Cahora Bassa - a model for southern African projects?

Chaminda Jayanetti

19/12/2007

For many Mozambicans, the acquisition of majority control of the Cahora Bassa hydropower plant by their government last month represented the sun finally setting on Portuguese colonial rule.

But away from the political sphere, the deal may have signalled a new dawn for project financing in the tricky territory of sub-Saharan Africa.

Project Summary

The Cahora Bassa dam is located on the Zambezi River in Mozambique's Tete province. Portugal started building it in 1969, when it was still colonial ruler.

Cahora Bassa is a controversial piece of infrastructure and during construction independence fighters attacked it as they saw it as an attempt by Portugal to maintain support for its rule. It was only completed in 1975 - the year of Mozambican independence.

The dam was operated by the JV Hidroelectrica de Cahora Bassa (HCB) - 18 per cent owned by Mozambique, 82 per cent by Portugal.

It is the biggest hydroelectric dam in terms of concrete volume in Africa and was regularly out of action during Mozambique's bloody civil war in the 1980s.

The hydroplant produces 2,075MW of power, most of which is sold on to South Africa.

After the plant's inauguration, Portugal and Mozambique intermittently discussed transferring control as set out in a 1975 agreement, but talks speeded up in recent times culminating in last month's deal.

Under the agreement, Mozambique purchased 67 per cent of the equity in HCB. The equity split now stands at 85:15 in the Mozambican government's favour.

Mozambique holds its share of equity via its state power company EDM.

In 2006, Mozambique paid Portugal US$250 million as the first stage of the transaction.

Now, Calyon and Banco BPI have each loaned US$300 million to finance the acquisition. The Development Bank of Southern Africa (DBSA) is also lending US$200 million as sub-underwriter.

This adds up to a US$1.05 billion total price tag - but the picture is more complex than that. The real purchase price is US$950 million with a 74:26 debt-equity ratio:

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- US$700m debt
- US$250m equity

The remaining US$100 million in lending is for debt refinancing for HCB.

Syndication of the debt is to be launched in February 2008.

South Africa's state-owned power company - Eskom - currently purchases 80 per cent of the offtake, with the rest sold on to other members of the Southern Africa Power Pool, mainly Zimbabwe.

Financing

Recent Mozambican infrastructure deals - such as the Mozal I and II aluminium smelters and the Temane Pande gas pipeline - were financed primarily by development banks and multilaterals.

In a country ravaged by civil war for much of its post-independence history, few western commercial banks were keen to get involved. This is a scenario that has been repeated across sub-Saharan Africa, with the solitary exception of South Africa.

Cahora Bassa is different - US$600 million of commercial bank debt from Banco BPI and Calyon points to a tipping point in confidence.

Insiders close to the deal credit these lead arrangers for structuring the financing in a manner attractive to commercial banks.

The Cahora Bassa deal is essentially a hybrid of project finance, structured trade finance and acquisition finance systems. Key within this mesh is the use of an offshore vehicle as a conduit for lending. The loan contracts are held with the offshore vehicle, and the money goes via the vehicle to Mozambique-based HCB.

Because the vehicle is based outside the territorial control of the Mozambican government, it is harder for Mozambique to circumvent the accounts and contracts, providing more security to commercial lenders.

This is a model that has been used in West African oil financing, but not in sub-Saharan power deals.

Linklaters' Andrew Jones, who acted for the lenders, says: "It's using techniques that are most often used for commodities such as oil and gas, where you are using offshore vehicles to look after cash flows. But applying that to this sort of transaction is pretty innovative."

Denton Wilde Sapte acted as legal adviser to the Mozambican government, with Morais Leitão Galvão Teles Soares da Silva providing legal advice to the Portuguese government.

Ernst & Young was financial adviser to the sponsors while Linklaters acted as legal adviser to the lenders.

Risk? What risk?

The adoption of an offshore vehicle structure helps to explain the surprising absence of political risk insurance. In new emerging markets, political risk insurance tends to be included within the deal as a guarantee against force majeure.

Outside of South Africa, Cahora Bassa is one of the first sub-Saharan infrastructure deals with uncovered commercial debt - no political risk insurance, no export credit agency guarantees.

A key reason for this is the deal structure, as explained above - an offshore vehicle protects the lenders from hostile dealings by the government.

But there are other factors at play. Southern Africa may be a volatile region, but Cahora Bassa features some of the most stable players in the area.

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One of the key confidence builders is that the two shareholders in the project are, essentially, governments.

In addition, the fact that the dam is a key strategic asset and source of foreign currency to Mozambique - which can finally take majority ownership of it after three decades of waiting - provides a strong incentive for the government to stick to the agreement.

Also boosting banks' confidence is the involvement of a credit-worthy offtaker - Eskom - and the dam itself has performed solidly for many years.

Then there is the involvement of the southern African development bank DBSA which also provides a stabilising force.

Conclusion

There are many respects in which Cahora Bassa is something of a one-off. There are few power facilities where ownership is vested in an ex-colonial country.

The fact that Portugal has maintained majority ownership of the plant for three decades after independence is testament to the unusually close relationship between former colonialist and ex-colony.

As a consequence, this kind of acquisition by one government from another is not likely to be repeated anytime soon.

But Cahora Bassa could nevertheless set a benchmark for the region. In a politically and financially volatile part of the world, the adoption of structured trade finance offshore vehicles could convince commercial lenders to step up to the plate.

Despite this being an acquisition deal, there is no reason why the offshore model couldn't be applied to new-build project finance - potentially opening up southern Africa to uncovered commercial lending.

As Linklaters' Andrew Jones says: "There are a lot of project finance deals coming up now in sub-Saharan Africa, and this model sets a good template for them."

The project at a glance

Project Name	Cahora Bassa
Location	Tete province, Mozambique
Description	2,075MW hydro - acquisition
Sponsors	SPV is HCB owned by Mozambique via EdM (85 percent) and Portugal (15 percent)
Operator	HCB
PPA	Eskom (1,500MW) - the rest is taken by members of the Southern Africa Power Pool, including Mozambique's EdM and Zimbabwe's ZESA
Total Project Value	US$950m
Total equity	US$250m
Equity Breakdown	Mozambique paid US$250m to Portugal for 67 per cent of HCB shares
Total senior debt	US$800m
Senior debt breakdown	Calyon - US$300m, BPI - US $300m, DBSA (sub-underwriter) - US$200m. Repayable over 10 years by Eskom
Debt:equity ratio	74:26
Mandated lead arrangers	Calyon, BPI, DBSA
Participant banks	Syndication set for February 2008
Legal Adviser to sponsor	Denton Wilde Sapte advised Mozambique; Morais Leitão Galvão Teles Soares da Silva advised Portugal
Financial Adviser to sponsor	Ernst & Young
Legal adviser to banks	Linklaters
Date of financial close	27 November 2007

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