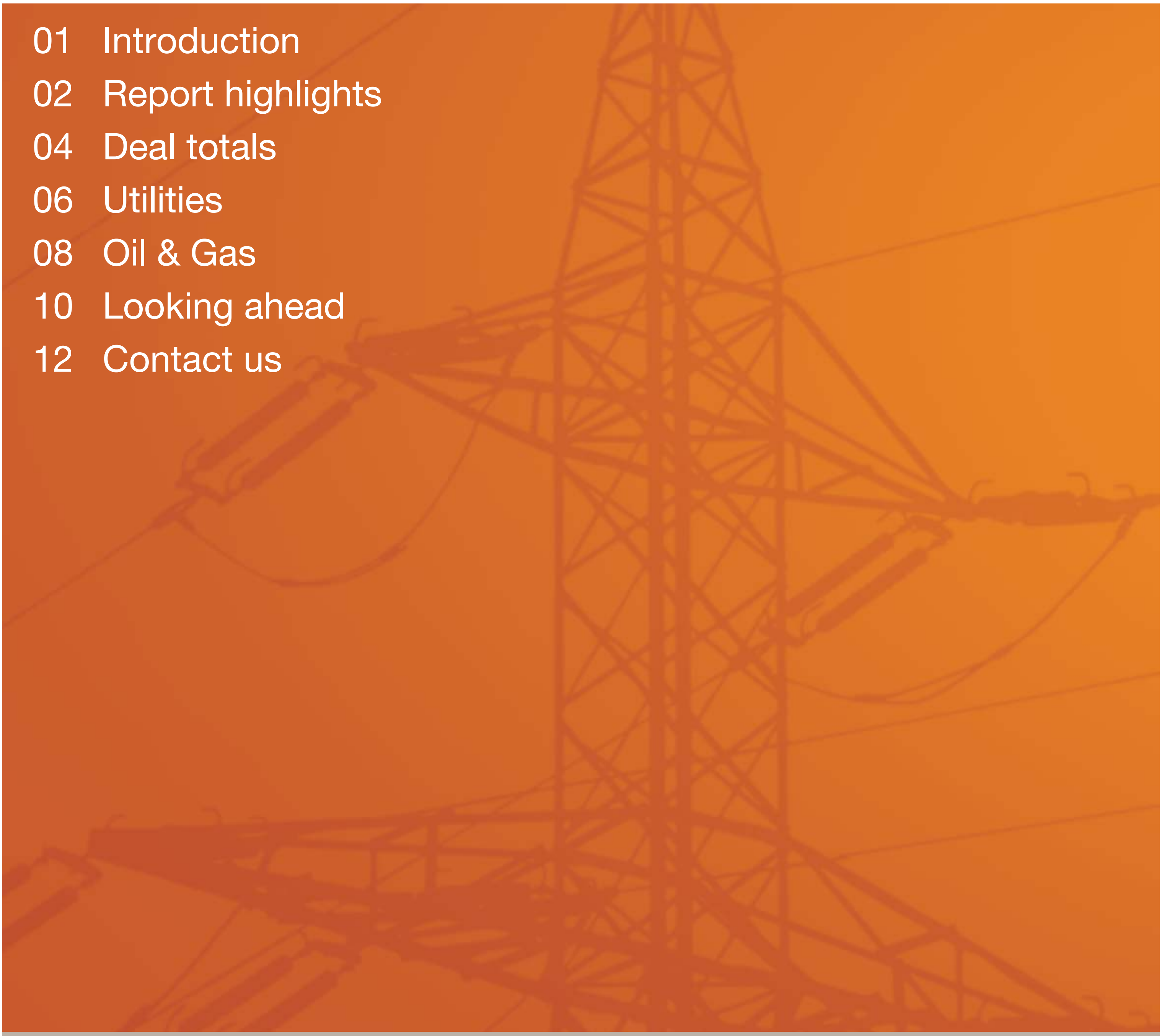
Industries
Energy, Utilities & Mining

Energy Deals*

2008 Annual Review

Mergers and acquisitions activity
within the Turkish energy market

Contents



Methodology and terminology

Energy Deals includes analysis of cross border and domestic deal activity in oil, gas and electricity markets in Turkey. The analysis is based on publicly available information and encompasses announced deals as of 31 December 2008, including those pending financial and legal closure. Deal values are the consideration value announced or reported and figures relate to actual stake purchased and are not multiplied to 100%. All presented totals of deals are inclusive of estimates for deals with no reported value. In addition, this document incorporates the results of a survey in wich PricewaterhouseCoopers spoke to management from both foreign and domestic companies active in the Turkish energy deal arena over the past two years. The document is also available at www.pwc.com/tr/

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We are pleased to bring you the first edition of *Energy Deals*, our analysis of mergers and acquisitions in the Turkish energy market. PricewaterhouseCoopers Turkey is launching this document with a view to provide current and future investors with an updated and a deeper insight on the deal activities that took place in the Turkish oil, power and gas markets in 2008. We also highlight, in a series of deal dialogues, the results of the survey conducted with major players in the Turkish energy deal market.

By all accounts, 2008 is a year that will be engraved in our memories, as the year in which the first three quarters were marked by a significant appetite to invest, and the rest by a struggle to survive with updated risk definitions. In this world of global investment, Turkey proved to be better positioned to weather the crisis than in the past and has done relatively well to be a safe shelter for energy deals, in particular. In fact, the total energy deal volume surged to US$6.6bn in 2008, shadowing those of previous periods mainly on the back of big ticket privatisations of the electricity and gas distribution companies, coupled with growing interest in renewable energy generation.

Looking into the future, we by and large agree with recent market outlooks indicating that tighter liquidity and lower risk appetite will likely translate into tougher and higher-cost access to financing. The credit and recessionary concerns are already rendering the investment landscape more conservative. At this point however, the mostly affirmative feedback derived from our survey allows us to remain confident in further enlargement in the energy deals landscape, on the back of growing domestic demand for energy and the busy privatisation agenda of the state energy assets. With this in mind, we hope to see the current regulatory challenges and the financing problems overcome and translated into much higher transaction figures in 2009.

02 Report highlights

Energy deals reach record values

The Turkish energy market has seen tremendous interest from both domestic and foreign investors in 2008; total deal volume reached US$6.6bn out of 19 deals, representing a surge compared with the average value of US$1bn posted over the previous three years (excluding Tupras privatisation in 2006). The launch of big ticket privatisations in the electricity and gas distribution segments was the key driver of this momentum. Though not as sizeable, the deal activity in the power generation front is also worth mentioning, reflecting the positive reaction to regulatory improvements to promote the use of renewable energy resources.

Utilities were the hottest deal arena

Utilities have been the busiest deal venue in 2008. Out of the total 19 deals, 16 were related to utilities, with a total activity of US$6bn, i.e. 90% of the total deal value. This sum includes the proceedings of the privatisation of the electricity and gas distribution companies, and the figures raised in private deals in power generation. The largest deal value, US$1.6bn, was hit in the privatisation of Baskentgaz, the natural gas distribution company in Ankara. The other mega deal was the privatisation of Baskent Elektrik, the electricity distribution company operating again in Ankara, the winning bid for which reached US$1.225bn. Except the sale of Akpet, the sixth largest fuel retailer, to Lukoil, no significant deal activity took place in the Turkish oil market, explained by the fact that c.90% of the petroleum retail market is shared among the top 5 players.

Local deal makers in privatisations

The weight of the local interest in privatisation was obvious. Foreign players preferred to get engaged into consortiums with local counterparts, rather than participating by themselves. The main reason behind their low interest was the uncertainties in the tariff structures in the electricity and gas markets. The acquisition of Izgaz, the gas distribution company operating in Kocaeli, by GdF Suez, on the other hand, constituted an exception to the absence of pure foreign interest in the privatisation tenders.

Strong outlook for 2009 despite the crisis

The privatisation tenders left incomplete in 2008 are to constitute the main transactions in 2009 and most probably in 2010. In the power arena, privatisation of state-owned distribution and generation assets as well as private deals in renewable energy will constitute the bulk of the deal activities. In the gas front, the privatisation of IGDAS, the gas distribution company in Istanbul, scheduled for the post-municipal election period, is the biggest deal prospect. Our outlook for the deal potential in the Turkish oil market remains doubtful given the existing market-related and regulatory constraints.

Although all these deal prospects are already shadowed by the ongoing shake-out in the financial markets, we maintain our optimistic stance for the energy deals to take place in 2009, on the back of the positive picture drawn in our survey. However, we still believe in the high vulnerability of success in attracting both domestic and foreign interest to the liquidity shortage and sustainability of the regulatory reforms towards full liberalisation.

04 Deal totals: a record year

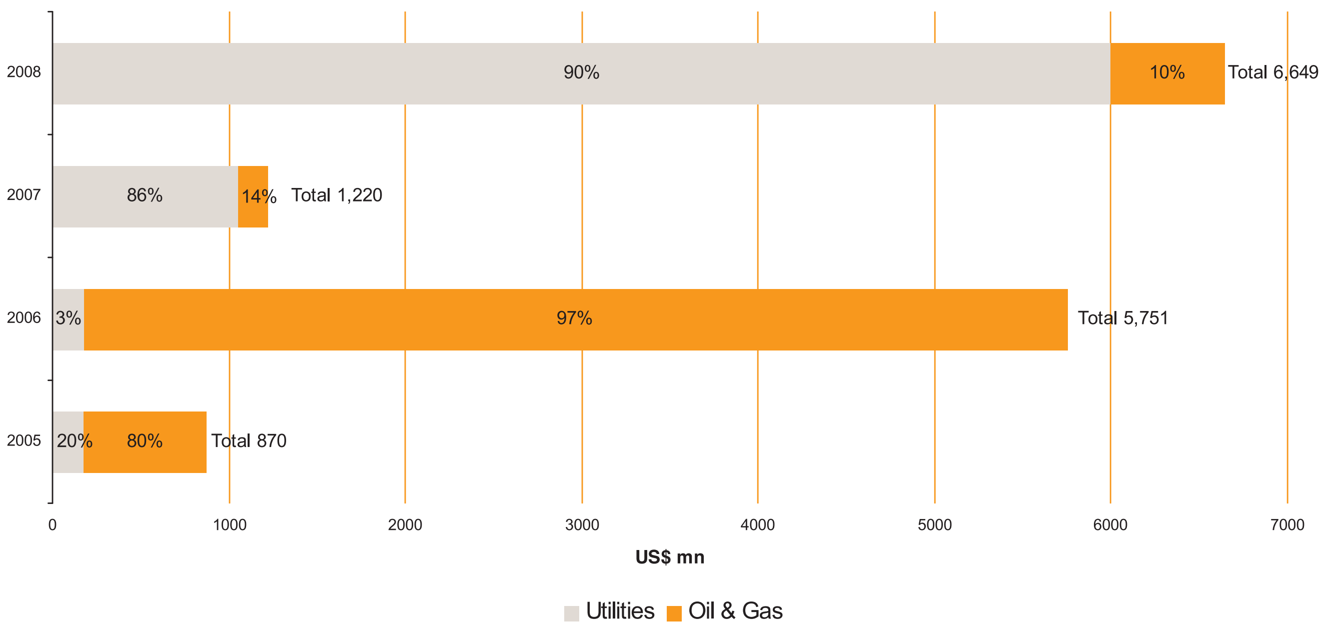
The total value of the energy deals in 2008 reached an all-time high of US$6.6bn, driven mainly by electricity and gas distribution privatisations and the acquisitions in power generation segment

In 2008, the Turkish energy market hosted a total of 19 deals in the public and private spheres, with a total value of US$6.6bn and an average of US$350mn per deal. This is the highest figure since 2006, which saw the privatisation of Tupras. Excluding this big ticket, the average annual deal volume since 2004 was in the vicinity of just US$1bn, marking 2008 as a high-flyer. The main driver of this pleasing result in 2008 was the privatisation of the utilities. Albeit dominating a tiny share in the total deals value, the acquisitions in the power generation segment were promising, mainly in terms of the strong multinational identity of the acquirers and the proof of positive reaction to the changes in regulation. The contribution of the deals in the oil & gas segments, on the other hand, remained limited at 10%.

Figure 1: **Total energy deals in 2007 and 2008**

	2007			2008			YoY change	
	Number	Value (US$ m)	Average value	Number	Value (US$ m)	Average value	% number	% value
Utilities	20	1,050	53	16	6,000	375	-20%	471%
Oil & Gas	3	170	57	3	649	216	0%	282%
Total	**23**	**1,220**	**53**	**19**	**6,649**	**350**	-17%	445%

Figure 2: **Total deal values between 2005 and 2008**

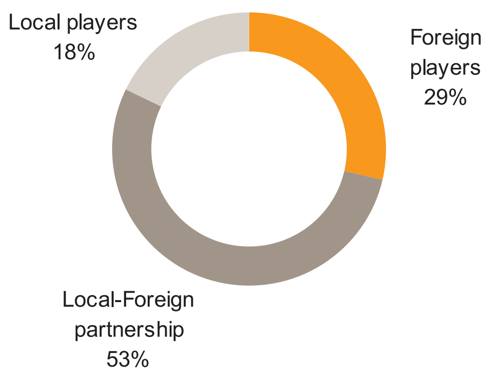


The resumption of the once redundant tender process to privatise the electricity distribution companies, coupled with the gas deals of the same nature carried the share of ‘public’ deals up to 72%.

Figure 3: **Public vs. private deals by value**

A closer analysis of the transaction participants’ origin reveals the fact that, for the big-ticket privatisations in particular, foreign players mostly preferred to partner with local investors. Accordingly, there were three deals that ended with the winning bids of such partnerships making up US$3.4bn, corresponding to 53% of the total deal value.

Figure 4: **Deal origins by value**

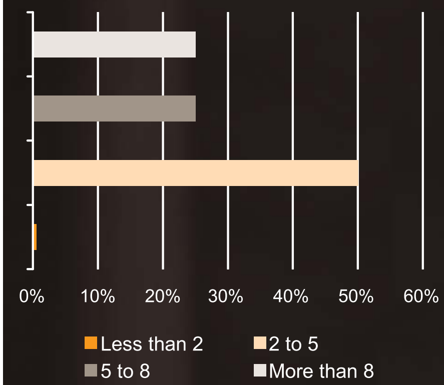


Western Europe continues to be the most active region in energy deals in Turkey. In fact, major players from France, Germany, Italy, the Netherlands and Austria comprised 58% of total deal volume in 2008 (including their local partners’ shares where applicable), in line with their strategy to extend their reach beyond their motherlands. On the other hand, it is important to note that none of these foreign participants was a private equity company but, they were all industry players.

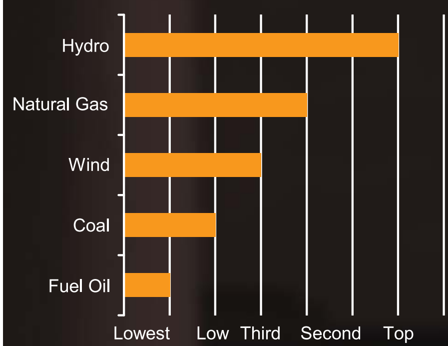
Energy deal dialogue:

We asked deal makers how many targets they have investigated in the Turkish energy market and what sources of energy they were considering for electricity generation. The majority of respondents indicated that they have considered two to five candidates so far, proving the busy energy deals agenda in the Turkish market. They also noted that hydroelectric and natural gas were their priority areas.

How many targets have you considered in the past two years?



Please rank your interest in the following sources of power generation



06 Utilities: the hottest deal arena in 2008

Privatisations of electricity and gas distribution companies in Ankara and the electricity distribution company in Sakarya were the top three deals in 2008 in the utilities sector

2008 has been a busy year for privatisations. The first package included the resumption of the tenders for Baskent and Sakarya electricity distribution companies. This was followed by another double-package including the Meram and Aras companies. The total amount raised for these four regions corresponding to an aggregate consumption level of 24.8bn kWh in 2007 (19% of the total domestic consumption) reached US$ 2.4bn.

On the gas distribution front, we saw two tenders for Baskentgaz and İzgaz, which supplied 4.2bcm of natural gas for a total of 1.2mn subscribers in 2007. The total proceeding, out of these privatisation deals was US$1.8 bn.

Figure 5: **Utilities deals in 2008**

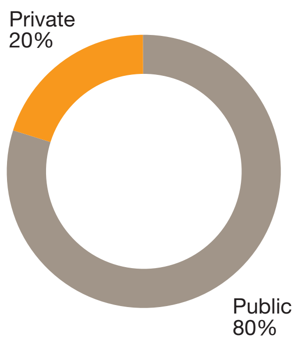
Date announced	Target	Stakes in %	Acquirer	Acquirer nation	Deal value (US$ mn)
05-Mar-08	Ankara Dogal Elektrik Uretim	100%	Zorlu Enerji Elektrik Uretim	Turkey	510
15-Mar-08	Baskentgaz	90%	Global - Energaz - ABN Amro	Turkey - Netherlands	1.610
23-Apr-08	Kayserigaz	40%	EWE AG	Germany	78
06-Jun-08	Ozarsu Elektrik	70%	Yesil Enerji (Global)	Turkey	4
01-Jul-08	Baskent Elektrik Dagitim	100%	Sabanci - Verbund - EnerjiSA	Turkey - Austria	1.225
01-Jul-08	Sakarya Elektrik Dagitim	100%	AkCEZ	Turkey - Czech R.	600
11-Jul-08	Bares Elektrik Uretim	100%	Italgen SpA	Italy	51
30-Jul-08	Tasyapi Enerji Grubu	50%	Cogentrix Energy	USA	n.d.
15-Aug-08	Izgaz	90%	GdF Suez	France	232
25-Sep-08	Meram Elektrik Dağıtım	100%	Alsim Alarko	Turkey	440
25-Sep-08	Aras Elektrik Dağıtım	100%	Kiler Holding	Turkey	129
28-Sep-08	Borasco	60%	OMV	Austria	n.d.
08-Oct-08	Ak Enerji Üretim	37%	CEZ	Czech Republic	303
23-Oct-08	Kayserigaz	40%	EWE AG	Germany	n.d.
23-Oct-08	Bursagaz	40%	EWE AG	Germany	n.d.
09-Dec-08	Polat Enerji	50%	EdF Novelles	France	n.d.
Total					**~6,000***

n.d: not disclosed
*Includes estimated deal value for undisclosed deals

Whilst the electricity deals in 2008 were higher in number compared to gas deals (11 electricity vs. 5 gas), we witnessed a more balanced distribution in terms of deal values, largely driven by the privatisation of Baskentgaz and Izgaz.

The dominance of the public deals was heavily felt on the utilities front, mainly on the back of privatisations that contributed to some 80% of total deal volume, while private deals remained at 20%.

Figure 6: **Public vs. private utilities deals by value**



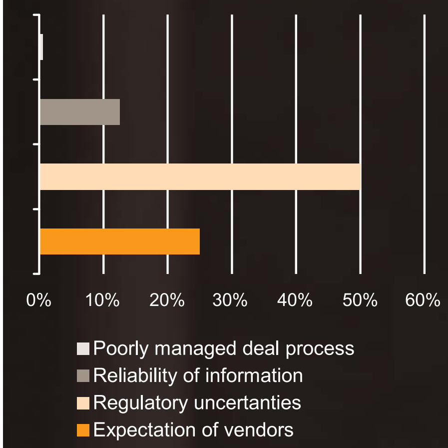
The rest of the deals in the utilities segment was dominated by the acquisition of renewable generation capacity, which posted a surge in itself. The automatic pricing mechanism that took effect in the second half of the year and the amendments in the Electricity Market Law and the Renewables Law positively influenced interest from foreign players.

Inspite of the negative global financial and economic outlook prevailing since early 2008, the deal activity remained strong and was evenly distributed throughout the year. Even in the fourth quarter, where the crisis elevated to its highest level, the Turkish energy market saw continued deal activity without loosing pace.

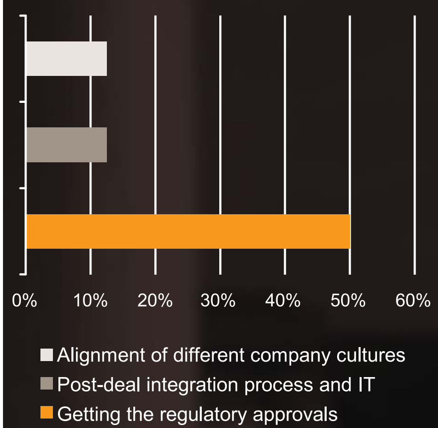
Energy deal dialogue:

Our survey indicates that regulatory uncertainties are the biggest challenge for investors during the deal process. In the post acquisition period, on the other hand, obtaining regulatory approvals remains the biggest obstacle.

Which one of the followings do you consider to be your biggest challenge during your deal process?



Which of the following is the greatest challenge in the post-signing period?



08 Oil & Gas: another slow year

The absolute dominance of top-5 players over 90% of the fuel retail market limits the attractiveness of the remaining players

2008 has been another slow year in the Turkish oil market. 90% of the fuel retail market was concentrated in the hands of the top 5 players, limiting the attractiveness for the remaining market actors. The only exception was the completion of the acquisition of Akpet (the sixth largest retailer with c.4% share) by Lukoil, in such a way as to narrow further the room for consolidation among the smaller players struggling to share a tiny slice of 6%.

The recently increasing margins in the lubricants sector, on the other hand, have not brought about sufficient action to qualify as a 'deal', but has instead pushed the big players to diversify their own portfolio with more sophisticated types of this product.

A similar picture in fuel retail has dominated the LPG scene, in that the top 7 dominate c.70% of the market, leaving the rest to 57 players. The rigid market structure given the strong distribution network of top 3 sharing 50% of the market do not leave much room to a brisk M&A field.

In such a stagnant environment, the only movement is seen on the storage front, mainly on the back of the strictly enforced National Stock Requirement regulation. To comply with their respective storage capacity requirements, the players are either investing in their own facilities or becoming engaged in storage asset transactions.

Figure 7: **Oil & gas deals in 2008**

Date announced	Target	Stakes in %	Acquirer	Acquirer nation	Deal value (US$ mn)
29-Jul-08	Akpet	100%	Lukoil	Russia	555
08-Aug-08	Akcakoca Natural Gas Project	27%	Petrol Ofisi	Turkey	80
23-Aug-08	Koc Statoil	50%	Aygaz	Turkey	14
Total					**649**

In the upstream segment, private players' expectation about the ratification of the long-awaited amendments to the Petroleum Law resulted in disappointment. In fact, the global players preferred to go for joint drilling with TPAO (state upstream company), instead of paying interest in the acquisition of a private license holder.

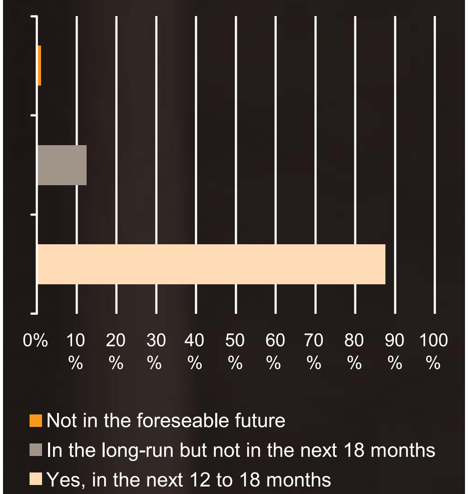
A similar inactivity was seen in refining. The silence on the EMRA front regarding the pending refinery applications blocked the plans of JVs intending to put considerable investment in plans. In the same vein, a lack of action by the Council of Ministers to clarify the details of its intention to incorporate an energy industry zone into facilities in Ceyhan frusturated the multinational players intending to invest in oil-related logistics and storage activities in the region.

The scarcity of local natural gas resources and the high investment needed to tap them has not constituted an attractive investment base for deals in the upstream segment of the natural gas value chain.

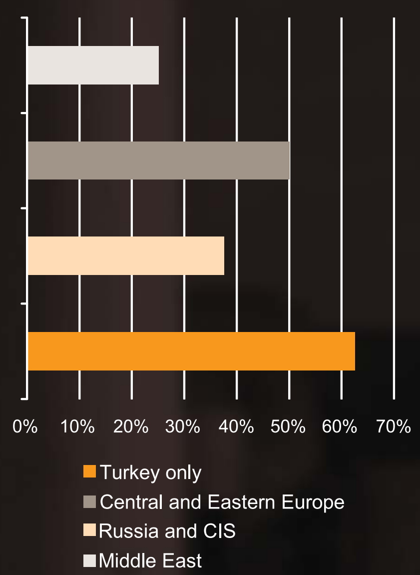
Energy deal dialogue:

The survey of market players indicates that despite uncertainties in the regulatory environment and recent economic downturn, interest in the Turkish market continues. Whilst 80% of the survey participants consider a deal in the next 12 to 18 months, Central & Eastern Europe and Russia and CIS stand out as other market places investors are considering.

Do you plan to do other deals in Turkey?



In which of the following regions will you continue to pursue acquisitions in the coming 18 months?



10 Looking ahead

Privatisation of EUAS generation portfolio as well as electricity and gas distribution companies and amendments to the Renewable Energy Law continue to present a promising future for the energy deals market

Not granted an exception, Turkey is not to emerge undamaged from the ongoing turmoil in the financial markets which is already frustrating 2009 investment plans around the world.

In such a turbulent global environment, making risk aversion the number one rule of thumb, what will differentiate one emerging market from its peers will be the well functioning regulatory structures supported by sound and sustainable incentive schemes. In that respect, a glimmer of hope appears in the Turkish electricity market, in particular.

The government still seems eager to go on privatising the remaining 15 distribution companies, despite a lack of foreign interest in the last two tenders.

In addition, although halted due to the collapse of Lehman Brothers, which was once a party to the the sell-side advisor consortium, the block sale / transfer of operational rights of a state portfolio of 15.4 GW installed capacity is expected to at least kick off in 2009.

Another tender package in the horizon relates to the construction and operation of two coal-fired power plants, each of 1,200MW, in the Afşin - Elbistan C and D Basins in southeastern Turkey. Please recall that a previous tender undertaken in June 2008 was cancelled on the grounds of low participation and high bids placed to sell the output to the state. Upon the successful completion of the second tender, expected in 2009, subsequent action is likely in the E and F Basins in the same zone. On the other hand, a much sounder step in the coal sector is in the making. The Privatisation Agency has recenty voiced its intention to put TKI (the state economic enterprise operating coal mines) on its tender agenda looking forward.

To further incentivise private investments in generation, an amendment proposal to the Renewable Energy Law, currently under the Turkish Parliament's consideration, is provisioning an upward adjustment to the feed-in tariff to bring it in line with the EU norms. This is to come with the differentiation of the existing unitary tariff structure and the extension of the incentive period per renewable source, constituting the other promising points of this proposal.

On the wind front, the market is looking forward to seeing the finalisation of the tenders to determine the ultimate license-holders among the ones who already applied for overlapping locations. Once this process is finalised, the market expects to see increased deal activity on this arena, in particular as an access to capital for local investors to finance these costly investments.

The sky is cloudier in the natural gas market.

The impossibility of reducing the BOTAS' market share in 2009 from its current level of c.90% to 20% has already become obvious. Therefore, a reasonable update in this scheduling should occupy top of the agenda. To render the new target feasible, given the inoperability of the existing gas release contracts, volume releases should also be allowed on an equal status with the gas releases.

A hot issue seen as the cure to the problem in this sector is the privatisation of BOTAS. Although this plan has been already stated by the Head of the Privatisation Administration, it seems likely to take a while, given the complicated structure and areas of operation of this enterprise.

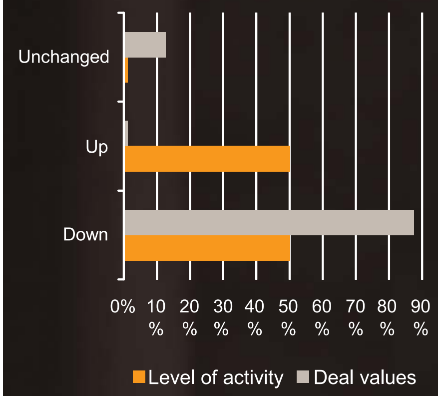
On the gas distribution front, nevertheless, the excitement lies in the privatisation of IGDAS (owned by Istanbul Municipality), expected to take place in 2009 according to statements by the Turkish Government.

The most silent area seems to be the oil market. Although recently urged by the Competition Authority to finalise the pending refinery applications, EMRA is yet to take any concrete action. Given the fact that top 5 fuel retailers dominate c.90% of the fuel retail market, little activity is expected in this segment. However, we still see a silver lining in the storage business on the back of capacity shortage problem of the retailers in complying with the National Stock Requirement regulation.

Energy deal dialogue:

Market players estimate that the current economic crisis is likely to lower deal values, however with a less impact on deal activity. Financing the deals will be the biggest challenge in the short term. On the other hand, survey respondents are less worried about meeting business plan targets.

How do you expect level of activity and deal values to evolve in the near future?



What do you consider as the biggest threat to energy deals?

Threat	Priority
Financing	Top
Volatility of energy prices	Second
Regulatory environment	Third
Meeting the business plan	Low

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