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Has Sithe Global changed with the IPP market?

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Sithe Global, one of the most storied names of the 1990s independent power project boom, is back. Does its Bujagali financing signal a new approach or business as before?
Catherine McGuirk talks to Thomas DeLeo, Sithe's chief operating officer.

Redirected Energies

The name Sithe embodies a very particular moment in global power markets, when the US model of private power development spread across the world. Sithe Energies developed a substantial portfolio in the US, as well as a number of projects in Asia, Africa and Latin America. Since the implosion of Enron, which pursued a similarly diverse set of prospects, US independent power developers ceded ground, and sold assets, to local, Asian and European multi-utilities.

Sithe, which was gradually dismembered at the start of the decade, is now back. Sithe Global, its current permutation, has been in operation since 2004, and was formed with much of Sithe Energies' management. In 2005, private equity group Blackstone acquired an 80% stake in the company, with Reservoir Capital, a hedge fund that had provided the venture's initial seed money, retaining 20%. Bruce Wrobel, Sithe's CEO, has a long-established relationship with Reservoir.

The developer has an active portfolio in the United States and Canada, with a number of projects in development, involving a diverse range of fuel types and technologies. It also has a pipeline of global projects, including ventures in the Yemen and Italy. Its expected equity investment in its development projects is $500 million. But the Bujagali financing, the new Sithe's second project, heralded Sithe's return to emerging markets, and its attempt to replicate the 90s spread of assets.

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At the end of 2007, Sithe closed the financing for the 250MW Bujagali Energy hydropower project in Uganda. The $880 million project featured $681.8 million in debt, which was provided by multilateral institutions, the European Investment Bank, the International Finance Corporation, the African Development Bank, FMO, DEG and Proparco (AfD), and also included $115 million in bank debt from, ABSA and Standard Chartered. The project also featured multilateral risk and investment guarantees, from MIGA and IDA.

Thomas DeLeo, the company's chief operating officer, explains that, while maintaining and cultivating a presence in other regions, "Many of the opportunities in Africa present Sithe Global with the right combination of project size and the type of development we have a depth of experience in, and are most comfortable with. These projects are interesting not only from a dollar and cent perspective, but also because of the impact they have on the relevant countries and communities."

The company generally favours greenfield development over acquisitions, says DeLeo, "unless there is a very good reason. For this reason, we have not participated in a number of the auctions in the past, for example, the Mirant assets in the Philippines."

He continues, "We are looking at unique market opportunities, and have a strong appreciation for private investment in developing regions."

First time round

Sithe Energies began in the US market with the 1,000MW Independence combined-cycle plant in New York, which closed in 1994. It also entered the global market place with international developments in Canada, Australia, Thailand and Pakistan, and with the large San Roque hydro project in Manila, in the Philippines.

San Roque is a multi-purpose hydro project, which Sithe Energies developed with Consi and Marubeni. It is now operated by Marubeni. The 200m dam had a contracted capacity of 350MW, and a designed capacity of 380MW, and when the developers closed its financing in 1997, it was the largest privately-financed hydro project in Asia, though it closed under fraught conditions in the midst of the Asian financial crisis. The crisis did not have any major impact on the financing, but the Thai contractor from the bidding stage went bankrupt, and the sponsor brought in Raytheon, with which it collaborated on later projects.

The financing bears some resemblances to Sithe's current projects, such as Bujagali, with the use of multilateral support, and the build, operate, transfer model. JBIC led the San Roque financing with a group of commercial banks in a 60/40 split. The project was funded with roughly $400 million from the government, with $200 million in equity and $500 million in debt. DeLeo explains that the government involvement with San Roque meant that the project had a very low weighted average cost of capital.

In 1999, Vivendi, Sithe Energies' major shareholder, began to focus on its multimedia properties, and decided to move away from infrastructure. The company was first acquired by Exelon, and then the assets were divested. "It was challenging to disassemble the portfolio we had worked so hard to build" says DeLeo. "Vivendi sold out at the time the energy market was at its peak, before 2001 when the market changed so drastically. After that the company was divested, and prior to that Bruce [Wrobel] had left."

Development, noughties-style

In Canada, Sithe Global is currently developing two projects in Ontario. The greenfield Goreway project in Brampton, is a 875MW natural gas combined-cycle plant, on which Sithe is the sole sponsor. The $1.1 billion deal closed with a mini-perm debt financing, with a term of construction plus five years. The construction phase is due to be completed by the end of 2008.

Brian Kubeck, a senior vice-president at Sithe Global, explained what was a winding road to closing the project: "Our bid lost, then the project was re-awarded. We negotiated the power purchase agreement with the Ontario Power Authority, which is actually an accelerated clean energy supply agreement, rather than a straightforward PPA [power purchase agreement]."

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The agreement involves an imputed revenue stream which is calculated according to certain formulas. If the revenues fall short of what Sithe bid as its net revenue requirement, the company receives a top-up payment from the OPA. If the revenue exceeds the requirement, 95% of the excess goes back to the OPA. The contract for differences approach, which has been repeated on projects from Invenergy and Calpine/Mitsui, allows Ontario to add capacity quickly and inexpensively, but work within the province's partially deregulated power market.

Sithe's other Ontario project is the Southdown 800MW natural gas-fuelled, combined cycle, which would also be a greenfield development, but has yet to start construction. Sithe needs to have a committed PPA in order to begin construction, and expects to bring the project to market within six to twelve months.

Kubeck notes that Sithe Global has found that, "The Ontario merchant power market was not attracting investment, and locational advantages were not fairly valued by the merchant market. The company's permitted Southdown site is in a busy corridor, where it would prove very difficult to find any other site." The Goreway project was subject to similar market conditions in those respects.

Its other North American projects are also awaiting financing and/or power purchase agreements. The portfolio is notably diverse in terms of fuel types and technologies. In the US, its planned projects are: Desert Rock, a proposed 1,500MW coal-fired plant, with two 750MW supercritical coal boilers next to the Navajo mine in San Juan county, New Mexico; River Hill, a proposed 290MW waste coal-fired plant in Karthaus, Pennsylvania; and Toquop, a proposed 750MW supercritical coal boiler project in Mesquite, Nevada.

DeLeo says that the Desert Rock project is in advanced development, with PPAs with various parties under discussion, and that Sithe is close to achieving permitting in New Mexico but has not yet closed on the project. Though Sithe maintains that the project is socially responsible, Desert Rock project has received a lot of bad press, pertaining to its location, and has split the project's hosts, the Native American Navajo nation.

Sithe Global is also developing the 1,000MW Teramo natural gas-fired project in Abruzzo, Italy; and the Ma'arib natural gas-fuelled project in Sanaa, in the Republic of Yemen. This latter project is a 50/50 joint venture with Consolidated Contractors Company (CCC), and has a 25-year fuel supply agreement with government.

In terms of how to finance this pipeline of projects, Kubeck says that, "the commercial bank market is our general preference, but we may consider converting to a capital markets financing after close." He also cites the positive experiences the company has had with multilateral financing where needed.

However, Sithe Global has noticed that the recent market turbulence has increased its cost of borrowing. Says Kubeck, "Spreads have widened to compensate banks as the cost of funding has increased, in some cases by as much as 60bp over Libor. This increase is passed to borrowers."

In the US, Sithe can also eke out some savings by using state tax-exempt bonds, where its fuel choices permit this. For the River Hill facility, the project will be eligible for tax-exempt financing because of it uses waste coal as a fuel. The project also benefits from its proximity to the waste coal sites, which keeps transport costs down. Though the capital costs are higher in installing the boilers, Sithe is taking the longer-term view that post-investment, the operating costs are significantly lower after the plant is built.

Africa the prize

Says DeLeo, "We want to be more involved in Africa, expanding on our resource base, as we view the region as having a lot of untapped investment potential, where there is a fair return for the risks taken. Our global attitude is that, in markets where the potential for a successful development project exists with a fair risk-adjusted return to the developer, there is a stronger likelihood of adding value in resources, job creation, and creating domestic wealth."

However, the risks in certain African regions are recognised, and the use of multilateral financing and guarantees speaks to that risk profile. Though DeLeo is aware of the challenges of developing such a large project in Uganda, he also views certain risk aspects as transcending borders. "Offtake and offshore risks are not geographic, revenue is needed domestically, for example in Guinea, and its mines have run for 40 years uninterrupted. The way risk is ▶

considered is important, as Bujagali is tied to the Ugandan economy, but political risk is only one of many risk considerations." For Bujagali, the primary mitigating factors were insurance from MIGA for the commercial banks and a partial risk guarantee from the IDA.

Tom Vis, a senior risk management officer at MIGA, explains that because Uganda is a landlocked nation, it was affected by the hostilities in Kenya in early 2007, and its road and rail links were cut off.Since these are the means for transporting heavy fuel for thermal projects into the country, power costs went up.

The project's previous developer was AES, and it has been under consideration for around 20 years *(a more complete account of the project's history can be found by searching "Bujagali" at www.projectfinancemagazine.com).*

Kubeck cites Bujagali as "a good example of a sustainable development due to the collateral effects of relieving the power crisis of the country. We will be able to supply power with a drastic reduction in cost," noting that "currently there are additional risks of shortages and emergency thermal generation, resulting in costs as high as $0.23 per kWh, and ultimately Bujagali will bring the cost of power down to around 6 cents per KW/hour, and avoid rolling blackouts. It is a question of how we handle the country risks."

Vis notes that, "only 5% of those who demand power in the country have access to it, but Bujagali could raise that to 10%. At peak demand times, there could be demand for around 300MW hours, and there is only 130MW on the whole grid." The benefits are tangible for a project that will initially provide a third of the energy supply, in a sub-Saharan country that was suffering from both social and economic fallout due to the power shortage crises.

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Sithe is now considering looking into a number of other African projects, and not only in the power sector. Kubeck suggests that it is possible for the company to "leverage off its experience into the infrastructure market, but without losing its appetite for power projects." SEACOM's financing, which was developed by a non-Blackstone-owned affiliate, with some Sithe's management, is the first example of this approach.

The SEACOM pan-African fibre-optic cable deal, which also closed in 2007, was initiated by some of the senior developers at Sithe Global, but was never part of the company's portfolio as Sithe and Blackstone have to date focused on power projects.

SEACOM's president, Brian Herlihy suggests that Sithe Global could replicate the deal on similar upcoming projects. Though, he says, "the project could not have been done without the guarantees, there are six other similar projects available, in Mozambique, Zambia, two in the Congo, and Ethiopia. There is hydro potential with Eskom too."

Returns and responsibility

Blackstone's interest in the company has changed how Sithe Global does business. DeLeo notes that Blackstone has a strong investment history in power, with very profitable investments in Texas Genco and Foundation Coal, for instance. Blackstone, like any other private equity firm, has an investment horizon much shorter than the term of a typical power project concession.

However, DeLeo also notes that the Sithe underlying philosophies have remained since Blackstone's involvement in 2005: "Our mandate is to develop power projects globally, to meet the demand and need in the market. The management and development group at Sithe is seasoned in sophisticated projects, and has the capacity in the generation business to achieve success in challenging projects, not only with a financial benefit to the off-taker, but also for the local population."

But Blackstone has an atypical tolerance for the lead times involved in developing infrastructure projects, which suits Sithe well. "Blackstone understands greenfield as a business model, and recognises the timeframe associated with it." Kubeck believes that these virtues are unusual, "Not all private equity is ideally suited to development, but razor-thin margins on M&A deals have created opportunities to accept some development risk, for enhanced returns."

To illustrate the potential in the region, Herlihy cites Billiton's Mozal aluminium project in Mozambique, which closed in 1998 at a time when, he notes, "there was very little investor confidence in the country."

However, the Sithe team regards that deal as an early example of a successful project financing in the region, and one which has influenced both the market and Sithe's investment strategies. It was a successful deal in a relatively untapped market, and by mitigating the associated political and economic risks, the sponsor used the market to its advantage. The example is instructive because another of Wrobel's companies, Global Alumina, is developing a $4.5 billion bauxite project in Guinea, accounting for a third of the country's bauxite, and has five more projects in the pipeline in Guinea. It is currently the largest infrastructure project in the country.

Sithe Global, like Sithe Energies, is looking eventually for an exit option, though not within a predetermined timeframe. "There is no ideal selling point, or preferred time to sell assets," says DeLeo. The risk of a project is higher at the start and goes down, but we see value in being close to the community, creating opportunities for lease back, sale or renegotiation of contract. But there is an added value in bringing a project online."

While, for now, Sithe has managed to reconcile the financial expectations of its principals and its business with the expectations of its private equity owners, managing the conflict between its responsible aspirations and its local critics is more troublesome. Many of its projects have faced public resistance in some form or another. It now needs to win the argument that the benefits of increased power capacity in constrained markets outweigh the potential social and environmental disruption. ■