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M&A: Persistence, willingness to adapt best practices key to successful mergers

by Jennifer Zajac

Management's persistence is the key to getting whole-company transactions done in the utility space, according to a report by **Oliver Wyman**, a management consulting firm, titled "Making Utility M&A Succeed in 2008."

Obtaining the necessary regulatory approvals requires resilience, given the amount of time and energy it frequently takes to close a deal. In addition, creating lasting value from a transaction "remains a tough proposition," the report states.

Strategic buyers also face more competition. "With private equity and financial players now entering the utility arena, such as Macquarie with Duquesne and Puget Energy Inc., and KKR with TXU, competition for good deals is intensifying," the report states. "Private equity players and infrastructure funds bring low-cost financing and an operational discipline to the table. Strategic buyers such as utilities need to creatively and aggressively identify the distinctive value that they can deliver."

What makes and breaks whole-company deals

As a general rule, any deal has the potential to surmount regulatory hurdles, according to said Alan Feibelman, a partner with Oliver Wyman and co-author of the report. How much it will cost the acquirer and whether the shareholders will benefit in the long run are major factors in a transaction. "In a lot of cases, it's not whether or not the deal will get approved but how much will it cost and is it worth it in the end," said Feibelman.

The report notes that value creation does not necessarily guarantee that a utility M&A transaction will close. Feibelman added that a deal will likely collapse if one of the players, be it a utility, regulator or special interest group, demands more than their fair share. "Merging two companies is fraught with challenges, and senior management and the board of directors must have the stamina and fortitude to see the process through," the report states. "Management will have to cope with uncertainty and stay the course throughout a long period between announcing and closing the deal. Executives must ensure that the deal makers outweigh the deal breakers."

The deal is done: Now what?

The utility sector has a mixed track record in terms of its post-merger success rate, according to Feibelman. Utilities have sometimes opted to

acquire a business and operate them independently rather than integrate it into its information systems, policies and operating practices, which oftentimes leads to inefficiencies over the long term, he said. Failure to integrate an acquired business may not only make it difficult to extract economic values, but future acquisitions may become more challenging as well, Feibelman said.

"Leading utilities go a step further, using M&A not just to drive costs out of the target company but also as a catalyst to transform and drive costs out of their own organization," the report states. "Beyond integrating operations, M&A should serve as a catalyst to transform both companies, not just the target. We typically find many 'performance Push' opportunities to transplant better practices in areas where pure synergies tend to be small — for example, in transmission and distribution (T&D) field work and generating plant maintenance."

Feibelman added that successful buyers have built-in policies and practices to fold acquired companies into their systems. "The players who have been more aggressive at integrating companies, and transplanting people, both from the acquired company to the buyer's company and vice-versa, the ones who manage the hard skills and soft skills, have been more successful," he said.

For a utility acquisition to be profitable over the long-term, the adoption of best practices must occur at the buyer's company as well as the purchased entity. Too often, management at both companies assume that change will only take place within the company being bought, Feibelman said. "No matter how good you are as the parent company doing the buying, there are always opportunities to improve," he added.

Utilities may struggle with renewable mandates

Feibelman noted that with more than half of the states in the country passing some form of renewable portfolio standards, some utilities will experience difficulty meeting renewable targets due to the long lead times associated with acquiring wind turbines and some of the issues facing the solar industry. "We may see some utilities looking to buy renewable assets as a way to meeting those standards but that remains to be seen over the next two years," he said.