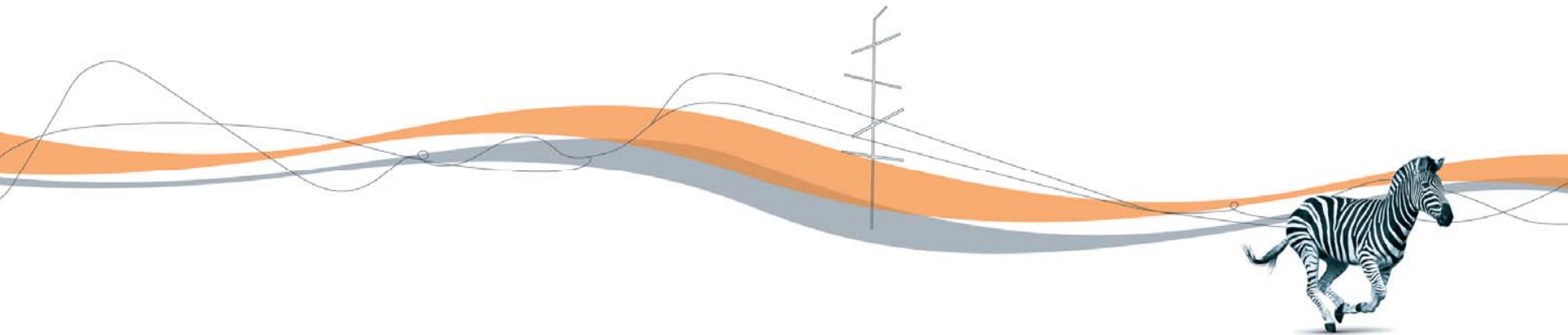


Raising capital for renewable energy projects after the Global Finance Crisis

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Agenda

- Project debt vs. corporate debt
- How project finance used to work pre-“GFC”
- How it is working now
- Equity market expectations for ROI – then and now
- The outlook for project finance

Project Debt vs Corporate Debt

- Or: It's all about certainty of cashflow

How Project Finance Used To Be

- Historically (until 2 years ago) infrastructure and power financing was dominated by long-term bond financing (CPI or AAA-wrapped) and/or bank financing
- Bond financing was for terms of 25+ yrs, for bank debt 10+ yrs not uncommon
- Pricing was as low as sub 50bps for bond financing (including wrap costs) and not much more for bank financing
- Banks would underwrite debt issues – up to \$500m or more per bank providing fast and competitive financing terms
- For large power projects (e.g. Loy Yang A) or regulated assets (e.g. Powercor) bond financing was common. For smaller generation projects bank financing was the norm
- Liquidity was abundant and supply exceeded demand
- Power projects well-supported by the bank market (proven asset class)

How Project Finance Used To Be (cont.)

- Supply exceeded demand
- Strong competition between debt providers chasing projects
 - Abundant capital
 - Low pricing
 - “Light” terms and conditions
- Debt finance driven by price and terms

Bank Financing Today

- Liquidity is tight, though power projects still sought (strong fundamentals)
- Virtually no banks are underwriting – the syndication risk is too high – they will only lend what they are willing to hold
- Several foreign banks have withdrawn from Australia (e.g. Toronto Dominion, Dexia) many others have stopped lending. There has also been rationalisation (e.g. ABN AMRO / RBS), rescues or failures which have reduced competition.
- Several smaller local banks have also retreated (e.g. Suncorp)
- Hold levels are down below \$100m per bank – as low as \$50m
- Gearing is down, ratios are up, pricing is up (300-350 bps margins, 200bp up-front), term is in (3-5 years preferred), conditions are tighter (e.g. market disruption, review events)
- Risk appetite has been significantly reduced
 - No merchant risk, no technology risk, tight requirements for EPC arrangements, etc
 - Many renewable energy sources are not technologically proven or have patchy track records

Bank Financing Today (cont.)

- How are banks rationing capital?
 - Relationships
 - Rock solid credit (proven technology, fully contracted offtake, EPC delivery, solid straightforward contracts, strong counterparties, simple structures, nothing unusual)
 - Attractive pricing
 - Favoured sectors or regions (varies by banks)
 - Alternative sources of income (advisory, swaps, agency, etc)
- The good news:
 - Local majors are still lending
 - Some foreign banks have confirmed their presence in Australia
 - Power (particularly renewables) is generally a favoured sector
 - Pricing is gradually tightening downwards
 - Good projects under \$300m debt should get financed

Bank Financing Today (cont.)

- Demand exceeds supply
- Low competition between debt providers – projects chasing lenders
 - Scarce capital
 - Relatively high pricing
 - “Belt-and-braces” terms and conditions
- Debt finance is being driven by availability of capital, not pricing or terms
- Ask not “is my project bankable?”, rather: “how bankable is my project relative to other projects or lending opportunities?”

Bond Financing Today

- AAA-wrapped bond market is non-existent. The monoline insurers have all been downgraded and bond investors have lost confidence in ratings
- Many wrapped bonds were going into structured vehicles and securitisations which are no longer viable so demand has dried up
- Local institutional investors aren't buying project bonds. There may be some CPI appetite but hasn't been much tested
- Some US corporate bond activity has been happening (e.g. Woodside) but nothing on the project front
- Even PPPs (government-related revenue streams) are not getting bond financing

Export Credit Agencies Today

- ECAs are government agencies that support their country's manufacturers, contractors or investors
- Traditionally ECAs have provided support where financing was hard to obtain (e.g. developing countries) but today that is everywhere
- Tend to be constrained by lots of rules and often slow to move but are now showing some more responsiveness and flexibility
- We have seen some activity in the power sector in the past (e.g. Bluewaters) but because finance has been so available they have not been a big feature
- Today ECAs are a real alternative especially for large projects
- Examples: EIB (Europe), Hermes (Germany), EKF (Denmark), EFIC (Australia), JBIC (Japan), DBJ (Japan), KEXIM (Korea)

Looming Supply Demand Imbalance

- Increasing Demand For Infrastructure Finance
 - Refinancing of existing bank and bond financing
 - Capex requirements of existing projects and companies
 - Corporate activity – especially from the listed fund sector (e.g. BBP, BBI)
 - Renewables projects driven by MRET, CPRS, Solar Flagships, REDP
 - PPP backlog and economic stimulus driven projects
 - Withdrawing banks selling loans
- Reduced Supply of Infrastructure Finance
 - Withdrawing foreign and local banks
 - Demise of bond financing
 - More conservative bank hold levels

Rewards for Project Lenders

- Upfront fee plus margin over borrowing cost (no upside)
- Massive downside if project underperforms (limited recourse to the project)
- Robustness of project is key → mitigate project risks

Risks for Project Lenders

- Market/Regulatory Risk
 - What will be the future price path of RECs under the newly legislated expanded RET scheme?
 - Interaction with proposed emissions trading schemes
 - Utility scale feed-in tariffs?
- Technology Risk
 - Impacts on capacity, efficiency, availability, durability
 - Is technology proven for process, scale, life of project?
 - Is the process guarantee worthwhile?

Risks for Project Lenders (cont.)

- Project Delivery Risk
 - Cost overruns (contingencies? fixed price?)
 - Time overruns (can impact hedging, regulatory phasing, contractual obligations)
 - Interface of different responsibilities
 - Are the risks being wrapped?
 - Who is managing the delivery process?
- Fuel Supply Risk
 - How reliable is historic data for prediction of future fuel supply?
 - How volatile is fuel supply around the average forecast?
 - How will climate change affect future fuel supply forecasts?

Risks for Project Lenders (cont.)

- Power Offtake Risk
 - Volume – firm volume or take-as-produced?
 - Price / Term – can a long term fixed price off-take contract be obtained?
 - Hedging – can short/medium term spot price exposures be hedged?
 - Creditworthiness of off-taker – how many are bankable in Australia?
- Grid Connection Risk
 - Does the project have priority connection to the grid?
 - What are the circumstances in which power export to the grid can be scaled back or curtailed entirely?

Risks for Project Lenders (cont.)

- Counterparty Risk
 - Critical if contracts cannot be easily replicated
 - Credit rating of counterparty: is it bankable?
 - Need to consider which entity is being contracted with
- Operations & Management Risk
 - Are reliable and proven operations and maintenance services available for the chosen technology over the life of the asset?
 - What is likely to wear over time? – are sufficient spare parts available?
 - How does the technology fare in freak weather conditions?
 - Good management might not be able to fix a bad project but bad management can ruin a good one

Equity Market Expectations

- Risk/reward pricing – the good old days – investors chasing projects
- Supply/demand pricing – the new reality – projects chasing investors
- Competition for equity capital
 - Acquisition of secondary assets trumping primary investment
 - Equity raising for existing companies at deep discounts
 - Investors “keeping their powder dry”
 - The golden rule – he who has the gold makes the rules

The Outlook for Project Finance

- Even when a project is economically viable, certainty of project cashflow becomes key for project debt financiers and equity investors
- Technology risk is still key
- Project structure can mitigate risk, but certain risk fundamentals will always remain
- Banks (locals in particular) are lending, together with export credit agencies, but continuing supply demand imbalance will keep capacity low, pricing high and conditions tight
- Good projects of a reasonable size should find sufficient finance from the bank sector (if you are not fussy about terms) and equity investors
- Understand the key risks of your project especially technology risk and commence discussions with potential project financiers early

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