European Energy M&A

Pre-deal Risk Mitigation as key Success Factor

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SynergyON

BELGERS ADVISORY

Summary

The COVID-19 pandemic has shaken the world and the scale of the crisis is unprecedented. Whereas M&A deal volumes and value dropped significantly due to the international financial uncertainty, contrary to previous economic shocks, global M&A activity recovered massively in the second half of 2020. For 2021, we expect a continued recovery in deal-making on an international scale. However, the pandemic has forced companies to rethink their strategy and we believe the drivers for deals have changed, with more attention for resilience, digitalisation, purpose and inclusion.

Contrary to many other industries, M&A activity in the European energy sector has remained at a constant level despite the COVID-19 crisis. The start of 2021 has been promising, laying the foundation for this year to become the most active in history both in terms of M&A volume and value. Our research shows that the market is fragmented and dominated by relatively low-value deals and single-acquisition buyers. Limited sector knowledge for non-energy sector buyers and limited M&A experience in general, appear to be risk factors. Managing and mitigating such risk is a challenge and must be a dynamic and integrated part of a company's culture. In our experience there are four critical risk mitigation tasks to perform pre-deal when considering a merger, acquisition, or other partnership as an opportunity for growth or diversification.

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M&A and Partnerships in 2021 – a Look at COVID

The COVID-19 pandemic has shaken the world, from politics to business and the way we all live our lives. The scale of the crisis is unprecedented, forcing governments and businesses globally to respond and sometimes even reset completely. Understandably, international M&A deal volumes and value dropped significantly due to the global financial uncertainty. However, contrary to previous economic shocks, global M&A activity recovered massively in the second half of 2020[1] .

M&A has always been an option for firms and investors to expand business segments, improve productivity and marketability, as well as to close product or capability gaps. For every buyer there is a seller, a firm or investor, that is looking to mitigate risk, refocus business or divest its assets. The pandemic has accelerated this behaviour with many companies rethinking their strategy, especially given the world-wide low interest rates and accessibility of capital in certain sectors. We believe the drivers for deals, though, have changed:

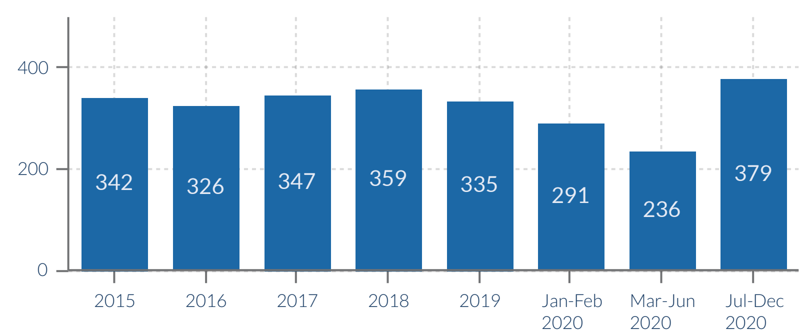
- International supply chains have proven to be vulnerable. Businesses are looking for **resilience and stability**, rather than solely price and outsourcing.

- Consumer demands and behaviours have changed as we all learned to adapt to a new way of living, working and consuming. Topics such as **purpose and inclusion** have been promoted to focus areas with a deeper anchoring in corporate mission and strategy.

- The COVID-19 crisis led to an acceleration of **digitalisation**, focused not only on communication but also on business processes. This includes digital tools used to perform due diligence and site visits, transforming how **trust** is created between organisations.

Public & private M&A[1]

Average monthly global count

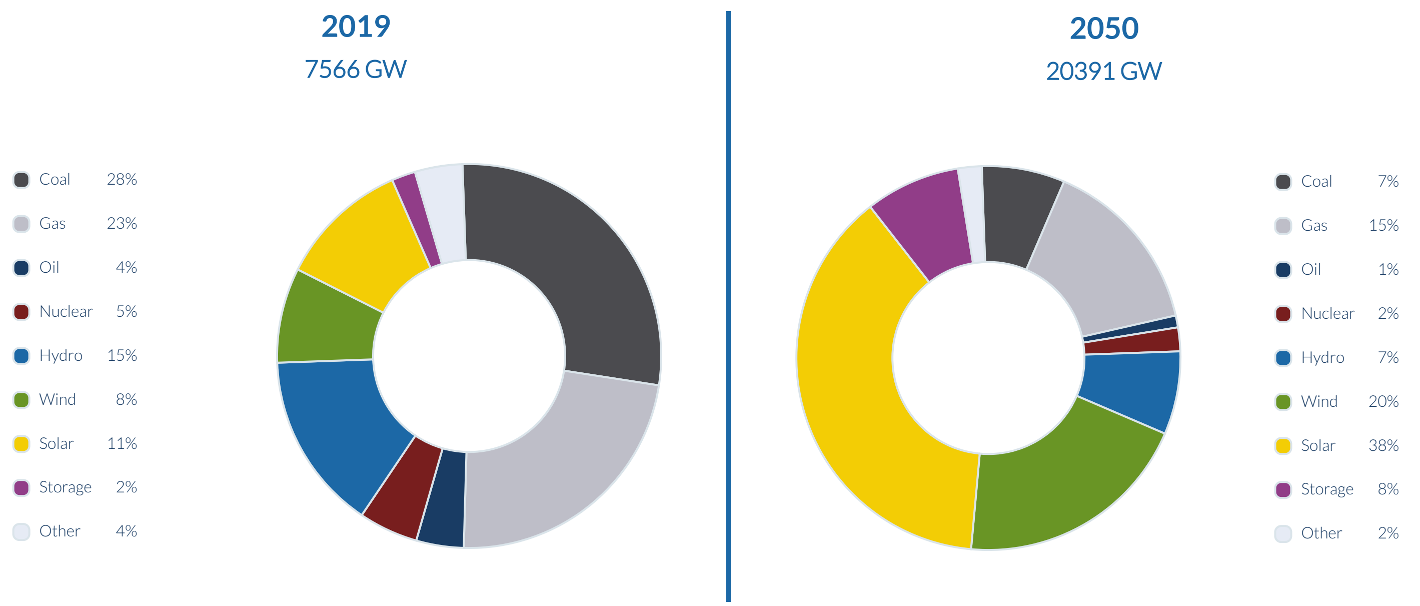


For 2021, we expect a continued recovery in deal-making on an international scale. Businesses will transform their strategies globally based on newly introduced considerations, re-evaluate opportunities and adapt to new risks. COVID-19 had a heterogeneous effect on various industry sectors creating on the one hand resilient and on the other hand highly impacted industries that will be part of a firm's consideration in its diversification strategy. We expect that **more investments will be aimed at technology & innovation** and that **companies** will try and **combine value creation with social considerations** in the form of environmental, social and governance (ESG) initiatives.

European Energy Market - Trends & Developments

The energy market is growing at a rapid pace. Where the total world energy use will rise by more than 20% until 2050[2], it is recognised that this demand can only be fulfilled whilst paying attention to world-wide problems, such as carbon emissions and air pollution. Technology will continue to support finding solutions to these challenges but also needs to find its way in an energy sector full of ageing assets, which were simply not meant to serve the needs of today's modern and digital society. A society in which customers now can and increasingly want to be a part of the sector, not only on the demand side but also on the generation side, for example through roof-top solar panels and electric vehicles that can be used as mobile power storage devices. The complexity of distributed generation is expected to become too large to be handled from central control rooms and more and more decisions will need to be taken at a local level.

Global installed capacity mix[2]



The 3D's – **decarbonisation, digitalisation and decentralisation** – are already and will continue to reshape the energy and transportation industries. For businesses that regard these developments as opportunities rather than as threats, could transform into leaders with tremendous possibilities. And these seem to be recognised already. While, as for many other sectors, 2020 was a different year due to the COVID-19 pandemic and uncertainty impacted the deal market in the first half 2020, M&A activity in the energy sector increased in the second half of 2020 with European M&A volumes reaching a three-year high in the fourth quarter[3]. We expect that this recovery will continue in 2021.

Renewables

The renewable energy sector is one of growing economic importance. Wind and solar alone are expected to supply 58% of electricity production globally by 2050, up from around 19% in 2019[2]. The main driver for this change is policy, based on longer-term agreements to meet climate goals on national, continental and international scale.

Portfolio rationalisation & rebalancing

Stable growth markets and performing investments are attractive to investors. The COVID-19 crisis has taught us that international supply chains and entire industries are vulnerable. Therefore, industry participants as well as investors that are not a part of the energy world yet, are expected to increasingly recognise the secure potential within the energy sector. Interest rates for offshore wind projects have for example linearly sunk from 300bbp above Libor in 2011 to 125bbp above Libor in 2020, indicating a reduced risk and potential gains for borrowers seeking to renew or invest in offshore wind projects.[4]

Fragmented landscape

This potential is also visible in the increasing number of start- and scale-ups within the sector, focusing on energy tech (control and storage systems, trade, waste & recycling, efficiency) and smart living (mobility, smart homes, agriculture & food) solutions. This fragmented environment of developers, especially in Europe, is expected to favour M&A activity towards further market consolidation.

With low interest rates and good access to capital (approximately 70 banks are active in European wind energy financing[4]) the challenge is finding the right opportunity to be brought into play at a positive return / risk ratio. Renewable energy and clean tech businesses seem to be in that sweet spot and will need significant capital over the next years, supported by governmental policies stimulating and regulating the transition to a zero-carbon economy. We expect these factors to boost M&A activity in the sector.

European Energy Market - M&A Activity

To get a more comprehensive picture of the M&A landscape in the European energy sector, we analysed the deals market in terms of transaction volume and value for the period 2015 until and including Q1, 2021[5].

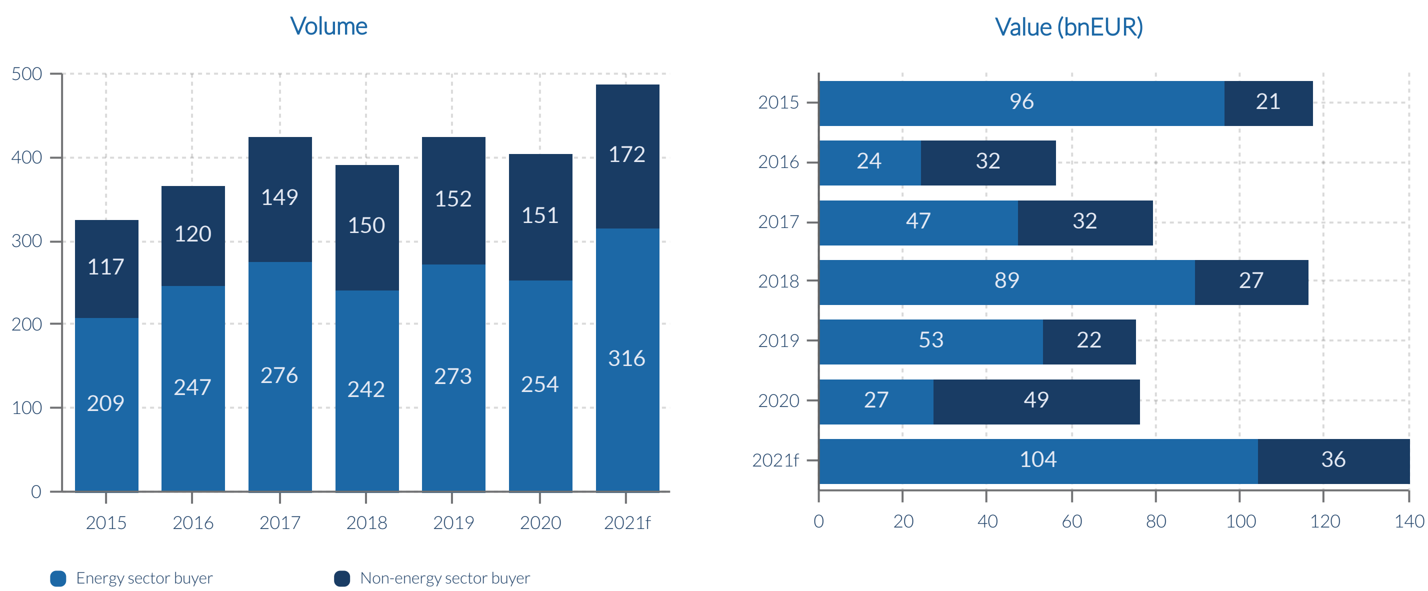
Energy sector target deals: steady competition and a promising start of 2021

First, we had a look at deals in which the target was a European energy sector company. The deal volume has been relatively steady over the past years at an average of 390 deals per year. In terms of total annual deal value, more volatility is observed but neither a trend up- or downwards over the entire period. As already mentioned earlier and especially thanks to a recovery in the second half of 2020, a COVID-19 drop is not visible from our analysis, neither in deal volume nor in value.

Looking at the acquiring parties, we noticed a rather stable competition between financial or non-energy investors and energy firms targeting European energy assets. On average 64% of all transactions were energy sector buyers acquiring European energy targets with a historically steady indication and no major changes.

2021 seems to be a promising year. Already 122 European energy sector targets were acquired in Q1 by either an energy (65%) or non-energy (35%) sector investor. And also in deal value, 2021 could become a booming year with a Q1 transaction value of over 35 bnEUR.

European energy sector targets | deal volume & value 2015 – 2021f



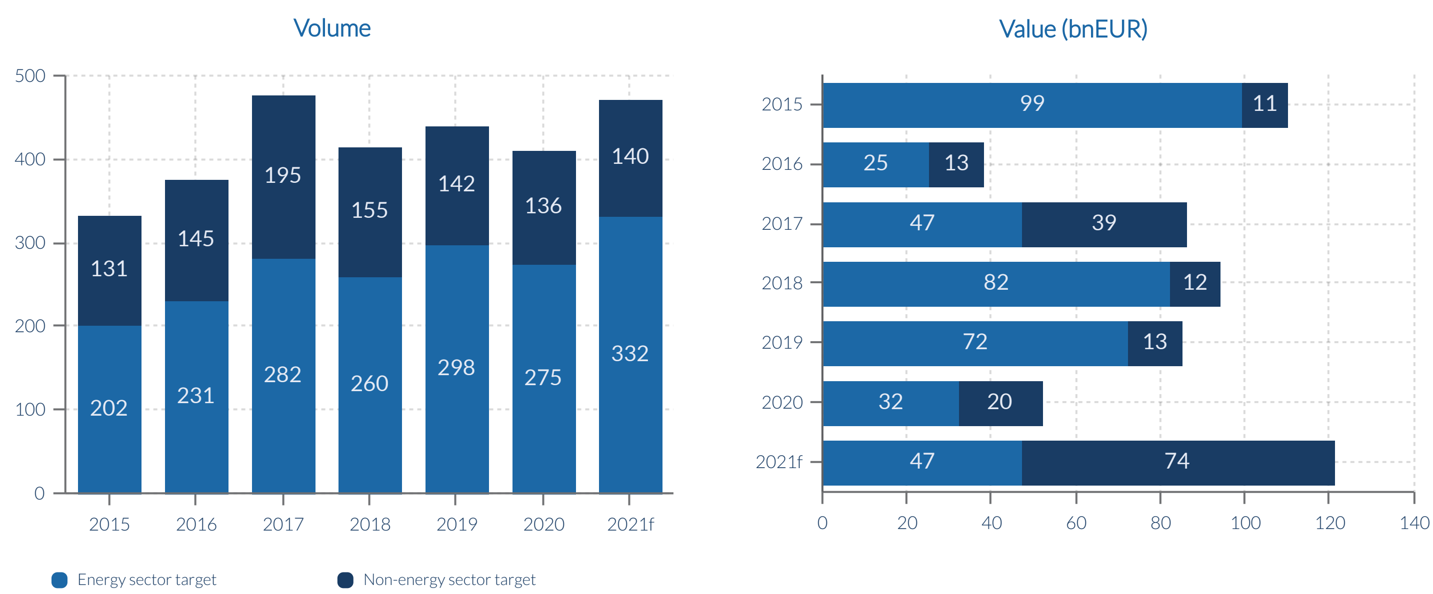
Within sector deals: increasing volumes, decreasing values

Over the recent years, European energy firms have increasingly engaged in transactions within the energy sector with a peak in Q1-2021, in which over 70% of all transactions by a European energy sector company was aimed at the acquisition of another company within the same sector.

In terms of transaction value, the picture is different as in Q1-2021 only 39% of the total value was related to a within-sector acquisition, which has been higher in nearly all recent years. This contrast can be explained by the impact of large, over 1 bnEUR deals. However, it is important to mention, that 2020 already showed a significantly drop in transaction value connected to energy projects. In Q1-2021 a further reduction is thus observed.

In other words, European energy firms are increasingly active in M&A within their own sector, but the single transaction value within the sector has been dropping, whereas – based on figures from Q1-2021, it is to be expected that energy firms will tend to look to other sectors in 2021 to sign the higher value deals.

European energy sector bidders | deal volume & value 2015 – 2021f



> **Based on figures from Q1-2021, it is to be expected that energy firms will tend to look to other sectors in 2021 to sign the higher value deals.**

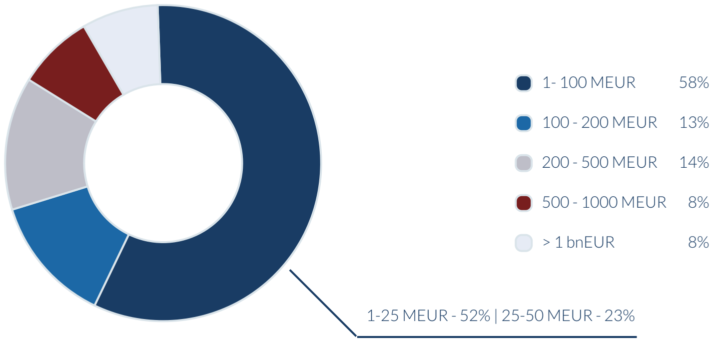
Fragmentation: low deal values and predominantly single acquirers

Since 2015, the European energy M&A market has been dominated by lower value deals. 58% of all deals in which a European energy sector company was the bidder had a deal value of less than 100 MEUR, more than half of which is even under 25 MEUR.

The same is true for deals in which a European energy sector party was targeted: 54% of the deals had a value of less than 100 MEUR, and also here more than half of those deals represented a value of less than 25 MEUR. Although transactions with a value over 1 bnEUR were recognized, they only account for 10% of the transaction volume in the investigated time period.

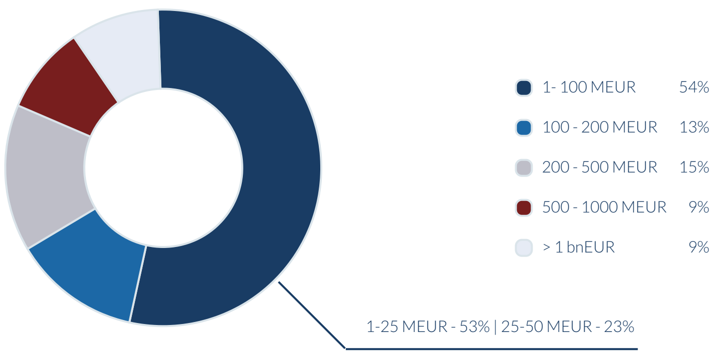
Deal value categorisation

European energy sector bidders | 2015 - Q1, 2021



Deal value categorisation

European energy sector targets | 2015 - Q1, 2021

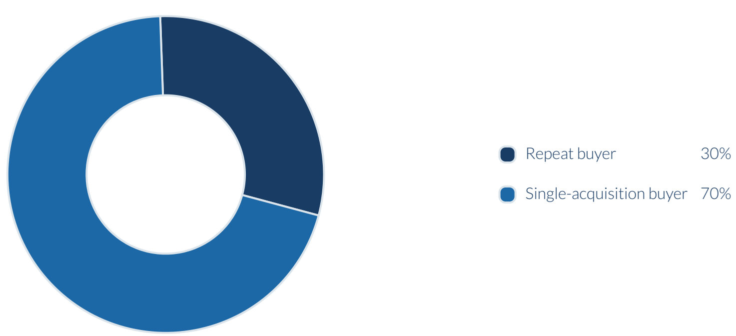


70% of buyers in the European energy sector only performed a single acquisition in the period 2015 – Q1, 2021.

A further analysis into the buying parties shows fragmentation as well. Our research shows that 70% of buyers in the European energy sector only performed a single acquisition in the period 2015 – Q1, 2021. The minority of serial acquirers such as Total, ENGIE, BKW Energie, BP, Shell and ABB have been performing 3 to 5 transactions per year in the European energy sector.

European energy sector buyers

Repeat vs. single-acquisition buyers | 2015 - Q1, 2021



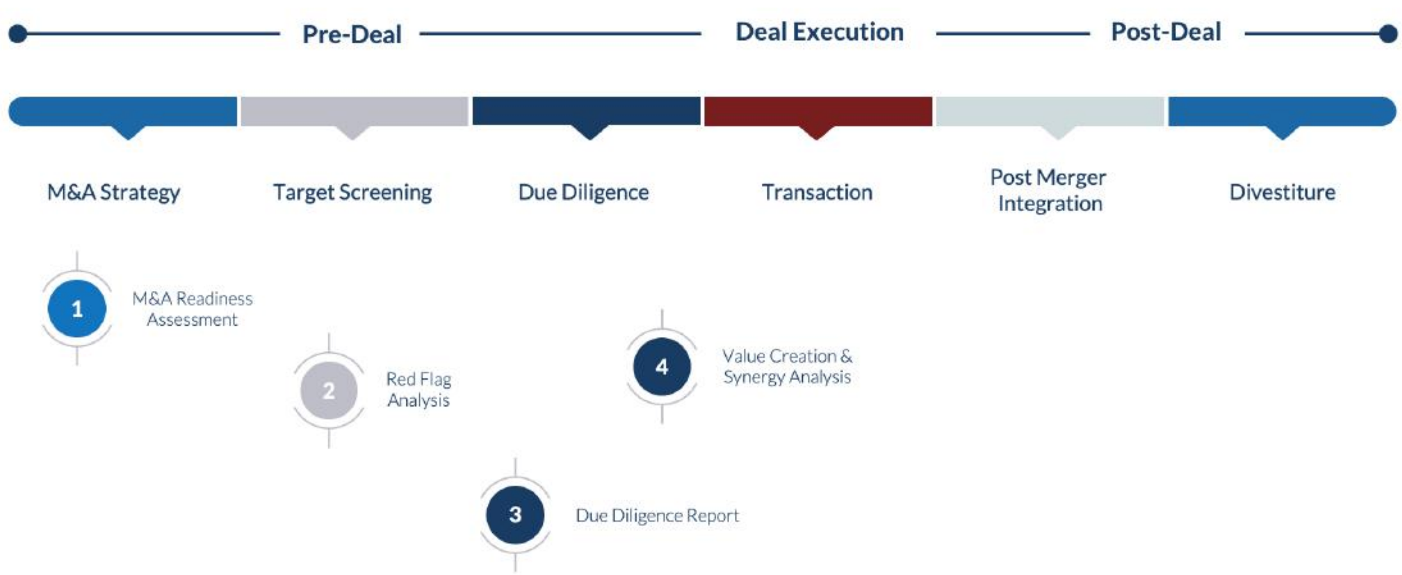
Challenges & Risk Mitigation

The European energy market is in motion and our research confirms that – contrary to many other industries – M&A activity in the European energy sector has been at a constant level despite the COVID-19 crisis. The start of 2021 has been promising, laying the foundation for this year to become the most active in history both in terms of M&A volume and value. However, we have seen that the market is fragmented and dominated by relatively low-value deals and single-acquisition buyers. Limited sector knowledge for non-energy investors and limited M&A experience in general, seem to be risk factors.

Managing this risk becomes the ultimate challenge. In the energy sector over 100 years ago, trial and error was the risk management method of choice and has since developed into digital simulations and modelling based on first principle physics. Today risk management is as complex as ever and is based on many factors such as regulation, policy, case law, scenario modelling, business intelligence, market research, trust and governance. Mitigating risks must be a dynamic and integrated part of the culture at all levels. In our experience of deal making there are **four critical risk mitigation tasks to perform pre-deal** when considering a merger, acquisition, or other partnership as an opportunity for growth or diversification.

A carefully but at the same time efficiently guided pre-deal process can make a significant difference and signal points of attention during valuation and negotiation, as well as for the post-deal integration phase.

Get in touch with us for more information.



1. M&A Readiness Assessment

Performing a readiness assessment as an exercise lead by management and executed by an external advisory aimed at identifying the gaps, awareness and bottlenecks in the organisation. Identifying the readiness of the organisation to be successful at capturing the synergies and at a successful post-merger integration.

A readiness assessment should start as early as possible, in some cases 1 year prior to any inorganic activity and should consider all functions of the organisation especially the support functions such as Finance, IT and HR. The assessment is usually a 2 to 4-week effort, depending on the organisation or business unit. M&A readiness will increase chances of success, reduce the stress on the organisation and highlight synergy opportunities.

2. Red Flag Analysis

The energy sector is a highly competitive market that requires speed and agility in order to compete in the early part of the M&A process. A Red Flag Analysis can be performed in 1-2 weeks, depending on transaction size and organisation, and should highlight 80% of the risks associated with the target. Knowing the major risks associated with the target early in the process allows a clear insight and focus on the next steps of the due diligence, valuation, and negotiations.

3. Due Diligence

A reduction of asymmetric information about the target asset can be achieved by providing either a vendor due diligence from the sell-side or performing a buy-side due diligence. The most common due diligences performed are commercial, operational, financial and/or legal, and depending on the business, possibly IT, cultural, or environmental. When performing a due diligence, it is important to set clear expectations from the start, the input information to the due diligence is typically historical in nature and not aimed at forecasting. Having experience in the business and the specific business model of the target will significantly increase the quality of the risk identification and lead to a proper evaluation of the risk / value ratio.

4. Value Creation and Synergy Analysis

Value creation in the M&A and partnership process has two main purposes. First, to justify any premium acquisition price to be paid above the value of the target and secondly to provide a forward-looking strategic plan of the target. Value creation and synergy analysis is planned prior to the signing and involves analytical evaluation of the business to develop synergy business plans. Synergies are classified as revenue, cost and financial, are forward looking and based on the co-creation of both companies working together to create value, focus opportunities, and integrate the value creation process.

A carefully but at the same time efficiently guided pre-deal process can make a significant difference and signal points of attention during valuation and negotiation, as well as for the post-deal integration phase.

About us

The partnership between **SynergyON** and **BELGERS ADVISORY** brings together all-round and comprehensive experience in M&A integration and organisation management, 28 years of combined experience in the European and North-American energy sector, extensive consulting and management backgrounds, and an international focus through business fluency in English, German, French and Dutch.

SynergyON

SynergyON leads and supports M&A, partnership, carve-out, Strategy and innovation service mandates throughout the corporate development cycle in Switzerland, Europe and Globally.

www.SynergyON.ch

BELGERS ADVISORY

BELGERS ADVISORY specialises in organisational design & development, transition management, and setting up and strengthening corporate functions such as HR, Finance & Compliance.

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