The trend towards deals for European gas networks has become strongly evident in the first half of 2013. It's a development that we predicted in earlier reports in this series and that is set to continue. Renewables deal activity has also stepped up and we now expect attention to turn to potential value in gas generation assets. Despite the current economic challenges, gas assets remain an attractive long-term investment opportunity.

Summer 2013

European Power & Renewables Deals

Half year M&A outlook

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Deal flow: network gas and renewables deals boost deal value

European power and renewables deal flow is holding up despite continuing uncertainty about government energy policy in a number of countries. The US$27.7bn total value of deals for European targets in the first half of 2013 is a third (33%) up on the US$20.8bn total for the last six months of the previous year. Indeed, it is not far off the US$29.4bn announced in H1 2012, a figure that was considerably buoyed by the US$11.1bn GDF Suez/International Power transaction.

Much of the increase in value is attributable to a flow of large deals for gas network assets. Back in Spring 2012, we flagged up the prospect of major changes ahead in Europe's gas transmission networks. With the value of deals for European gas targets rising more than fourfold, from US$4.3bn in H2 2012 to US$13.6bn in H1 2013, this trend is now quite evident. Renewables deal flow is also proving quite resilient, despite some degree of regulatory uncertainty. A rise in the value of renewables deals, along with that of gas targets, has more than compensated for a relative lull in power deals.

Many of Europe's leading power utility companies continue to focus on divestments. Both E.ON and GDF Suez made significant steps in their respective divestment programmes with the sale of stakes in Slovakian energy company Slovenský Plynárenský Priemysel (SPP) (see 'deal makers'). In March 2013, Italy's Enel announced a €6bn disposal programme as part of its 2013-2017 plan which will add to deal flow in the period ahead. With a widening gap between mature markets and growth markets, the focus is cashflow and margin preservation in the first while strengthening the balance sheet to focus on expansion in the second.

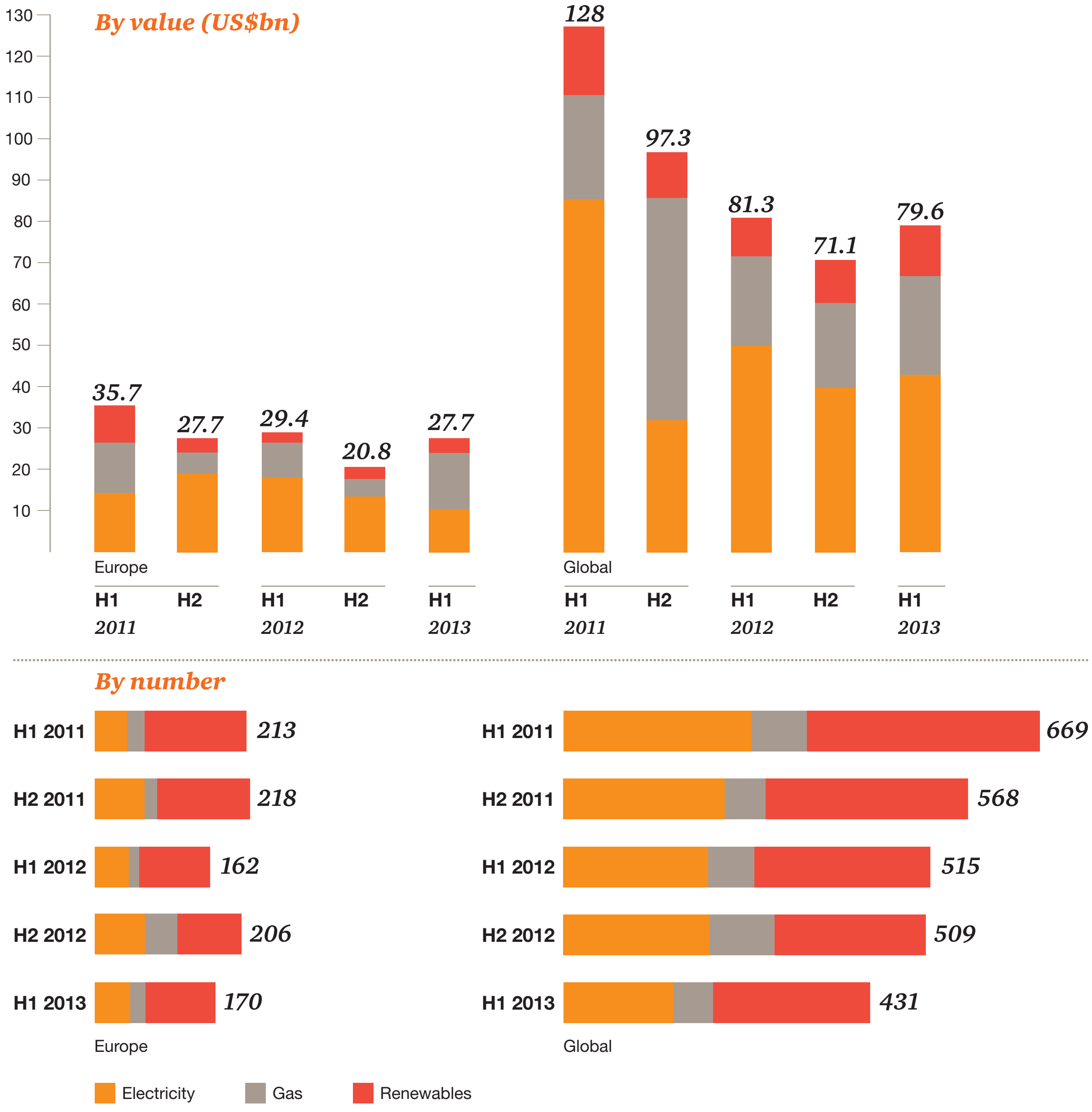
In Enel's case, the growth focus is on Latin America, worldwide renewables and eastern Europe. The challenging nature of the environment in its mature European market is reflected in the company's intention to reduce its generation capacity by 11.9% in the next five years, from the 59GW it had in 2012 to 52GW in 2017[1]. Indeed, Enel ended H1 2013 with the announced intention to sell its Marcinelle 420 MW combined-cycle gas turbine power plant in Belgium to Gazprom.

It's no surprise that where opportunities to dispose of non-core gas generation assets exist they are being seized in the current spark spread environment. The contrast in circumstances of gas generation, as compared to gas network assets, is stark. Many gas-fired plants are mothballed in the UK, Germany, France, Italy and other countries. We look more closely at the implications of this for future deals in our 'deal focus' section.

The outlook for the second half of 2013 remains positive with a number of deal processes currently underway and other processes expected to start in a number of countries. These include Fortum's expected sale of its electrical distribution networks in Finland, Sweden and Norway, the Irish government's sale of Bord Gais Energy and the potential disposal of a stake in Greece's state owned power transmission operator, Admie.

1 Enel 2012 results, 2013-2017 business plan, 13 March 2013.

Figure 1: ***Half year power and renewable energy deal trends – Europe (by target) and global***



Source: European Power & Renewables Deals, Summer 2013

Deal makers: eyes turn to southern and eastern Europe

Much of the attention of big dealmaking has been on the Czech Republic and Italy. The largest deal of H1 2013 saw Czech company EPH buy a 49% stake in Slovak gas utility SPP from E.ON and GDF Suez in a US$3.5bn transaction. The deal meant that E.ON was able to reach its divestment programme target ahead of schedule while also taking GDF Suez a step along its own asset sales road.

As at May 2013, E.ON had €17bn of disposal proceeds already materialised with an expected €3bn more to come from expected sales, including its stake in uranium enrichment company Urenco.[2] On the acquisition side, E.ON's growth market moves include acquisitions of the power distributors for the Toroslar and Ayedas regions in Turkey made by Enerjisa, its joint venture with Sabanci. These will increase Enerjisa's Turkish customer base to around nine million – a 25% market share.

The trend towards consolidation of European gas network assets has gathered pace with the sales of TIGF in France by Total and Net4Gas in the Czech Republic by RWE, which like its big utility peers is part-way through a divestment programme. The US$3.3bn purchase of TIGF by Snam, the lead partner in a consortium with GIC, the Singaporean sovereign fund and EDF, is an important move by the Italian gas transport and storage operator company in the developing interconnection of European gas markets. A busy half year for Snam also saw the book-building sale to the market of a 15% stake in the company by Eni, as part of the oil company's exit from Italy's gas networks.

International interest in network assets is high. Another group reportedly bidding for TIGF consisted of Belgian gas company Fluxys, teamed with banking and insurance companies plus the Abu Dhabi Investment Authority. The gas network appetite among insurance and financial investors was also evident in RWE's US$2.1bn Net4Gas sale. The Czech gas grid operator was bought by a consortium of Allianz and Borealis Infrastructure, the investment arm of Canadian pension fund Ontario Municipal Employees Retirement System. There was also considerable international investor interest in the May 2013 private placing of a 5.36% stake in Italian power grid operator Terna.

The flow of renewable power deals has stepped up a notch and we expect it to continue in the remainder of 2013. Leading the way was the US$774m sale by Dong Energy of its 25.7% stake in Swedish hydro power company Kraftgarden. The move completes Dong's exit from hydropower. In other deals, Polish power utilities PGE and Energa were on the buy-side for the onshore renewable generation businesses of both Dong Energy and Iberdrola, as both exited from Polish onshore windpower. Dong is divesting assets to enable it to focus on growth in offshore wind generation. The Iberdrola sale follows similar moves in France as part of its 2012-14 plan of divesting assets in non-strategic markets.

The year has been quiet so far in terms of inward investment in the European power sector from Chinese and Japanese investors. But we do not see this as indicative of any reduction of interest. We continue to expect such buyers to be competing for power assets in Europe, particularly on the generation side, in both conventional and renewable generation, when suitable opportunities become available.

Figure 2: ***Top five deals for European power targets***

No.	*Value of transaction (US$m)*	*Date announced*	*Target name*	*Target nation*	*Acquirer name*	*Acquirer nation*
1	*3476*	*15 Jan 13*	*SPP (49%)*	*Slovak Republic*	*Energeticky a Prumyslovy Holding - EPH*	*Czech Republic*
2	*3262*	*5 Feb 13*	*TIGF*	*France*	*Snam (45%); GSI (35%); EDF (20%)*	*Italy*
3	*2051*	*28 Mar 13*	*Net4Gas*	*Czech Republic*	*Allianz and Borealis Infrastructure*	*Canada*
4	*1914*	*9 May 13*	*Snam (11.6882%)*	*Italy*	*Market purchase*	*Italy*
5	*1725*	*15 Mar 13*	*Toroslar Elektrik Dagitim*	*Turkey*	*Enerjisa Enerji Uretim*	*Turkey*

Figure 3: ***Top five deals for European renewable energy targets***

No.	*Value of transaction (US$m)*	*Date announced*	*Target name*	*Target nation*	*Acquirer name*	*Acquirer nation*
1	*773.6*	*27 June 13*	*Kraftgarden (25.673%)*	*Sweden*	*Kymppivoima; EPV Energy; Helsingin Energia*	*Finland*
2	*318.7*	*19 Feb 13*	*Dong Energy's Polish onshore wind portfolio*	*Poland*	*PGE ; Energa*	*Poland*
3	*266.8*	*26 Feb 13*	*Iberdrola's Polish onshore wind portfolio (75%)*	*Poland*	*PGE; Energa*	*Poland*
4	*222.7*	*13 Feb 13*	*Six wind parks in Germany and two in France*	*Germany*	*KGAL GmbH & Co*	*Germany*
5	*220.2*	*6 Feb 13*	*Four wind farms (SSE)*	*United Kingdom*	*Greencoat Capital LLP*	*United Kingdom*

Source: European Power & Renewables Deals, Summer 2013

2 E.ON, Capital Market Story, May 2013.

Deal focus: gas generation up for grabs

Current market conditions are making life tough for operators of gas-fired plant. But they could be attractive for investors willing to take a view on a turnaround in the outlook for gas generation in Europe. Investor attention is being drawn to potential low valuations as current owners are forced to reduce their exposure and trim their portfolios. We expect transactions for gas power plants to play an important part in deal flow in the coming months.

The expansion of renewables, cheaper imported coal, overcapacity in the current economic environment and low wholesale prices are crowding even the most technologically-advanced gas plant out of the market. The situation is evident in a number of European countries, including France, Germany and the UK. Market conditions have been particularly difficult since 2011. Companies with strong balance sheets can afford to mothball plants and sit things out. But time is running out for more highly leveraged owners, particularly among independent power producers. They are having to offload assets or continue to refinance.

This is providing opportunities for investors able to wait for the market environment to change and plants to regain profitability. One such example is the group of investors led by Australian bank, Macquarie, which closed the purchase of the 819 MW combined-cycle gas-fired Sutton Bridge Power Station from EDF Energy in March 2013. The sale by EDF was a divestment obligation arising from its purchase of British Energy rather than as a result of the current market. But the Sutton Bridge acquisition is the second UK gas-fired power plant that Macquarie has invested in, following the acquisition of Baglan Bay from General Electric earlier in the year, as it takes a long term view that gas generation's profitability will improve.

As well as financial buyers, private equity investors could feature on the buy-side. They are more involved in the sector than before as they seek to deploy the proceeds from newly established specialist energy funds. Gas generation assets could form part of a mix of assets for the funds. In addition, a number of Japanese trading houses are seeking to build presence in European generation.

Investors who prefer greater certainty but are still looking for exposure to gas fired generation have the opportunity of looking at power stations with long-term tolling contracts. Ireland's state electricity utility, ESB, announced in February 2013 its intention to sell its 50% shareholding in each of its international tolling plants, Marchwood Power Ltd in the UK and Bizkaia Energia SL in Spain. As well as the buyers outlined above, these assets could attract investment interest from Chinese generation companies and infrastructure funds.

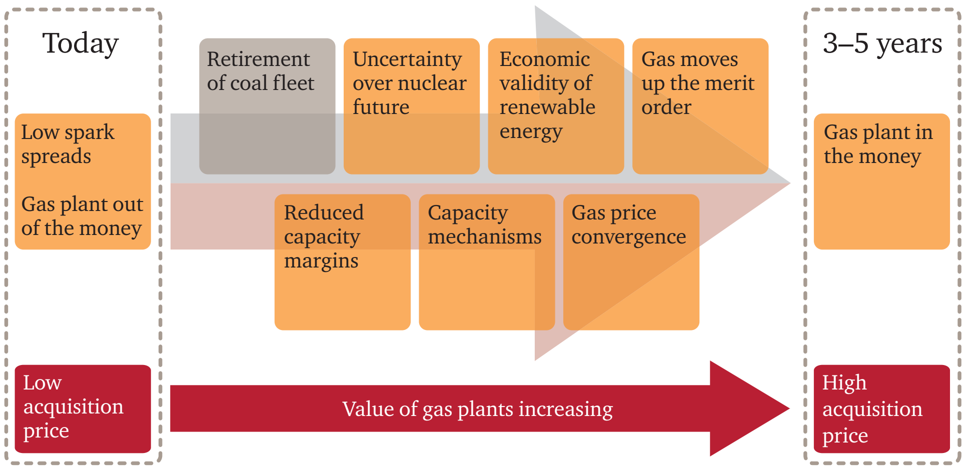
A key factor in the current situation is that declining US gas prices have increased the volume of exported coal. Low European coal prices make coal a higher margin fuel source than gas. As a result, coal is presently preferred as a power source with the 'dark spread' (a measure of gross margin of coal-fired power stations) much wider than the 'spark spread' (the equivalent measure for gas-fired plant).

But, despite the current market, gas assets remain an attractive long-term investment opportunity. A number of factors point to their value increasing over a medium term time horizon (see figure 4).

One key development is the imminent retirement of coal plants due either to age or decisions to opt out of the EU Large Plant Combustion Directive (LPCD). Plants that opted out are limited to a maximum of 20,000 hours of further operation and must close completely by the end of 2015. The favourable 'dark spread' has led to operators of coal power stations burning through these hours at a faster rate and closures coming forward earlier than their expected 2014/15 dates.

Other factors indicating a more favourable medium term outlook for gas include developments in the gas supply chain that point to a more globalised market. Global gas price convergence should narrow the gap between spark and dark spreads in the medium term. On the regulatory front, current uncertainty surrounding government support for thermal plant through measures such as capacity mechanisms, are expected to resolve in the next year or so as governments react to the current anomalous market position of gas. Such policy development is all the more likely given continued uncertainty around nuclear generation and the long timescales associated with bringing new nuclear power onstream.

Figure 4: ***Gas assets are an attractive long-term investment opportunity***



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Methodology

European Power & Renewables Deals includes analysis of all global power utilities, renewable energy and clean technology deal activity. This version focuses on the European market. We include deals involving power generation, transmission and distribution; natural gas transmission, distribution and storage; energy retail; and nuclear power assets. Deals involving operations upstream of these activities, including upstream gas exploration and production, are also excluded. Renewable energy deals are defined as those relating to the following sectors: biofuels, biomass, geothermal, hydro, marine, solar and wind. Renewable energy deals relate to the acquisition of (i) operating and construction-stage projects involved in the production of renewable energy and (ii) companies manufacturing equipment for the renewables sector. We define clean technology deals as those relating to the acquisition of companies developing energy efficient products for renewable energy infrastructure.

The analysis is based on published transactions from the Dealogic 'M&A Global database' for all electricity, gas utility and renewables deals. It encompasses announced deals, including those pending financial and legal closure, and those which are completed. Deal values are the consideration value announced or reported including any assumption of debt and liabilities. Comparative data for prior years and quarters may differ to that appearing in previous editions of our analysis or other current year deals publications. This can arise in the case of updated information or methodological refinements and consequent restatement of the input database.