

Making Utility M&A Succeed in 2008

Despite many hurdles, merger and acquisition deals are getting done, as shown by National Grid/KeySpan, TXU, and WPS/Peoples Energy. However, obtaining the necessary regulatory approvals requires persistence and resilience, and creating lasting value from a merger or acquisition remains a tough proposition.

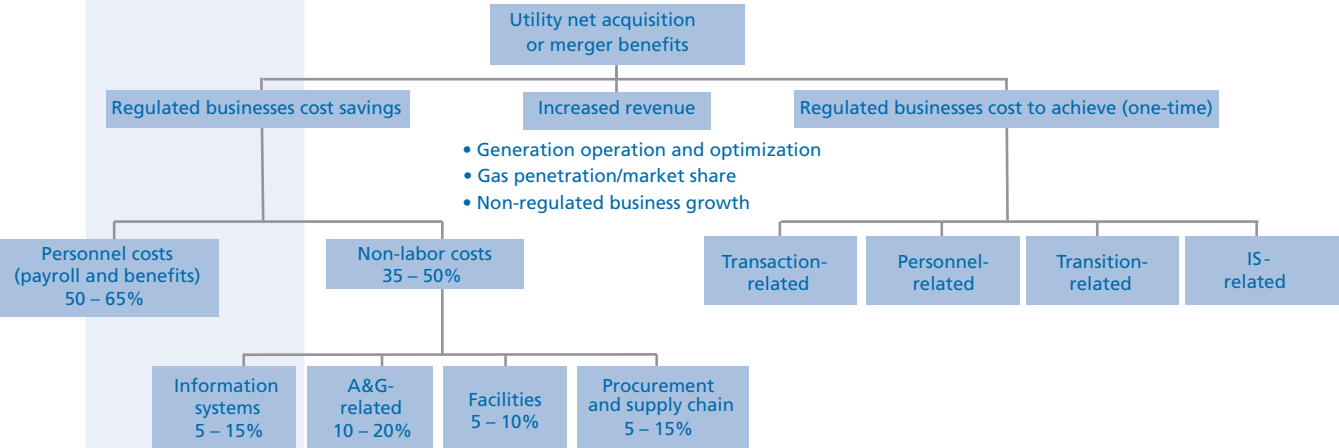
With private equity and financial players now entering the utility arena, such as Macquarie with Duquesne and Puget, and KKR with TXU, competition for good deals is intensifying. Private equity players and infrastructure funds bring low-cost financing and an operational discipline to the table. Strategic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

Unlocking the Value

Most utilities focus M&A value creation on cost reduction and operational improvement. Some also pursue revenue growth opportunities by leveraging underused assets, such as power plants, or by extending their natural gas or unregulated businesses. 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.

Oliver Wyman’s recent work with utility transactions has focused on helping companies examine and evaluate the deal up front and successfully deliver value during post-merger integration planning (Exhibit 1).

Exhibit 1 Potential value-creation opportunities



Beyond Synergies

Strategic buyers in the utility industry cannot make deals succeed financially through synergies alone. They must tap other sources of value as well.

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. Exhibits 2 and 3 illustrate the types of performance push improvements possible in T&D operations.

Leading utilities also use M&A to acquire talented senior managers, migrate to new ERP or operational information systems, standardize processes and practices, and transform an organization’s culture and behavioral norms.

Exhibit 2 Significant value comes from “performance push” opportunities

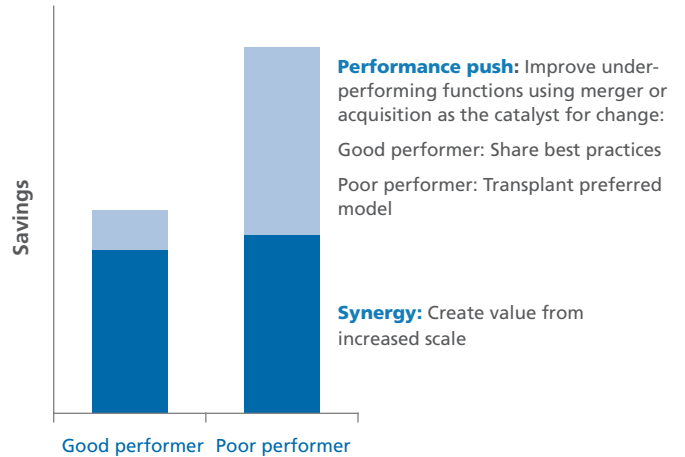


Exhibit 3 Representative T&D or energy delivery value-creation opportunities

	Cost	Asset optimization and utilization	Risk mitigation or management
Synergy	<ul style="list-style-type: none"> • Headquarters and back office consolidation • Adjacent service territory and field operations integration • Information systems • Material and equipment standards • Procurement • Training course development 	<ul style="list-style-type: none"> • Facilities • Corporate office space and buildings • Service centers • Inventory: Safety stock, emergency spares • Specialized construction equipment 	<ul style="list-style-type: none"> • Material availability (inventory) • Labor (strike) contingency planning
Performance push	<ul style="list-style-type: none"> • Field crew work practices and methods • Process streamlining • Engineering and construction standards • Contractor and project management • Maintenance program design 	<ul style="list-style-type: none"> • Project evaluation and selection • System planning criteria • Engineering and construction standards • Vehicles 	<ul style="list-style-type: none"> • Service levels • Reliability and gas leak response practices • New business / customer hook-ups • Engineering and construction standards • Reliability program management • Environmental and safety programs

Persistence and Resilience

Value creation does not guarantee that a utility M&A transaction will close. 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.

For the utilities sector, the fragmented regulatory structure in the United States poses challenges

that other industries do not face: typically requiring many regulatory approvals and many local stakeholder demands to appease. 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, as shown in Exhibit 4.

Exhibit 4 Utility deal makers and breakers

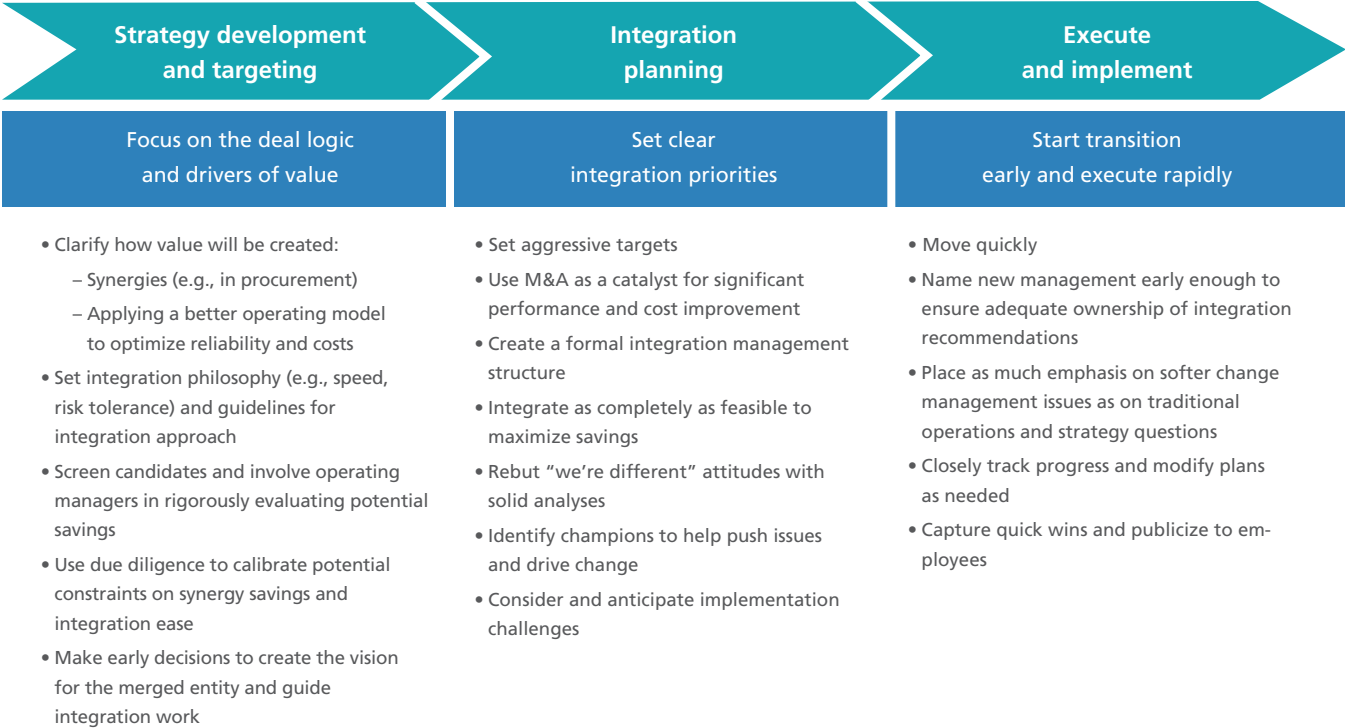
	Deal makers	Deal breakers
Economics	<ul style="list-style-type: none"> • Potential to create significant value from M&A combinations <ul style="list-style-type: none"> – Synergy savings, primarily from combining back office (A&G) functions – “Performance push” value from transplanting capabilities and practices to take performance to a higher level 	<ul style="list-style-type: none"> • Risk of giving most or all value to other stakeholders (e.g., customers, special interest groups) to acquire regulatory approvals, leaving little upside value for shareholders • Risk that regulators will seek to capture synergy value from the integration of unregulated businesses in addition to the value from the regulated entities
Corporate vision and strategy	<ul style="list-style-type: none"> • Opportunity to quickly acquire capabilities through M&A, rather than growing or nurturing internally <ul style="list-style-type: none"> – People or expertise (e.g., management talent, trading capabilities, power plant management skills) – Information systems • Desire to build scale quickly 	<ul style="list-style-type: none"> • Transaction is opportunistic and not based on a corporate strategy
Relationships and culture	<ul style="list-style-type: none"> • Cultural fit between companies supports the development of strong relationships between leaders of the two entities • CEO demographics – one leader ready to retire in near future • CEO’s desire to leave a legacy 	<ul style="list-style-type: none"> • Differences that naturally arise between two companies’ leaders during the long “engagement” (regulatory approval) period foster tension and a “we-they” mindset • CEO demographics – neither leader looking to retire or move on • Both CEOs have strong need to lead, rather than also act as a team.
Regulatory approval process	<ul style="list-style-type: none"> • Acquisition of a distressed asset is often easier, as regulators may be happy to see a management change. 	<ul style="list-style-type: none"> • Difficult to acquire well-performing company if regulators are satisfied with management status quo • Jurisdictional protectionism (e.g., parochial staffing level requirements) inhibit ability to achieve synergies
Management priority or focus	<ul style="list-style-type: none"> • Desire to get the deal closed • Tolerance for uncertainty, willing to deal with long and uncertain approval period 	<ul style="list-style-type: none"> • Desire to put the deal behind them • Need to put a stake in the ground and not face uncertain, seemingly endless regulatory approval process

Successful Post-Merger Integration

Success requires careful planning and targeting, as well as aggressive execution. Oliver Wyman employs a variety of best practices to help utilities in their M&A planning and post-merger integration.

As shown in Exhibit 5, we organize these practices around three main stages: developing the integration strategy, performing post-merger integration planning, and implementing these plans.

Exhibit 5 Integration best practices



Oliver Wyman’s M&A Experience

Oliver Wyman’s recent work with utility M&A transactions has focused on helping companies evaluate deals up front and successfully deliver value while navigating the post-merger integration planning process.

Oliver Wyman brings extensive post-merger integration experience to the table, along with a proven set of approaches and tools to drive post-merger integration planning and implementation. Our

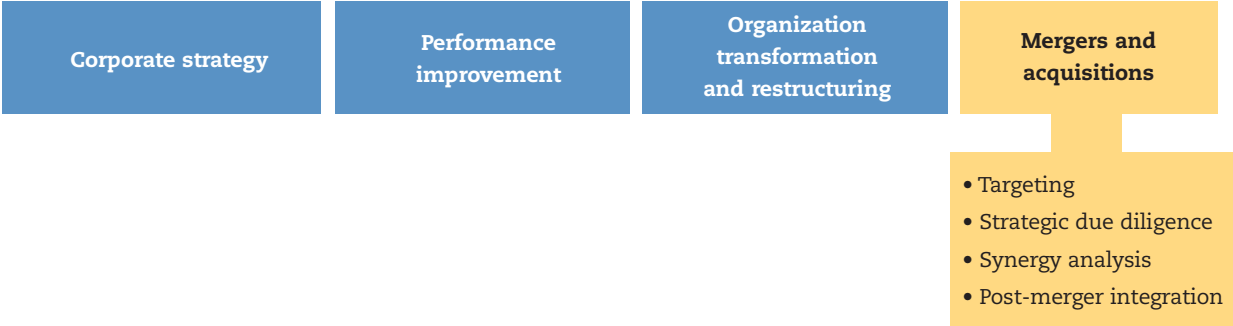
services encompass the full M&A lifecycle from strategy development and targeting through integration planning and execution. We use our deep understanding of the utility industry to help clients think more aggressively and creatively about how to unlock value. Our goal is to deliver revenue and cost synergy value greater and faster than pre-deal estimates, and to help pave a smoother transition that unlocks the major drivers of value. ❖

About Oliver Wyman

With more than 2,500 professionals in over 40 cities around the globe, Oliver Wyman is the leading management consulting firm that combines deep industry knowledge with specialized expertise in strategy, operations, risk management, organizational transformation, and leadership development. The firm helps clients optimize their businesses, improve their operations and risk profile, and accelerate their organizational performance to seize the most attractive opportunities. Oliver Wyman is part of Marsh & McLennan Companies [NYSE: MMC]. For more information, visit www.oliverwyman.com.

Oliver Wyman’s Energy Practice

Our dedicated consultants have significant experience in the energy and utilities sector. Previous clients include more than 75 electric and natural gas utilities in North America and Europe, as well as a range of unregulated service providers to energy companies and utilities.



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