren year despite the backlog of stalled projects requiring financing, because lenders and institutional investors continue to shy away from the region.

Some investors have been burned so many times they are no longer willing to inject capital in the Latin American energy sector, says **John Anderson**, director in the bond and corporate finance group at **John Hancock Life Insurance Co.** in Boston. "We've all been in Latin America and it didn't work out so I doubt it would work out now," he explained at a recent power conference in New York.

Dan Morash, managing director and global head of project finance for **CIT** in New York concurs. Investors will stay away because the risks of currency devaluation and corporate governance changes remain too high ktktk.

The inability of developers to execute project loans last year resulted in the cancellation of a large number of Latin power projects. **Gabriel Salas**, a Latin American equity utility analyst at **Bear Stearns** in New York, says, "The project loan market collapsed suddenly [in the latter half of last year] and caused a very quick financial drain. Once the availability of funds stopped, companies found themselves in a liquidity crisis and unable to continue construction on projects."

Project Cancellations

Adriana De Aguinaga, an investment officer at the **Inter-American Development Bank** in Washington, D.C., estimates that approximately 80% of projects either under construction or in the early development stage were cancelled in 2002. "The region is in need of additional capacity so even though this drop in development might not have an immediate affect, it will probably have a long-term impact on these countries," she says.

Financiers' downbeat forecasts contrast vividly to the mood 12 months back, notes one New York lender. "Before **Enron** collapsed, people thought business would pick up, but after[wards]...there was a loss of confidence in the sector and everyone was running for the hills. Since so many projects are being halted, the near-term prospect for project finance looks grim."

The slew of projects that have been delayed include **Alcoa's** \$700 million Santa Isabel hydroelectric project (1,087 MW) in Brazil (PFR, 7/22), **El Paso's** \$340 million Araucaria gas-fired project (469 MW) in Brazil (PFR, 7/4) and **InterGen's**

\$700 million Carioba gas-fired project in Brazil (PFR, 12/9).

But a small handful of deals were successfully executed included the financing for Termopernambuco, a 520 MW \$290 million combined-cycle natural gas-fired facility in the state of Pernambuco, Brazil, which closed in June (PFR, 7/15). Lead banks **Banco Bilbao Vizcaya Argentaria** and **Société Générale** put together a \$160 million non-recourse loan and six other banks committed to the deal. Low gearing and a strong offtake contract facilitated this deal's passage.

M&A

Merger Activity Falters As Bidders Fail to Materialize

The Latin American utility sector is unlikely to witness many mergers or acquisitions this year, forecast market watchers, because potential bidders are being scared away from the region by economic volatility, regulatory and political uncertainty and fears of further currency devaluation.

Even if the regulatory environment improves, the level of M&A deal flow will rest on whether the capital markets open up again, says **Gabriel Salas**, a utility equity analyst at **Bear Stearns** in New York. "The power sector is a capital intensive industry that needs cheap financing to operate well. If the bond and loan markets don't give it a thumbs up, but instead call for caution, then few deals will get done as there aren't many companies able to shell out a couple of billion dollars to make acquisitions," he explains.

The stumbling block in 2002 was a dearth of buyers. "You have a number of companies looking to get out of Latin America and sell everything, but nobody wants to buy. The market for selling assets is saturated," laments Salas.

Despite the tough environment a handful of sale were executed. The largest deal of last year was the Peruvian government's agreed sale of two generators, **Egasa** and **Egesur**, to Belgium's **Tractebel** for \$167.4 million. Bankers say the deal was the only Latin utility privatization to be successfully executed last year. The offer from Tractebel, the sole bidder in the public auction, was just above the \$156 million base price set by the government.

Commenting on Tractebel's acquisition, Salas says, "Tractebel is very unusual in that even though the market collapsed, it has managed to do quite well. It is one of the only companies that has the ability to make acquisitions in this environment," he says. Salas points out that other international developers such as **CMS Energy**, **AES**, **Endesa**, **Duke Energy** and **NRG Energy** all have retreated because of a loss of investor confidence in the region, which has weighed on their share prices back home.

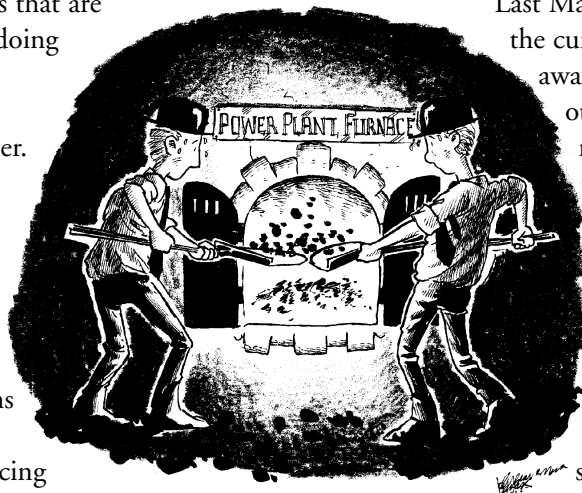
2003 PREVIEW EUROPE

U.K. Financiers Focus On Restructuring, Ready Plant Takeovers

The City's power project finance community is set for another tough year as financiers grapple with restructuring the slew of existing U.K. power plant project loans that are either in default or perilously close to doing so. "The name of the game is damage limitation rather than courting new business," says one London-based lender.

The near 40% fall in U.K. power prices last year left all merchant plant financings and a lot of other project loans close to default. "You show me a merchant plant and I'll show you red ink," says the lender. Another adds that there are at least eight project loans that will need to be reworked over the next few months. These include financing for AES DRAX, British Energy's Eggborough plant, and debt associated with the Damhead Creek, Enfield and Killingholme plants. Alan Baker, head of power at Credit Lyonnais in London, estimates that between 5-10 GW of plant financing in the U.K. may have to be reworked.

Some U.K. power plants are in such a weak financial state



that it's looking increasingly likely that their equity investors and operators could walk away from the plants and hand over the key's to the plants' financiers. Now that their equity investment in the plants has become worthless, there's little incentive to remain, explain financiers.

Last March AES became the first sponsor in the current generation market crisis to walk away from a U.K. plant (PFR, 4/1) and others could follow suit. Entergy is reportedly considering handing over the keys to its 800 MW Damhead plant in Kent if it cannot find a buyer shortly.

Some of the U.K.'s largest project lenders also have begun discussing the possibility of pooling their project loans together if the equity owners forego ownership and create a large bank-owned IPP. Neil Bedall, a power sector bond analyst at Barclays Capital in London, says such a structure could make

sense for banks not wanting to take a significant write-down on their project loan books, but warns it would not help relieve the main underlining problem that's bedeviling the U.K. generation market, namely oversupply. "This would merely perpetuate the problem," he argues.

Exodus

U.S. Players Retreat Stateside

A swathe of U.S. energy merchants and independent power producers look set to withdraw from Europe's power markets over the next 12 months, continuing a trend that emerged last year in the wake of Enron's collapse and increased rating agency and investor scrutiny over power companies' liquidity margins. "U.S. equity investors are pushing U.S. utilities to focus on core domestic operations and enhancing liquidity, and are punishing them for speculative trading and merchant operations overseas," explains Adrian Barton, head of power trading at NRG Energy in London.

All but the most committed North American europhiles are set to scale back their operations or exit the continent completely in 2003, predict market watchers. The likes

of NRG Energy, Aquila and Dynegy already have put their wires or generation assets on the block as part of a full-scale withdrawal. Others, such as Duke Energy and Reliant Resources, have clipped the wings of their trading desks in an attempt to rein in costs.

TXU's decision to cut adrift its TXU Europe subsidiary last fall was perhaps the most dramatic departure of the year. The move shocked like no other U.S. exodus because TXU had spent considerably more time and money than most in building up a vertically integrated utility business. Despite the depth of this investment, the decision to exit Europe seemed to be made within a matter of days following the stock markets' brutal response to the announcement of losses at TXU's European arm.

Following the announcement of U.K. losses on Oct. 4., U.S. investors sent TXU shares hurtling southwards. Within



2003 PREVIEW EUROPE (cont'd)

five days the shares had fallen more than 50% to \$16.25. On Oct. 9 Dallas-based TXU decided to cut its losses and pulled the plug on a pending \$700 million bailout to restructure U.K. power contracts, a move that effectively cast the subsidiary adrift with little chance of survival. TXU Europe duly filed for bankruptcy on Oct. 14, following the sale of its five million U.K. customer business to **E.on**.

While U.K. trading losses played a pivotal and unique role in TXU Europe's demise, the failure was emblematic of most U.S. failures in Europe. Like many of its U.S.

counterparts TXU Europe was felled primarily by external factors beyond its control, most notably a funding and liquidity crisis at the parent level and a loss of confidence among U.S. investors, explains **Ross Hunter**, U.K. utility trading leader at **PricewaterhouseCoopers**. "Most were forced to draw in their horns because of a lack of access to the capital markets in the U.S.," he argues, adding the need to post significant amounts of trading collateral following Enron's collapse became too burdensome for many trading shops to keep afloat.

U.S. Players: Who's Left In Europe?

OUT

Aquila

Trades: Has ceased trading
Assets: **Midlands Electricity**
Comment: Has closed London and Essen, Germany offices and is looking to sell its U.K. wires business (Midlands Electricity)

Duke Energy

Trades: U.K. and France
Assets: Rouen CHP (103 MW, France)
Comment: Ceased trading German, Italian and Nordpool markets in September and plans to exit the U.K. and French power markets early this year.

Dynegy

Trades: Is winding down its European power trading business
Assets: Has agreed to sell Dynegy Storage, its U.K. gas storage business
Comment: N/A

El Paso

Trades: Is looking to wind down European trading business
Assets: Fife (115 MW, U.K.), Enfield (396 MW, U.K.), Kladno (350 MW, Czech Rep.), EMA (70, Hungary)
Comment: Plans to exit Europe

Mirant:

Trades: Has ceased trading
Assets: None
Comment: Has sold 44% stake in German utility **Bewag** and 49% stake in U.K. utility **Western Power Distribution**

NRG Energy

Trades: U.K.
Assets: Enfield (380 MW, U.K.), Killingholme (680 MW, U.K.), Mibrag (380 MW, Germany)
Comment: Is looking to sell assets

TXU Europe

Trades: Is winding down business
Assets: Two German utilities (**Braunschweiger Versorgungsn** and **Stadtwerke Kiel**)
Comment: Has sold U.K. customer business and plants. Is looking to sell German and Nordpool operations

Williams

Trades: : Has ceased trading
Assets: None
Comment: Closed down trading operation in September.

IN

Cinergy

Trades: U.K. power
Assets: Ely (30 MW, U.K.) Redditch (40 MW, U.K.)
Comment: No plans to exit trading, but will consider sale of assets

Edison Mission

Trades: U.K.
Assets: First Hydro (2,088 MW, U.K.), Lakeland (220 MW, U.K.), Derwent (214 MW, U.K.), Spanish Hydro (82 MW, Spain) IVPC2 Wind (283 MW, Spain), Doga (180 MW, Turkey)
Comment: Has no plans to exit market

Entergy

Trades: Trades European power markets through **Entergy-Koch Trading**, a JV with Koch.
Assets: Damhead (800 MW)
Comment: Is reportedly looking to sell Damhead.

Reliant Resources

Trades: Belgium and surrounding markets
Assets: Una portfolio (3,478 MW, Belgium)
Comment: Closed London trading desk in September

Bankers Turn Gaze Southwards

With the U.K. power market mired in financial chaos, project bankers are pinning their hopes on project level financing opportunities emerging in southern Europe and the Middle East, though most predict deal-flow will remain thin at best.

Abhay Ketkar, at ANZ Investment Bank in London, says the main area of new project loan activity in Europe will likely be Spain and Italy. He notes for example that Tractebel is seeking project level financing for its acquisition of the 2.6 GW Interpower generation portfolio from Enel. Others note that U.K. IPP International Power is looking to develop a number of greenfield projects in Italy.

Despite its troubles back home lenders are cautiously optimistic that U.S. developer AES in conjunction with an

offtake agreement from Gaz de France will forge ahead with its much delayed 1.2 GW Cartagena IPP in southeastern Spain (PFR, 8/12). Another Iberian deal that could reach the market this year is a roughly EUR500 million loan financing a portfolio of wind farms being built by Madrid-based Grupo Dragados. Westdeutsche Landesbank, La Caixa and Dexia Credit Local have been retained to arrange the deal (PFR, 7/30).

Bankers also predict that the Middle East could prove a fruitful market, though ANZ's Ketkar cautions that much rides on how the situation in relation to Iraq pans out. Abu Dhabi is likely to be a focus of attention with two of the biggest project mandates, Um al Nar and Taweelah A10, likely to reach the bank market over the next six months. Ketkar is also optimistic that we could see an IPP in Oman, and ECA-supported IPP financings in markets like Iran and Jordan.

QUOTES OF THE YEAR 2002

"It was the best of times. It was the worst of times." So wrote novelist and renowned fence-sitter Charles Dickens of the French Revolution. The unparalleled upheaval in the transatlantic power industry this past year witnessed a similar dichotomy of sentiment from industry participants:

The Cup's Half-Empty



- *"It would be a logistical nightmare."*—Neil Beddall, credit analyst at **Barclays Capital**, commenting of some U.K. banks' plan to set up a lender-sponsored generation company to encompass many of the near-bankrupt U.K. power plants (PFR, 12/23).

- *"Knuckles are going seriously white at 13%."*—Mark Robinson, utility equity analyst at **Commerzbank** in London, commenting on worries that tightening generation capacity margins in the U.K. could lead to power shortages (PFR, 12/16).

- *"You couldn't have picked a worse time to unload the business."*—Derek Gordon, head of project finance at **Abbey National Treasury Services**, reflecting on ANTS' decision to unwind its GBP3.25 billion project loan portfolio (PFR, 12/9).

- *"There are just too many guys trading too little stuff."*—Ed Tirello, managing director and senior power strategist at **Berenson Minella** in New York, commenting on **Duke Energy International's** plan to scale back its European trading operation (PFR, 10/14).

- *"New York is in trouble. Big Trouble."*—John O'Brian, principal at **Skipping Stone**, warning about the potential for summer price spikes in the Big Apple power market (PFR, 4/29).

The Cup's Half-Full



- *"We're in the same pot of stew as everyone else, but there are some good companies in the pot."*—Jim Gipson, v.p. at **Williams**, commenting on the tough environment facing the Tulsa, Okla. energy trader and the rest of the U.S. energy trading and power industry (PFR, 6/24).

- *"This is the perfect time for a company that has traditionally picked low hanging fruit to buy an orchard."*—Warwick Busfield, an analyst at **Fahnestock** in New York, praising **DTE Energy's** decision to hunt for acquisitions while valuations remain depressed (PFR, 11/25).

- *"It is not a big deal. It is just a question of flipping the name on the door."*—Thor Lien, managing director of **AEP Energy Service's** Nordic weather team, reflecting on **AEP's** decision to sell the operation less than a year after it was acquired from Enron Nordic Energy (PFR, 11/11).

- *"We think the market's there for the taking."*—Karl Miller, co-founder of private equity boutique **Miller McConville & Co.**, enthusing about investment opportunities in the embattled U.S. generation market (PFR, 11/4).

EXELON SEEN

(continued from page 1)

located in Pittsburgh, would bridge the geographic gap Exelon has between its **ComEd** utility in northern Illinois and **PECO Energy** in southeastern Pennsylvania. He adds DQE might consider foregoing its independence as this would be one of the easiest ways of boosting shareholder value in a depressed market that offers little organic growth opportunities.

The talks mark at least the second time that Exelon has courted DQE in recent months. In September **Oliver Kingsley**, senior executive v.p. at Exelon, told *PFR* it planned to acquire an integrated utility in the Northwest or Midwest while valuations remain depressed (*PFR*, 9/9). Kingsley was not available to discuss the matter late last week as he was traveling on business.

Bankers later said it was courting a handful of regional utilities including **Cinergy**, DQE, **NSTAR** and **CMS Energy** (*PFR*, 9/23). In November, Exelon entered serious discussions

with two separate utilities, including DQE, but talks broke down because they couldn't agree on pricing (*PFR*, 11/25).

Commenting on the decline in valuations, a New York banker says that over the past two years valuations for healthy utilities unsoiled by scandals have declined 20%-30% and are continuing to do so. "It is likely that DQE thinks there is going to be very little increase in its value, if any, and it has therefore decided to get whatever price it can get now. On the flip side, if it waits its value could decline further," he says.

Exelon operates the largest nuclear fleet in the U.S. with 10 power stations, representing approximately 20% of the country's nuclear power capacity. Its utilities distribute energy to more than 3.4 million electricity customers in northern Illinois through ComEd and 1.5 million electricity and 430,000 gas customers in southeastern Pennsylvania through PECO Energy.

Pittsburgh-based DQE is the parent of **Duquesne Light**, a transmission and distribution company, which delivers energy throughout southwestern Pennsylvania. —*Amanda Levin*

CALPINE LOOKS

(continued from page 1)

of the two portfolio loan facilities, cash flows from operational plants are used to finance units under construction, but Calpine also has to stump up fresh funds. It wants to restructure the deal because it doesn't have the cash on hand, reasons **Jeff Wolinsky**, credit analyst at **Standard & Poor's** in New York, who was unaware of the plan.

Calpine plans to increase liquidity via asset sales and raise cash via leaseback structures. But at the moment it would be tough for the company to inject the \$700-800 million needed to meet its construction guarantees under the financing, say bankers.

Calpine is waving the carrot of accelerated amortization rates on the two construction revolvers to get lender approval for the project cancellation. The IPP has offered to divert the cashflow from operational plants—that was originally earmarked to complete the five projects—to pay down loan principal, says one financier mulling the amendment.

For example, by the time the \$1 billion project revolver dubbed CCFC 1—which has six out of its nine plants funded and operational—matures in November, the released cashflow would take the principal down to \$900 million, the financier explains. The change is also being sought for the \$2.5 billion CCFC 2 loan, which has 10 out of 12 projects online and matures next year.

Financiers say it's unclear which way the banks will vote. One banker says the heart of the issue is the value assigned to the unfinished plants as this affects the security package on the loans. Completed plants generate cash and so have a relatively easily discernible asset value when compared to an uncompleted

facility. While some bankers see value in work already put into construction, others treat the value more as an option on generation that may have no immediate value. The potential for technical issues to impact a project when construction starts again can also make valuation tricky, says one banker.

There appears to be a gulf between those favoring approval of the changes and others who think the banks are not extracting enough from Calpine in return for letting it out of the construction guarantee. One project financier says the banks are not pushing hard enough, adding lenders would not be sufficiently compensated for the impact the cancellations will have on the security of the loans.

—*Peter Thompson*

Quote Of The Week

"Syndication is on life support because there are only a few mega deals on the horizon."—**Mike Pepe**, head of project and export finance at **IntesaBci** in New York, commenting on the viability of large project loan syndication desks, given the small size of most deals in the project loan pipeline (see story, page 5).

One Year Ago In Power Finance & Risk

Cogentrix Energy, a privately-held Charlotte, N.C.-based independent power producer, was looking for a merger partner and had hired **Goldman Sachs** to find a suitor. [**Aquila** announced its intent to purchase Cogentrix in April, but both companies terminated the agreement in August, citing a volatile and uncertain market.]