

Presentation  
CHP Workshop  
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Financing DG/CHP Projects

Marathon Capital, LLC

# Marathon Capital, LLC

- Private Merchant Bank- 14 Members
- Total Focus on Power
- Provides/Arranges M&A and Corporate/Project Financing
- Specialization in Small and Medium Projects (\$2 million to \$150 million)
- Concentration in North America/Western Europe
- Offices in NYC, Phoenix, Bannockburn (HQ's)

# Marathon- Areas of Focus

- Distributive Generation/Co-Generation/CHP/Demand side Projects
- Renewables including; BioGas, Wind, Geothermal, BioMass , Gasification, etc.
- QF/PURPA Projects

# Market Factors- Distributive Generation/CHP

- Steadily Growing Market/Varies Dramatically Region by Region
- Several Progressive States (Michigan) have passed DG laws which promote development.
- Clear Support from FERC, DOE and new Energy Bill (both versions)
- Drivers include project economics but can also include redundancy and pollution reduction.

# Market Characteristics-DG/CHP

- Most Host Companies prefer outsourced solution around a long term contract
- Most projects are fueled by gas, however we have seen projects fueled by biogas, biomass, waste coal, etc.
- Large host company preferences seem to be moving towards bundled contracts involving all utilities including fuel, power, steam and water.
- Fragmented provider market, very regional.

# Marathon's Approach-DG/CHP

- Operate as Financial Advisor to Sellers, Buyers and Developers of DG/CHP projects.
- Utilize tax, accounting and project financing expertise.
- Focus on larger (\$2 million +) projects with solid contracts, credit worthy hosts.
- Creating a proprietary Sr. Debt fund which will increase the supply of LT fixed rate debt/lease product to this market.

# Financing DG/CHP Projects

- Hosts/Users are divided between Commercial, Municipal/State and Federal segments.
- Contracts take three basic forms;
  - leases (hell or high water) written as obligation to hosts,
  - structured as “performance contracts” with stated savings or
  - written as long term energy services agreements.
- Funding strategy can vary dramatically depending upon term and transaction size.

# Critical Considerations-Developer

- Generally desire true Sale Treatment at commercial cut-over.
- Require off- Balance Sheet treatment if holding the asset.
- Seek flexible documentation which accommodates additional expansion/similar projects with same Host.
- Seeks to be "neutral" on fuel cost changes (i.e. either fuel costs are passed through to the host or a long term contract is set up for duration of contract.
- Requires non-recourse financing for up to 100% of cost (This of course requires adequate Host credit quality)
- Seeks adequate "free cash flow" to cover ongoing operating expenses and return of and on equity investment.
- Looks for leverage at the end of lease and ESA, etc.

# Critical Considerations-Host/User

- Overall cost is same or less than centralized solution.
- Redundancy is higher than via centralized solution.
- Leases (municipal and commercial) are generally “off-balance sheet”
- Performance Contracts/ESA contracts are to be treated as expense (not capitalized on B/S)
- Fuel Supply must be thought through and risk must either be taken or hedged.
- Operations and Maintenance considerations should allow for payment escrows if performance standards are not achieved.
- Leases/ESA should allow for plant closings, curtailment of operations, etc.

# Observations:

- Substantial liquidity around well documented municipal, state and Federal contracts.
- Significantly less liquidity surrounding commercial contracts, especially smaller (less than \$5 million) and/or longer (beyond 10 years) deals.
- Debt “sizing” starts with EBITDA and term of Lease/ESA agreement (Drives Debt/Lease levels). Usually maximum debt is utilized.
- Most public developers are generally better off selling the project on or before completion of construction. This allows them to take any developer profit/EPC profit upon sale. Alternative is to force them to take these profits over the holding period of the asset.
- When the significant tax benefits from deferrals cannot be utilized by developer, they should generally be “moved” to an efficient holder (this can be accomplished via leasing).

# Final Concept-Distributive Generation is Here to Stay!

- 20<sup>th</sup> Century will be looked back on as the age of **centralized** coal, nuclear, oil and Hydro plants.
- The economics of centralized gas fired plants (4 cents per KWh) are only marginally lower than the most efficient gas fired distributive generation projects (4.5 cents per KWh).
- Utilities generally produce at 99.9% of efficiency, leaving customers without power almost 8 hours per year. **This is way too high for many, many customers who really need 99.999% redundancies.**
- When the economics of transmission and distribution systems are added (3-5 cents per KWh) to the centralized costs, DG wins every time.
- Given the “patchwork quilt” of the transmission system, putting electrical production at the point of demand is a huge “enabler” which passes both the economics test and the redundancy test.