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KPMG green energy M&A report

Government support is key driver as 63% expect growth in subsidies

In the face of adversity, the global energy industry is feeling positive about the future of renewables. Indeed, 78 per cent of senior executives from across the industry believe renewable energy projects are economically viable despite collapsing fossil fuel and commodity prices and the credit crunch, KPMG's annual report into M&A in renewable energy reveals. Meanwhile, according to Péter Kiss, KPMG's Global Power & Utilities sector leader, while the EU has set a 20% target for the share of renewables in final energy consumption by 2020, the current financial crisis and economic slow-down have obviously slowed the progress of renewable projects.

KPMG's research (entitled 'The winds of change') surveyed 200 senior executives from across the global energy industry and has uncovered 'hot spots' for future deal activity and the implications of the recession on the market.

The report reveals, that enticed by generous government subsidies, almost twice as many respondents (42 per cent) identified the US as the country where they were looking to invest compared to the second most popular destination (India 24 per cent). US political announcements on supporting green initiatives have bolstered other international commitments, which in turn have had a profound effect on the global energy industry with 63 per cent believing subsidies will increase. While some large energy companies in Europe feel stymied not just by finance but also by the old chestnuts of planning and access to the grid, the US is starting to look more attractive to foreign investors with stable government stimulus creating the potential for a more profitable deal environment. Interestingly, 81 per cent of Europeans believe US President Barack Obama will deliver on his environmental commitments, compared with 51 per cent of Americans.

Renewable M&A survey, key facts:

- 78 per cent believe renewable energy projects continue to be economically viable;
- 63 per cent predict government subsidies will increase (compared with 37 per cent last year);
- The industry continues to favour more established technologies: over 60 per cent believe that onshore wind and solar power will grow by more than 5 per cent in 2009, compared to only 38 per cent expecting similar levels of growth in offshore wind, and only 19 per cent in marine technologies;
- 42 per cent of respondents intend to invest in the US; 24 per cent in India; 22 per cent in China and 21 per cent in Canada (respondents could be investing in more than one country);
- 44 per cent think the Copenhagen conference (to find a successor to the Kyoto treaty) will mark a significant breakthrough and will lead to increased investment, compared to just 18 per cent who disagree.

The renewable energy sector has been hit hard by the economic downturn, however, with the NEX index of renewable companies recording a drop of 65 per cent from January 2008 to March 2009; most of which was recorded in Q4 2008.

According to the survey, the size of deals looks set to change and the age of the multi-billion dollar deal seems to be at an end, at least in the short term; almost four times as many respondents arguing that these are likely to decrease in number as those expecting an increase. Furthermore, less than a quarter (24 per cent) of companies expect to invest in excess of US\$100 million in renewables M&A in the next 12 months compared to 39 per cent last year.

The recession has changed the deal-making landscape dramatically, with the key beneficiaries seemingly being larger utilities and power companies, who are well placed to take advantage of any opportunistic disposals. The lack of strong balance sheets and long-term relationships with lenders put many smaller developers at a disadvantage: 70 per cent surveyed from smaller companies (with less than US\$500m in revenue) are finding financing harder to come by than a year ago, compared to 57 per cent of larger companies. The respondents also predicted a fall in activity originating from hedge funds, infrastructure funds and private equity houses. The research suggests that, while third party financing is proving difficult to secure, those able to leverage off strong corporate balance sheets - such as the large power companies - are well positioned to pick up bargains.

Implications of economic downturn on M&A activity, key facts:

- 58 per cent expect to make significant reductions in planned or ongoing projects because of the economic downturn;
- 58 per cent said they will be spending less than US\$50m on M&A this year;
- 55 per cent of respondents expect an increase in deals with delayed or contingent payments;
- 57 per cent of executives from large companies (more than US\$10 billion in revenue) said finance is now more difficult to obtain compared with 70 per cent of executives from smaller companies (less than US\$500m in revenue).

Meanwhile, the development of renewable energy utilisation is a central aim of the European Union, according to Péter Kiss, KPMG's Global Power & Utilities Sector Leader and Head of Sector, Energy, KPMG in Central and Eastern Europe. "The EU has set a 20% target for the share of renewables in final energy consumption by 2020," he explained "Increasing the share of renewables-based generation in the total energy consumption mix will significantly reduce greenhouse gas emissions."

Taking into consideration the numerous factors affecting the outlook for the development of renewable generation in Central and Eastern Europe, the current financial crisis and economic slow-down have obviously slowed the progress of renewable projects. Financial institutions' risk appetite has decreased significantly as they are becoming more and more cautious about where they put their money.

According to Kiss, banks are looking for commercially bullet-proof projects and renewable investments which are still much more expensive than conventional power generation technologies and therefore can only be viable with significant state support (investment subsidies and/or operating subsidies), so they are at a disadvantage.

"Looking at the potential of renewable resources, size of the electricity market, gap to meeting EU targets and the attractiveness of support schemes," said Kiss, "some the most attractive targets for wind, biomass and/or hydropower generation and geothermal investments may be in Romania, Poland, the Czech Republic, Croatia, Hungary, Slovenia, and Bulgaria."

"Renewable energy also contributes to security of supply by increasing the share of domestically produced energy, diversifying the fuel mix, and diversifying the sources of energy imports by making it possible to import electricity and/or fuel for biomass generation from within the EU - which also makes for an opportunity to increase the proportion of energy obtained in politically sound regions," he contended.

“Finally and most importantly, the positive externalities of renewable energy projects should also be taken into consideration when evaluating green investments, since their positive impacts such as job creation, enhanced R&D activities, and a healthier environment represent significant value for society, things which go beyond financing,” explained Péter Kiss.

Notes:

- **About the research:**

‘The winds of change: an insight into M&A in the renewable energy sector in 2009’ is the second piece of research into the renewable energy market written by KPMG in co-operation with the Economist Intelligence Unit and is available as a separate PDF or by visiting www.kpmg.co.uk. The research includes the results of a survey of 200 senior executives within power generating businesses, renewable energy suppliers, energy distributors, oil and gas majors and banks from across the global energy industry. A range of company sizes were represented including the industry’s largest operators: 23 per cent of respondents had annual revenue of US\$10bn or more. The respondents were broadly evenly split between Europe, North America and Asia-Pacific, with the remainder from Latin America, the Middle East and Africa.

- **KPMG's Energy and Utilities Advisory Services in Central and Eastern Europe (CEE)**

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