



The winds of change

An insight into M&A
in the renewable energy sector in 2009

ADVISORY





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About the research

This report is an annual review of M&A activity within the renewable energy sector. It was written in co-operation with the Economist Intelligence Unit and is based on a survey of 200 senior executives from across the global energy industry, conducted in February and March 2009.

All respondents are from management positions, with 71 percent holding executive boardroom positions or who are directors or vice-presidents. They represent power generating businesses, renewable energy suppliers, energy distributors, oil and gas majors and financial investors. A range of company sizes are represented, including some of the industry's largest operators: 23 percent of respondents had annual revenue of US\$10bn or more. They are broadly evenly split between Europe (32 percent), North America (30 percent) and Asia-Pacific (26 percent), with the remainder from Latin America, the Middle East and Africa.

Supplementary to the survey results, interviews were also conducted by the EIU with the following senior executives:

Airtricity

Donal Flynn, CFO

A leading renewable energy company developing and operating wind farms across Europe. In January 2008, the sale of Airtricity was completed to Scottish and Southern Energy Plc.

BP Alternative Energy

Katrina Landis, COO Alternative Energy

A global energy company investing in a portfolio of cleantech and renewable energy operations. Since 2005, BP Alternative Energy has invested around US\$2.9bn in wind, solar, biofuels, and hydrogen power with carbon capture and storage.

Essent

Erik van Engelen, Director of Innovation

A Netherlands based vertically integrated energy company. Essent develop and operate both conventional and renewable generating resources as well as being a major supplier of electricity and gas.

Macquarie Group

Daniel Wong, Division Director,

Macquarie Capital Advisers

A global provider of banking, financial, advisory, investment, and funds management services. Macquarie is dedicated to sourcing investments across renewable technologies including wind, solar, landfill gas, hydro, biomass, biogas, and geothermal.

Moody's

Neil Griffiths-Lambert and Helen Francis,

Vice Presidents and Senior Analysts,

EMEA Utilities and Infrastructure Finance Team

Moody's Investors Service is among the world's most respected and widely utilized sources for credit ratings,

research, and risk analysis. Moody's provides research data and analytic tools for assessing credit risk, and publishes market-leading credit opinions, deal research, and commentary, serving more than 9,300 customer accounts.

Mainstream Renewable Power

Manus O'Donnell, Head of

Corporate Finance

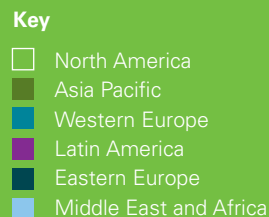
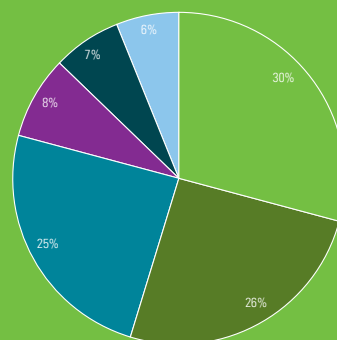
Development, construction and operation of wind, solar, thermal and ocean current plants. Mainstream works closely with governments, development partners, and investors to deliver successful projects.

ScottishPower Renewables

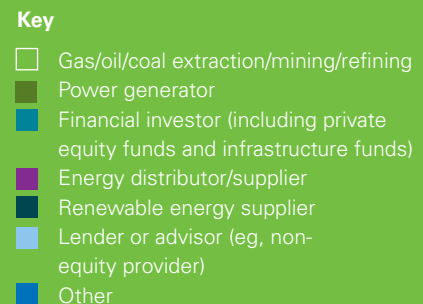
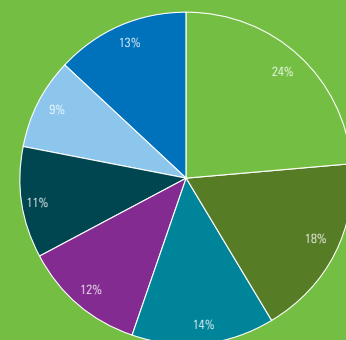
Keith Anderson, Managing Director

Part of Iberdrola Renovables Group, the world's biggest producer of renewable energy. ScottishPower Renewables is currently the UK's largest developer of onshore windfarms with over 30 windfarms fully operational, under construction, or in planning.

Location of survey respondents:



Businesses represented by survey respondents:



Source: Economist Intelligence Unit 2009

Foreword



Andy Cox
Partner,
KPMG in the UK
Global Head of
Energy and Utilities
for Transaction
Services

Since our last survey into Renewables M&A, “Turning up the heat,” was published in May 2008, major shifts in the global economy have had a significant impact on many aspects of the renewables sector. While respondents last year were clearly worried that a bubble was developing, their concerns today focus much more around how the renewables M&A market will react to the new financial landscape. Without doubt, the global financial crisis has made access to capital for even the largest players in the sector difficult. Nevertheless, the fundamental drivers which have made renewables such a dynamic sector in the last few years remain, notably the climate change agenda, dwindling fossil fuel stocks and concerns over the security of energy supply. Despite the financial difficulties, our respondents - more than 200 executives across the global energy industry - agree that renewable energy projects will continue to be economically viable.

Digging down into the detail, the report unearths some interesting insights into where many energy companies are planning to invest their cash in the coming year, how much they are seeking to commit and the underlying factors motivating their ambitions. Understandably, we are witnessing step changes in who is investing, how much is being invested, and how deals are being financed. A significant change from last year is that buyers appear to be less willing to pay a premium for development pipelines, evidence perhaps that some of the froth in valuations last year may have dissipated. Yet the M&A market is by no means dead, and our report suggests that activity is likely to continue through 2009 and beyond, as potential bargain opportunities arise for those who have both the will and the means to invest.

Our respondents have also identified how changes in the political climate could affect the industry. As governments seek to reinvigorate national economies through a series of fiscal stimulus packages, one of the key beneficiaries is clearly green energies. Nowhere is this more evident than in the United States, the country which respondents see as by far the most attractive for investment in the next 12 months. A key factor is the election of Barack Obama, with respondents from across the globe having faith that he will be able to deliver on his green promises.

We are going through challenging times across the M&A market and the renewables sector is no exception. Despite this, a range of positive signals remain, driven primarily by national government commitments to meeting challenging renewable energy targets. The renewables deal environment is changing: this survey provides valuable insight into what the future deal environment might look like.

Andy Cox

Executive Summary

The world has seen immense financial turmoil in the last year, and the renewables sector has been no exception. A white-hot, if not overheated, M&A environment changed dramatically in the space of several months in late 2008, with more speculative premiums paid to undeveloped projects disappearing overnight. Multi-billion dollar deals in early 2008, such as the acquisition of Airtricity by Scottish and Southern Energy for US\$2.2bn, have so far not been evident in 2009. In tandem with the rest of the global economy, the momentum shifted dramatically as the financial crisis worsened sharply in September, with the fourth quarter of 2008 recording the lowest volume of corporate M&A in renewables for over three years. So what is the outlook for the year ahead?

Despite the global economic meltdown, a significant majority of energy sector executives interviewed for this survey believe renewable energy projects remain economically viable. Seventy-eight percent of respondents to our survey believe renewable energy projects continue to be economically viable, a key indicator of the sector's ongoing importance amid the general economic gloom. Similarly, despite the financial turbulence, executives believe M&A continues to prove valuable for many of those engaged in it. In considering their last acquisition, 37 percent of executives experienced an increase in shareholder value, compared with just 8 percent who suffered a decline. More important for the long term is that two of the underlying reasons for the substantial growth in the sector over the last few years—climate change and energy security—remain as pertinent as ever.

The US, India and China are being targeted as key countries for investment in M&A. The US is likely to be the most popular target for M&A deals in the year ahead. Forty-two percent of all respondents say that they will be investing there in the next year, notably heading the list of destinations for European respondents. India, China and Canada are also popular, with 24 percent, 22 percent and 21 percent of respondents respectively, earmarking them for investment (respondents could be investing in more than one country). This interest is very likely to be closely linked to stimulus activity in these countries. The US government's stimulus funds targeted at the renewables sector, for example, which include both grants and tax credits, are certainly attracting attention. China, too, will direct more than one-third of its stimulus spending towards environmental initiatives, including renewable energy projects. Nearly two-thirds (63 percent) of respondents expect growth in government subsidies during the year ahead (up from 37 percent in last year's survey).

Investors are switching their attention to productive operating assets, at the expense of undeveloped ones. Given the tougher operating environment, executives are focusing their attention on deals considered lower risk. Direct asset acquisitions nearly doubled in 2008 compared with 2007. The big losers were companies that had been obtaining planning permission for projects or only developing them to a very early stage and then selling these off at a premium. Such activity has now dried up, which is probably a healthy sign. "The shift from early to later stage development is a better

...underlying reasons for the substantial growth in the sector over the last few years—climate change and energy security—remain as pertinent as ever.

reflection of where the value lies," says Manus O'Donnell, head of corporate finance for Mainstream Renewables. An overview of completed deals in early 2009 (deals by Valero Energy, Green St. Energy and HGCapital provide some examples) confirms this clear preference for asset acquisition, ahead of just licenses or approvals. Daniel Wong, division director, Macquarie Capital Advisors agrees: "In terms of [operating assets], the market is still relatively active. In terms of owners of development businesses ... that is where the greatest volatility has been experienced."

Despite these positive signals, however, the typical size of M&A deals is far smaller than a year ago, with overall activity in the sector remaining muted. More respondents to this survey expect a further decline, rather than an increase, in the size of transactions over the next 12 months (37 percent compared with 30 percent). About half (49 percent) foresee a drop in the volume of transactions worth over US\$1bn (compared to just 13 percent expecting an increase) and, of those who expressed an answer, 58 percent say that their companies would be spending less than US\$50m on M&A in the coming year. Donal Flynn, CFO of Airtricity, warns "we are not at the bottom yet." Once things pick up again,

some of the conditions that helped to stimulate the growth of recent years are likely to be absent such as intense competition for development opportunities and easy credit. Assets will continue to come onto the market, especially from distressed companies, but, in the words of Katrina Landis, COO of BP Alternative Energy, there will just not be the “growth we have seen for the last several years”.

Large corporates with strong balance sheets and well-established banking relationships are likely to be the main beneficiaries. Other interested buyers may struggle to find financing. More companies are

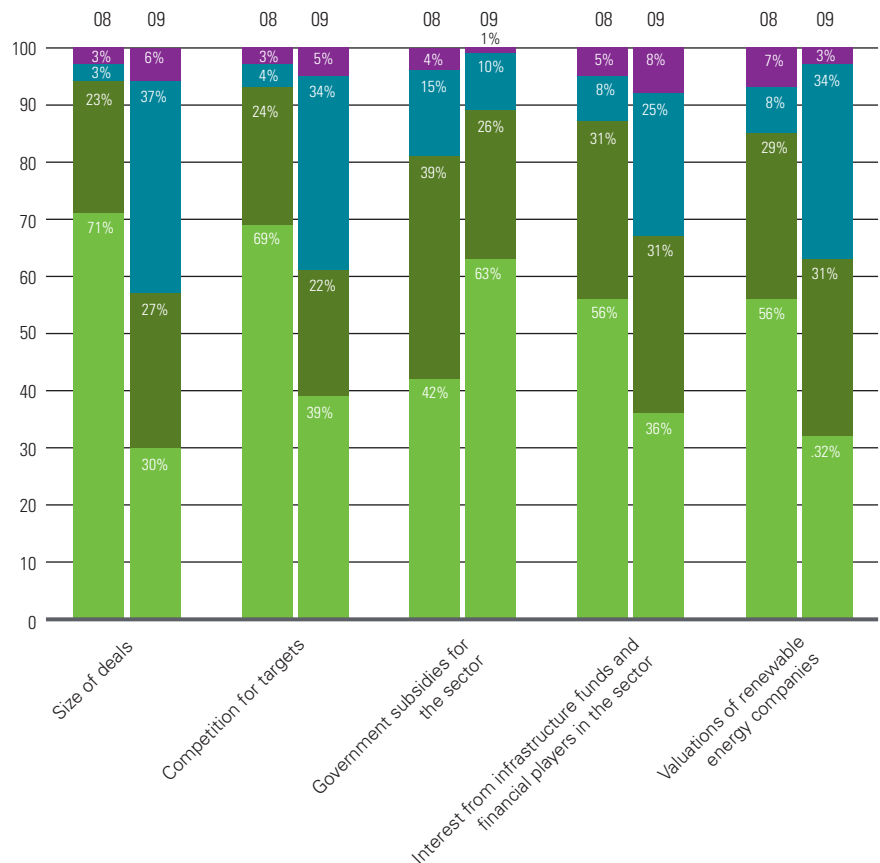
expecting to make purchases in the coming year than actually did last year, but in an opportunistic way. “People with money are definitely waiting for bargains,” says Mr Wong of Macquarie Group. One recent example has been the US\$477m acquisition by Valero Energy of the assets from VeraSun (which entered Chapter 11 bankruptcy filing in October 2008) in April 2009—less than a year after VeraSun’s larger merger with BioEnergy. However, those in need of finance should expect to work hard to secure funds. Many banks are showing little interest in one-off deals that do not support an ongoing relationship. Smaller companies are encountering particular troubles: 70 percent of those with annual revenue of under US\$500m

are finding financing harder to obtain. Larger companies are also squeezed: 57 percent of those with sales of over US\$10bn complain of the same problem*. Instead, where possible, companies are turning to balance sheets and cash reserves, while also making greater use of deferred payments in funding investments.

“The shift from early to later stage development is a better reflection of where the value lies”

Manus O'Donnell, Mainstream Renewables

Over the next 12 months, what change do you expect to each of the following aspects of the M&A environment for renewable energy?



“We are not at the bottom yet.”

Donal Flynn, Airtricity

Key

- Increase
- No change
- Decrease
- Don't know

Source: Economist Intelligence Unit 2009

* Economist Intelligence Unit, 2009

The crunch hits renewables



M&A in the renewable energy sector began 2008 in good form: Scottish and Southern Energy's US\$2.2bn purchase of Airtricity started the year. Then, in June, Bosch bought a 54 percent controlling interest in ErSol Energy and put out an offer for the rest, which represented a purchase price of US\$1.67bn. In December 2008, GDF Suez acquired FirstLight Power Resources for US\$1.9bn. Such activity helped to put overall M&A numbers for 2008 slightly ahead of the record pace set in 2007. According to New Energy Finance (NEF), a specialist information provider, overall renewables M&A activity reached US\$67bn, up from US\$61bn. This includes private equity, venture capital purchases and other buy-outs. Pure corporate equity M&A and asset acquisitions also rose, to US\$49bn from US\$43.2bn.

Aggregate figures, however, hide a substantial drop in M&A activity in the latter half of the year. According to NEF, corporate M&A in renewables

declined from the first quarter 2008 —with the last three months showing the worst result since the second quarter of 2005. This decline in M&A in the latter half of the year partly reflects trends across the entire financial world, as the collapse of several major US banks last year crystallized investor concerns. Global M&A activity (across all sectors) fell in 2008 to US\$3.1trn from a record US\$4.4trn in 2007. For the year ahead, the Economist Intelligence Unit forecasts that activity will fall by about a third to US\$2trn.

Like other sectors, M&A in renewable energy companies is simply being affected by greater caution as the price of stocks across the economy has plummeted. Shares in renewables companies, however, have done noticeably worse than average. From January 1 2008 to March 25 2009, the NEX, an index of renewables companies, dropped by 65 percent, with most of the impact being felt between the start of September and

"The markets are nervous"

Donal Flynn, Airtricity

the end of November. In contrast, the decline over the same period for the Dow Jones, for example, was 42 percent.

Infrastructure funds have been hit particularly hard. Mr Wong at Macquarie Group highlights a general market trend for these vehicles to be traded at a discount on the values of their underlying assets. Shares more generally, however, are suffering a similar fate. Even some larger individual companies are trading at less than the replacement cost of assets currently in production. Mr Flynn at Airtricity believes that the decline has been excessive, "but the markets are nervous".

Doom and gloom, however, is not the complete story.

Despite the gloom, positive signs are evident

Amid the economic turmoil, a range of positive signals remain. Certain basic, underlying factors that have driven growth in the industry remain in place. As Mr Flynn points out: "Climate change is still as big an issue as before; security of supply is as big as before." Mr O'Donnell at Mainstream Renewables agrees. "Renewables over the short term will continue to grow," he says. "The pace will pick up in the

medium term. Governments have set targets. All these things are going to attract industry players." Finally, while fossil fuel prices have slumped from the significant reduction in demand, they will rise again once economic growth resumes.

Respondents to our survey strongly concur: 78 percent of executives believe investments in renewable

energy projects remain economically viable, although returns will generally drop. About one in five of these may require a change in how they are funded in order to remain viable, but just 15 percent felt that the credit crunch and simultaneous drop in fossil fuel prices had actually made further renewable investments economically unviable.

Then and now: the disappearance of the billion-dollar deals

Target company 2009	Stake	Acquirer	Purchase price, US\$	Completed
Selected assets (from Verasun Energy)	100%	Valero Energy	\$477m	Apr, 2009
Photovoltaic pipeline (from OptiSolar)	n/a	First Solar	\$400m	Apr, 2009
Alta Wind Project	100%	Green St. Energy	\$390m	Mar, 2009
Solar assets (from AIG Financial Products)	n/a	HGCapital	\$379m	Mar, 2009
Amper Central Solar (from Acciona)	34%	Mitsubishi	\$329m	Mar, 2009
2008				
Airtricity	100%	Scottish and Southern Energy	\$2200m	Feb, 2008
FirstLight Power Resources	100%	GDF Suez	\$1900m	Dec, 2008
ErSol Energy AG	100%	Bosch	\$1670m	Jun, 2008
Enersis (from Babcock & Brown Wind)	100%	Magnum Capital Industrial Partners	\$1450m	Nov, 2008
US BioEnergy	100%	VeraSun (merger)	\$700m	Apr, 2008

Selected major renewable energy M&A deals, Jan-Apr 2009 versus Jan-Dec 2008

Sources: Bloomberg; Zephyr; deal values as per M&A databases; where necessary, deals converted at historical exchange rate to US\$.

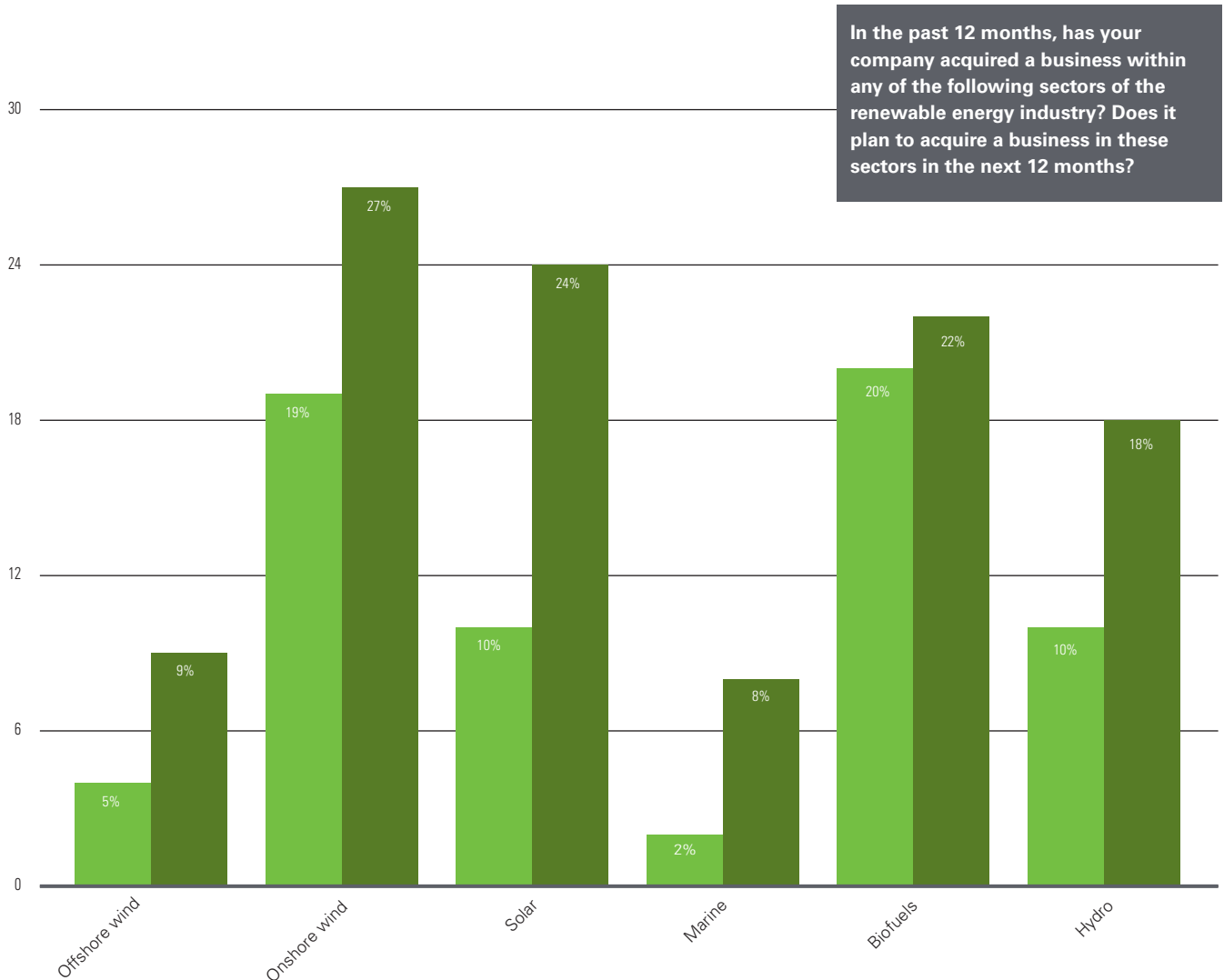
Similarly, respondents are also remarkably optimistic about the industry's immediate prospects. Roughly six in ten think that onshore wind (62 percent) and solar (60 percent) will grow by over 5 percent this year, and nearly half believe the same of biofuels (48 percent). As expected in the current risk averse climate, respondents are not expecting significant growth in the less developed industries of offshore wind and marine technology.

Looking specifically at M&A, whatever today's challenges, these activities

are still profitable. Just under 40 percent of respondents agree that their last acquisition had added to shareholder value by more than 5 percent, compared with just 8 percent who saw a decrease. These figures represent a deterioration from last year—61 percent compared with 3 percent—but still show that M&A activity is seen as being much more likely to be beneficial than harmful to companies. Indeed, the current dislocation between share prices and the value of underlying assets would normally make M&A highly profitable.

Moreover, respondents seem to be looking more favorably at buying. As the chart shows, in every category of technology, more expect to purchase a business in the next year than have in the past year, particularly in the more established technologies of onshore wind and solar.

Finally, the very recession that is causing the sector so many problems may also be prompting a reason for optimism. Government stimulus spending, especially in the US, is becoming greener in nature.



Key

- Have acquired in the past 12 months
- Plan to acquire in the next 12 months

Source: Economist Intelligence Unit 2009

Stimulating growth: the crucial role of governments in renewables

Government regulation and support have always been fundamental to the viability of the renewables sector. Without active assistance, fossil fuels are simply cheaper. Helen Francis, a vice-president and senior analyst in the EMEA Utilities & Infrastructure Finance Team at Moody's, the rating agency, calls government policy "critical" to a successful sector. Her colleague, Neil Griffiths-Lambeth, also a vice-president in the team, notes a strong correlation between the strength of the regulatory regime and activity in renewables.

Our survey suggests that most companies do not expect countries to succumb to the temptation to relax existing targets and rules in the name of economic expediency. Overall, 61 percent expect government determination to either stay the same or increase, compared with just 27 percent who see an easing. Mr Flynn at Airtricity reflects the views of many interviewees that there is no signal that governments are walking away. "The reverse is actually true," he notes. Europe has recommitted to its 2020 targets, and the new US administration has already begun counting the income from a new cap-and-trade regime. The concerns driving carbon emission policy, such as climate change and energy security, are just as relevant to developing countries as they are to developed ones.

More striking still, 63 percent expect an increase in government subsidies for the sector over the next year (up from 37 percent last year). This partly reflects the much anticipated US stimulus, but the opinion goes beyond just one region: while 90 percent of US respondents foresee a rise in government help, so do 65 percent of Europeans and 46

percent of those in the Asia-Pacific region—all well above last year's overall averages. Quite simply, renewables should be one of the winners in the current round of government pump-priming. "If governments are looking to stimulate various economies, renewables infrastructure ticks a lot of boxes," says Mr Flynn. The UK's 2009 budget, presented in April, promises an additional £535m of support for offshore wind investments through the country's Renewables Obligation scheme. It also includes up to £4bn of new capital from the European Investment Bank, earmarked for renewable energy projects.

At the national level, the biggest news is clearly the green approach of the new US administration. A total of 63 percent of respondents believe that, even with the economic crisis, the new US president, Barack Obama, will be able to deliver on his campaign commitments regarding renewable energy and climate change. US policies are sparking interest, as research by HSBC shows, along with a number of other countries, the US is putting serious money into renewables via its stimulus spending package [see table - page 10]. This, in turn, is driving investor interest. Forty-two percent of respondents say that they envisage their company investing in renewables in the US in the next year, making the country by far the most common choice. India, China and Canada are also popular with 24 percent, 22 percent and 21 percent of respondents respectively, earmarking them for investment. Although there is a marked preference for companies to invest within the region in which they operate, the US is not just the expected preferred destination for money among Americans, but also for



Europeans. It is not just the stimulus money. Ms Francis points out, foreign companies also seem to be drawn by the fact that the federal government is giving out grants rather than merely tax credits [see box - What's in the US Stimulus Bill? - page 12].

"If governments are looking to stimulate various economies, renewables infrastructure ticks a lot of boxes"

Donal Flynn, Airtricity



The likely impact on the renewables sector in the US and beyond is unclear. The stimulus is more likely to revive than to overheat the US industry. After a number of years of substantial growth, renewables in the US suffered heavily from the credit crunch. All companies in the sector suffered, but biofuels were especially hard hit. At the beginning of 2008 VeraSun merged with US-based BioEnergy to create the country's largest ethanol

producer in an all-stock deal valued at about US\$700m. However, financing constraints and a sharp drop in ethanol prices resulted in VeraSun filing for Chapter 11 bankruptcy in October 2009 before auctioning off its assets to Valero Energy for just US\$477m in April 2009. The market now has more than enough development opportunities for companies with cash to exploit. In other words, the current doldrums of the US renewables industry gives

the government room to use stimulus payments. As Keith Anderson, managing director at ScottishPower Renewables, notes, such a policy in the UK, or in other markets, could simply reflate the premium for early development projects because of the restriction on the number of viable sites arising out of slow planning permission or other constraints.

A Climate of Recovery? The climate change investment dimension of economic stimulus plans

Country	Fund USDbn	Period Years	Green Fund USDbn	% Green Fund
Asia Pacific				
Australia	26.7	2009-12	2.5	9.3%
China	586.1	2009-10	221.3	37.8%
India	13.7	2009	0.0	0.0%
Japan	485.9	2009 onwards	12.4	2.6%
South Korea	38.1	2009-12	30.7	80.5%
Thailand	3.3	2009	0.0	0.0%
Europe				
European Union	38.8	2009-10	22.8	58.7%
Germany	104.8	2009-10	13.8	13.2%
France	33.7	2009-10	7.1	21.2%
Italy	103.5	2009 onwards	1.3	1.3%
Spain	14.2	2009	0.8	5.8%
United Kingdom	30.4	2009-12	2.1	6.9%
Other EU states	308.7	2009	6.2	2.0%
Americas				
Canada	31.8	2009-13	2.6	8.3%
Chile	4.0	2009	0.0	0.0%
US EESA*	185.0	10 Years	18.2	9.8%
US ARRA**	787.0	10 Years	94.1	12.0%
Total	2,796		436	15.6%

*EESA - Emergency Economic Stabilization Act

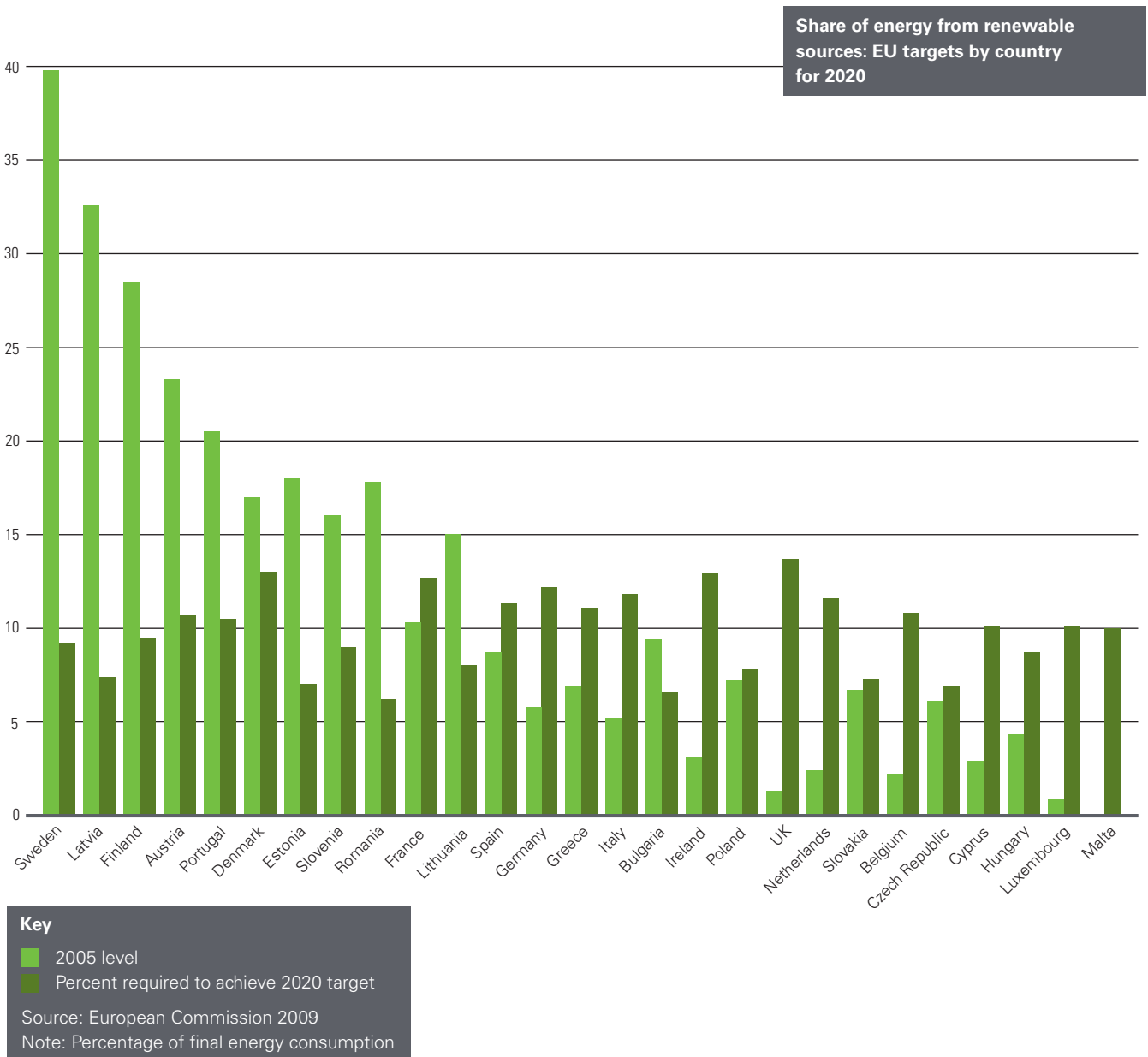
**ARRA - American Recovery and Reinvestment Act

Source: HSBC estimates, February 2009

This harks back to another unchanging, basic fact of life for renewables companies: in the long term, success depends as much on enlightened, sensible government policy providing a predictable investment environment as it does on business acumen. Indeed, some of the problems that sparked the M&A boom in renewables—notably a disconnection between targets for renewable energy demanded of generators and the ability of the

planning system and market to cope with such growth—may have merely gone into abeyance, able to resurface in better economic times, rather than disappeared. Mr Griffiths-Lambert explains that even in the EU, the number of countries hitting current targets is very small. “Is the EU going to get a bigger stick?” he asks. “Here in the UK, we signed up to ambitious targets, but people can’t build out. There aren’t enough connections to the

grid. There are still planning restrictions. We’ve seen investors pull out of [projects] because of any number of issues.” The financial crisis may have saved governments from a bubble created by combined demands for greater use of renewable energy and tight restrictions on where it could be deployed. They should take advantage of the space to try to prevent this recurring in the recovery.



What's in the US Stimulus Bill?

The American Recovery and Reinvestment Act of 2009, also known as the Stimulus Bill, contains substantial provisions relating to renewable energy and energy conservation. The exact amount depends on how much the tax incentives finally cost the Treasury, but the best estimates are that the Act will require US\$39bn in spending and about US\$18bn in tax credits.

Not all of this money will be of direct relevance to the renewables industry. In fact, the spending addresses a broad range of issues, including, for example, US\$5bn for weather-proofing homes and nearly as much for energy conservation in federal buildings. One of the most important uses for renewables is the US\$11bn set aside for modernization of the country's electricity grid. Although smart grids are mentioned in the bill, the system at the very least needs a traditional upgrade if it is to transport large volumes of wind-generated electricity from places like the Midwest and Texas to the coasts, where much of the nation's power is consumed.

Renewable energy companies are particularly interested in the Act's tax provisions, which should remove some important problems for investors in renewables, including the following:

- The production tax credit (PTC). A per energy unit credit lasting ten years from when a facility begins generating power. This has been extended by three years, to cover wind facilities that enter service before the end of 2012, and those of most other renewable technologies before the end of 2013. The previous

practice of renewing the credit annually had led to a pattern of relatively high investment at the start of the year that decreased markedly by the end.

- The investment tax credit (ITC) that allows companies, rather than claiming the PTC, to take a tax credit of 30 percent on the costs of a renewables facility. This has been extended to wind, geothermal and biomass operations. Previously solar was the only major technology covered. The scheme allows operators to access tax credits much earlier than the PTC.
- A grant program allowing companies, instead of claiming the ITC, to receive a grant for the same amount within 60 days of bringing a facility into service. Not only will this help credit-restricted companies faster than the ITC, it also makes investment far more interesting to smaller companies, as well as large foreign investors who do not have the US tax bill to benefit fully from the ITC or PTC. There is no limit on the amount of grant money available under the Stimulus Bill.

Help for the renewables sector does not stop there. A total of US\$6bn has been set aside for loan guarantees, which should help to relieve the difficulties that companies are facing in accessing funding. Moreover, the newly proposed budget includes an extra US\$26.3bn for the Department of Energy in 2010, a 10 percent increase on 2008. Although the proposal contains no specific spending programs, it makes clear that at least some of this will go to promoting renewable energy.



Different players, different focus

Too great a focus on the fallout of financial turmoil or on signs of hope for future growth amid the wreckage, however, can hide a significant underlying shift in the renewables M&A market. Investors have been refocusing on what they really want to buy. Overall, even with a healthy first quarter, corporate M&A in renewables dropped from US\$25.9bn in 2007 to US\$18.4bn in 2008, according to NEF. The companies that have suffered most are those that had no assets in production, but whose valuations relied on the potential for development based on planning permission, and sometimes little else. This is somewhat reminiscent of the dotcom collapse. "The days of getting planning

permission and selling it for a premium are gone," confirms Mr O'Donnell of Mainstream Renewables. Mr Anderson of ScottishPower Renewables adds that his company has always been careful to give detailed information on the state of development of projects in its pipeline. Investors, however, had previously tended to look at pipelines as generic. "Not enough was done to differentiate their value," he argues. "If you go back 9-12 months in the UK, we were seeing people buying development projects at very high premiums. That has certainly gone out of the market." Mr Wong at Macquarie Group also notes that it is the development side of the market that has seen the greatest volatility and where profits have dropped.

"The days of getting planning permission and selling it for a premium are gone."

Manus O'Donnell, Mainstream Renewables

On the other hand, citing both wind and solar examples in Europe, Mr Wong explains that, perhaps surprisingly, operating assets are still being traded at reasonably good value. Assets actually generating electricity, rather than shares based on promises in the wind, are what investors are seeking. Indeed, the direct purchase of assets rather than corporate equity jumped from US\$17.3bn in 2007 to



US\$30.6bn in 2008, according to NEF. Our table showing the largest deals of 2008 and 2009 to date also illustrates the trend: the majority of buyers are now snapping up operating assets rather than large scale development portfolios [see table - page six].

This change alone will affect the M&A picture in the current economic environment, as large utilities or their subsidiaries are finding it easier than smaller companies to access financing for investment. An even bigger development, however, is the decline in the number of financial investors. Last year, when listed separately, infrastructure funds were seen as among the biggest likely buyers by 35

percent of respondents, private equity by 32 percent and hedge funds by 12 percent. This year, the combined figure for all of these is just 31 percent. "A year ago there were a lot of financial players chasing assets," says Mr Flynn. "The PE guys don't have the money any more, and the banks are being a lot choosier [whom to back]. You are not seeing many financial players." Instead, he believes that the primary activity is coming from large European utilities, with strong balance sheets and access to funds. Mr Anderson has seen a similar shift. He notes that many of the small developers who used to achieve such high premiums by selling in the early stages of a

"Operating assets are still being traded at reasonably good value"

Daniel Wong, Macquarie Capital Advisers

project did so to financial investors. Moreover, a year ago there were a large number of financial players and funds looking to take a stake in big offshore projects. Today, "most of that money is gone," says Mr Anderson. In particular, according to Mr Wong, while infrastructure funds are still around, hedge funds and, to a lesser extent, private equity, have left the scene.

These are not the only changes likely to affect the renewables M&A market.



Renewables M&A will not recover overnight

The positive signs for renewables discussed in this report show some of the underlying promise of the sector. Nevertheless, recovery will be slow here as everywhere else. In general, respondents to our survey are noticeably more pessimistic than those who took a similar poll last year. In early 2008, participants expected both the size and the volume of M&A deals to grow. Over the next 12 months, however, 57 percent of respondents expect that the size and the number of deals will either stay at current levels or decline further. "We are not at the bottom yet," says Mr Flynn of Airtricity. He argues that it is difficult to say how long the situation will last, certainly to the end of 2009, although he notes that it will vary by market.



*"Due to the world crisis,
all the activities that
are not strictly
must-do suffer"*

Erik van Engelen, Essent

"The shift from early to later stage development is a better reflection of where the value lies."

Manus O'Donnell, Mainstream Renewables

Various specific factors will continue to dampen the scale and volume of renewables M&A deals in 2009. The first is the broader economic situation. Of respondents who had considered a takeover in the last year, but had not gone ahead, nearly half (48 percent) cited doubts arising from the economic climate as the main cause for their caution. They have good reason: the Economist Intelligence Unit expects the world economy to contract by 2.6 percent this year at market rates. Similarly, 58 percent of all those surveyed expect to make significant reductions in either planned, or sometimes even ongoing, projects because of the downturn.

Quite simply, as Mr Wong notes, "capital is more expensive, so there needs to be more of a capital allocation exercise" than previously, deciding between M&A or alternative uses for those funds. More generally, Mr van Engelen of Essent explains that: "Due to the world crisis, all the activities that are not strictly must-do suffer."

Secondly, disagreement over price valuations is dampening activity. Sellers demanding too much were the leading cause of deals failing in the last year, cited by 55 percent of relevant respondents. This may simply reflect an initial unwillingness to drop prices as M&A activity declined. Mr Wong refers in particular to some "price stickiness" among development companies, which is where the greatest volatility has been experienced. Looking ahead, however, even with the significant decline in share prices, uncertainty persists. Roughly equal numbers expect valuations to increase (31 percent), stay the same (32 percent) or decrease (34 percent). Moreover, nearly one in three respondents still worry about a bubble, and 42 percent of these think it will burst this year, making immediate investment by them unlikely. Even those who see no bubble, however, disagree about price dynamics: they are split relatively evenly between those who say there never was one and those who say it burst last year. Interviews for this study suggest that the question requires further nuance. Mr O'Donnell of Mainstream Renewables echoes many when he says if there were a bubble, it would be an overvaluation of early stage assets. "I don't think renewable energy assets as a whole were overvalued. The shift from early

to later stage development is a better reflection of where the value lies," he argues.

When a recovery does occur, however, renewables valuations will lack some of their previous sparkle. Ms Landis of BP Alternative Energy says that her company expects that markets will be challenged throughout 2009 and into 2010. "When the recovery comes, it will be slow and it will take time to get back to where the markets were [in 2008]," she says. Mr Wong agrees. Before the credit crunch, renewables M&A saw a "perfect storm," with utilities needing to build out their capacity quickly, a restricted supply of development projects and easy access to capital. Now, he notes that many large utility companies have substantial renewables businesses and pipelines on their books, so the level of activity should come down.

The biggest barrier, however, and the one which will define those able to benefit from current conditions and those forced to sit on the sideline, will be access to cash.

"When the recovery comes, it will be slow and it will take time."

Katrina Landis, BP Alternative Energy

The shape of the market in the coming year

The new balance of risks and opportunities in the renewables market is likely to create a different M&A picture. Companies will be looking for opportunities, sometimes as those facing bankruptcy hold fire sales, but will be unlikely to take big gambles, especially in an environment where access to funding is severely constrained. "There will be assets coming onto the market, but we won't see the growth we have seen for the last several years. It will be more consolidation than growth," confirms Ms Landis.

Survey respondents believe that M&A in the near future will be smaller scale

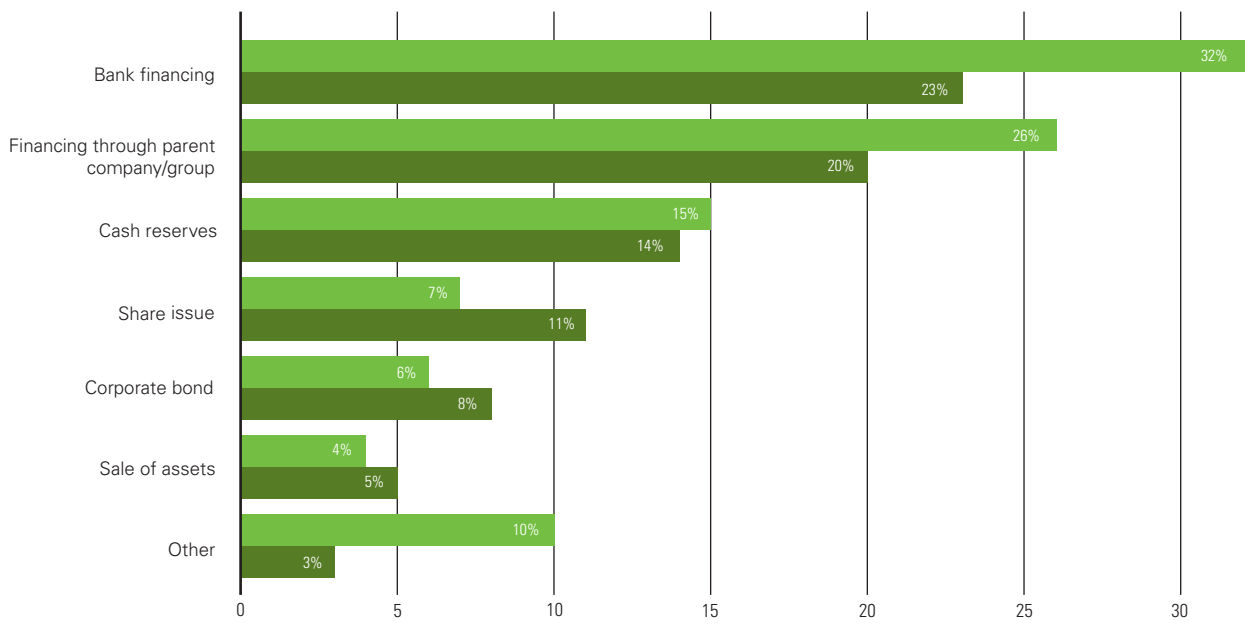
and opportunity driven: 49 percent expect the number of deals worth over US\$1bn to decline, compared with 13 percent who expect an increase. Moreover, of those who expressed an answer, 58 percent say they would be spending less than US\$50m on M&A in the coming year.

Mr Wong at Macquarie Group notes that "people with money are definitely waiting for bargains. Trading in operating assets is still relatively active." The strategies of companies interviewed for this study bear him out. Mr Anderson at ScottishPower Renewables says that his company prefers to develop its own sites, but

"It will be more consolidation than growth"

Katrina Landis, BP Alternative Energy

On which of the following will your company rely most heavily to fund investment into renewables over the next 12 months?



Key
■ 2009 Responses
■ 2008 Responses
 Source: Economist Intelligence Unit 2009

"What is key at the moment is whether there is value. We can afford to be a lot choosier"

Donal Flynn, Airtricity

will engage in M&A "if there is a very good strategic fit and if we can drive value out of the transaction." Similarly, Mr Flynn describes Airtricity's current approach as opportunistic. "What is key at the moment is whether there is value. We can afford to be a lot choosier," he says, including in terms of the stage of development.

The key to being able to exploit these opportunities, however, will be financing. A vast gulf exists between those buyers with the cash on hand to pursue deals versus those without.

Just under 40 percent of respondents to our survey say they are having a significantly harder time securing funding for renewables projects, with a further 25 percent finding it moderately more difficult. Along with other investments, this has a direct impact on M&A: bank financing is the most common means of funding, cited by 32 percent of companies as the one they would rely on most heavily. The growth in the use of banks reflects the even bigger problems in the stock and bond markets. The number of companies likely to issue shares to fund investments is down from 17 percent in last year's study to 7 percent this year, and those using corporate bonds from 10 percent to 6 percent.

Mr Griffiths-Lambeth at Moody's says companies used to finance themselves primarily through banks but loans are now hard to get and margins very high,

with many lenders not prepared to support renewables. Mr van Engelen of Essent agrees that now is a tough time for financing: "I don't know of any tricks [to get around the problem]," he says, and adds that, "even with guarantees from substantial partners, it remains complicated to get banks interested."

"Banks are less inclined to do one-off deals, and are focused instead on longer-term relationships."

Manus O'Donnell, Mainstream Renewables





Mr Anderson believes the problem, however, varies “dramatically” with the size of the company. The largest companies in the survey—those with annual sales of over US\$10bn—are finding it easier than the smallest—those with less than US\$500m in revenue per year—to secure what money is available. A total of 57 percent of big company executives confirm that financing has become harder to obtain, compared with 70 percent of respondents from smaller companies. Larger companies benefit not only from presenting a lower risk, banks are also interested in the long-term business they can represent. According to Mr Flynn, when it comes to capital allocation, many banks are far pickier with project sponsors with whom they don’t have a key relationship. “[Financing] is a much bigger issue for financial players and smaller developers than bigger utilities. This will drive consolidation,” he says. Mr O’Donnell of Mainstream Renewables agrees: “Banks are less inclined to do one-off deals, and are focused instead on longer-term relationships.”

At the same time, those companies that can, in particular larger ones, are turning to other sources of finance. Among the biggest companies in the survey, 34 percent expect to rely on financing through the parent company for renewables investment, the most common means of funding for that group. Nearly one in four (23 percent) will either tap cash reserves or turn to their banks. For the smallest companies, however, about one in three (32 percent) will need to head to the bank, while only 17 percent have cash reserves and 16 percent

think they will access group financing. According to Mr Anderson, large utility-backed developers are continuing to fund their projects from balance sheet and existing cash flow. “Where the market is seeing issues is on the independent developer end,” he says.

Smaller companies simply have fewer fundraising options at their disposal. The stock markets are at a low point. Meanwhile, as Mr Griffiths-Lambeth points out, bond issues of under £100m do not make economic sense and low grade bonds are out of favor anyway. Purely financial investors are leaving the scene, and banks are not interested.

The better position of larger companies is relative rather than absolute. Ms Landis notes that banks are “extraordinarily conservative” compared to last year. Among other things, they want all parties involved in a deal to have at least single A credit ratings, and are unwilling to take any technology risk, to the point of insisting that they will not provide funding for wind projects where the turbines are deemed to be too risky. “Even when you clear all of these hurdles,” she says, “they still want to charge you a large number of basis points.”

Sellers themselves may need to provide funding: 55 percent of respondents expect an increase in the number of deals with delayed or contingent payments rather than up-front money. “It is really a very big challenge,” confirms Mr van Engelen of Essent. An ability, where necessary, to find such creative arrangements may well differentiate the winners from the losers in the new M&A environment.

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