Transaction Advisory Services

Maximising the value of wind projects

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Ernst & Young's Renewable Energy Group

With a dedicated 35 – strong team of specialists, supported by a network of over 75 international advisors, Ernst & Young's Renewable Energy Group helps clients to maximise value from renewable energy activity. The Group provides advice and services in the following areas:

- **Financial Advisory and valuation**
- **Financial modelling and structuring**
- **Taxation**
- **Finance raising**
- **Asset value optimisation**
- **M&A**
- **Market entry strategy**
- **Procurement strategy**
- **PPA tendering**
- **Transaction support**
- **PE advice**
- **IPO advice**
- **Carbon economy advice**

Technologies

- **Onshore and offshore wind**
- **Biomass and biofuels**
- **Energy from waste**
- **Wave and tidal**
- **Solar**
- **Fuel cells**
- **CHP**
- **Landfill gas**
- **Hydro**
- **Geothermal**

Opportunities to maximise / value

Portfolio type	Opportunities available
Early stage development portfolio	➢ Joint ventures to co deliver portfolio ➢ Disposal of portfolio with some retained share ➢ Milestone earn-outs UK and overseas trade players, some PE investors
Late stage development portfolio	➢ Joint ventures ➢ Structured disposals (value sharing on project delivery) ➢ Portfolio consolidation Trade players, PE houses, infrastructure funds, hedge funds
Pre-construction	➢ Project by project disposals ➢ BOT (build, operate, transfer) ➢ Project financing Trade players, PE houses, infrastructure funds, hedge funds
In operation	➢ Refinancing - extracting any refinancing gain ➢ IPOs ➢ Disposals Capital markets, project finance providers, equity markets

Update on equity markets

Market drivers

- Increasing project size and capital requirements (WTG deposits, grid connection deposits) putting financial pressure on independents
- UK and overseas trade buyers pursuing onshore and offshore opportunities
- Financial institutions aggressively pursuing onshore wind and other renewable opportunities
- Intense competition for investments
  - Reducing return requirements
  - Accepting some development risk
- Is there enough supply (particularly given turbine constraints)?

Recent trends

- Infrastructure funds have been dominant in acquisition of operational assets
  - Babcock and Brown
  - Macquarie Bank
  - Zephyr transaction
- Private equity investors increasingly prepared to accept development risk
  - Structured portfolio deals possible
  - Opportunities to share exit value upside
- New valuation models being employed to ascertain potential exit value
  - PE multiple based values (IPOs)
  - Trade sale values (EBITDA)
- Very active M&A market

Update on debt markets

Market drivers

- Debt liquidity increasing with new banks entering sector
- Lenders attracted by strong deal flow, and improving sponsor quality
- Improved understanding of technology (history of operating hours), wind risk and RO regulatory regime
- Debt available for acquisition finance and project dividend streams

Appetite shown for offshore lending

- Refinancing opportunities exist
- Construction finance available for new projects

Recent trends

- Banking fees / margins under pressure from new entrants
- Debt cover ratio requirements reducing
- Reducing requirement for PPA tail beyond loan tenor
- Project gearing increasingly determined by cash flows
- Banks willing to lend to portfolios on P50 rather than P90 forecasts
- Hedge funds are joining infrastructure funds and PE houses in the market, adding new flexibility to deal structures
- Operating lease products beginning to emerge that satisfy new tax rules

PPA strategy – avoiding value dilution

Indicative terms offered to generators		
	Short-term PPA	Long-term PPA with floor
Brown power	90%	70%
ROC	95%	80%
ROC recycle	95%	75%
LEC	85%	80%
Total indicative value*	£90.6 MWh	£73.5 MWh

*Indicative value will vary with generator's view of future prices

- Value dilution occurs when counterparty required to take on risk
  - Mark to market exposure
  - Counterparty credit risk
- Carefully structured PPA should minimise risk borne by counterparty, and maximise value to generator
- The new challenge of ROC banding

Structured PPAs/debt facility

Opportunity to disaggregate constituent parts of PPA

- Revenue stream consists of different risk profiles (ROC, power)
- Debt can be structured in accordance with these risk profiles
- Lenders' appetite to take some market risk expose provides opportunities for minimising value dilution

Financial instruments emerging	
Price risk Volume risk	Further opportunities for optimising value

Contracting decisions – reducing costs and managing risk

LENDERS NEED TO REDUCE RISK

Construction

- Fixed price EPC
- Managed multi contract
- Warranties / bonds / LD's
- Limited technology choice

Capital costs

Operations

- Long-term O&M contracts
- In-house O&M
- Insurances

Operating costs

Revenue

- Long-term PPA
- Floor prices / guaranteed income
- Limited counter-party choice

Income

- The US market is the Big Gorilla, India and China are next
- Some flexibility with Lenders regarding contracting strategy
- Construction and O&M costs can be reduced through careful contracting processes
- Critical to identify, quantify and manage key risks to protect shareholder value
- Turbine availability is key: increasing trend for alliances
- Supply chain also constraint

Equity Structuring

Equity vs shareholder loans (sub debt)

- Dividends to ordinary share capital restricted by accounting rules
- Shareholder loans facilitate
  - accelerated returns
  - less tax payable in the SPV, providing more cash available to service senior debt

Transfer pricing rules in the UK

- Any equity structuring needs to take account of transfer pricing rules and thin capitalisation (April 2005)
- Has had some impact on VC's and private equity funds
- Highlights importance for investors not to accept any tax risk in relation to purchasers

Other issues

- Efficient use of capital allowances
- Joint ventures / consortium structuring
- Group / consortium relief
- Tax based financing

Cross-border investments

- Complex structuring to ensure:
  - Repatriation of distributions is efficient
  - Capital allowances are utilised

Conclusions: Maximising value

- Don’t forget the wind speed!
- Don’t forget the turbine
- Maximise for planning and pray for grid connection
- Consider ROC banding strategy
- Use appropriate financial techniques
- It is a sellers market
- Consider experienced independent advice
- Wind rights are the oil reserves of the future

Financing a sustainable future

Contact

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