# Winds of change

## Government subsidies have made Europe a favourite hunting ground for buy-out groups targeting renewable energy. By *Daniel Schäfer*

SOME OF THE WORLD'S LARGEST private equity groups such as Blackstone and KKR, who are always on the lookout for higher returns and to increase the number of assets they manage, have discovered a new prey to hunt.

Renewable energy projects have become a hotspot for private equity investments in the past few years, with specialised funds and infrastructure groups in particular buying into wind farms and solar energy schemes. And Europe, where a number of governments have long generously subsidised the sector, has become the buy-out bosses' favourite hunting ground for such assets.

Four years ago, private equity and infrastructure funds invested €500m ($666m) into European renewable projects between them, according to research by HgCapital, the European mid-market buyout group and the largest investor in the renewable sector by amount of capital raised. By 2010, this number had risen to €900m, and the sector is on track to spend almost €2bn on such deals this year.

"There has been a lot more activity since the credit crunch, because utility companies are cash constrained and have turned from buyers to sellers of assets," says Tom Murley, head of HgCapital Renewable Power Partners.

His point is underlined by a different way to measure the activity: between 2004 and 2006, private equity funds made 70 renewable energy investments; since 2008, there have been 170 investments.

This year has seen a flurry of deals in the sector, particularly during the summer. In June, KKR, the US private equity fund, made its first renewable energy investment by teaming up with Italy's Sorgenia to build wind farms in France. One month later, it partnered with Munich Re, the German insurance company, to spend more than €100m on a stake in 42 solar power plants in Spain and Italy.

The deal was announced on the same day as Axa Private Equity, the French private equity group, became its home country's fourth-largest wind farm operator after joining forces with renewable energy producer Neon to snap up renewable energy activities from Verbund, an Austrian electricity company.

A month later, Bridgepoint, the UK-based private equity group, spent $851m on wind farms in Spain.

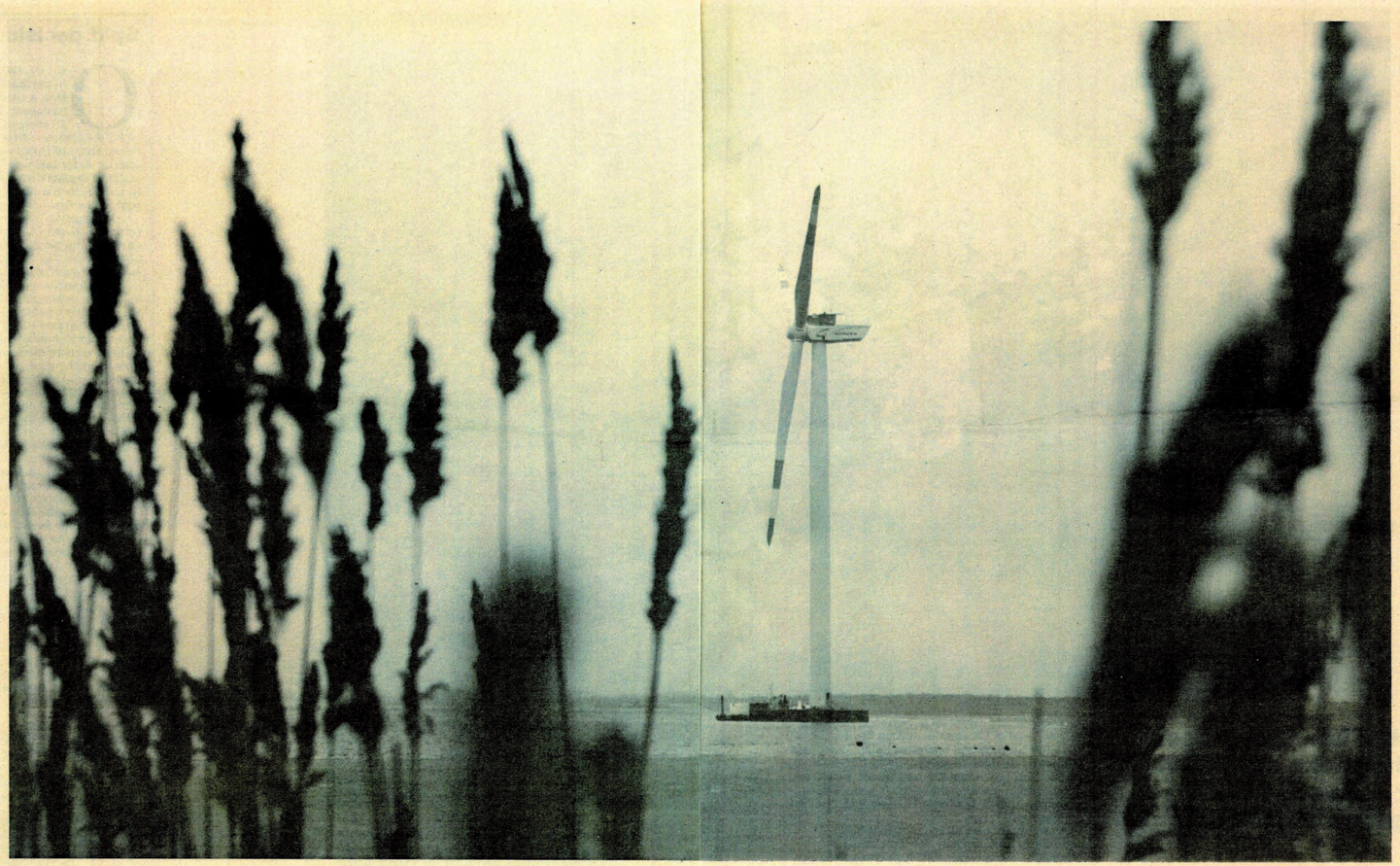
Also in August, Blackstone, the US private equity investor and fierce KKR rival, made a big splash by announcing it would invest €2.5bn in the construction of Germany's two largest offshore wind farms. This investment marked one of the biggest ever moves into renewable energy by a global buy-out group (*see panel, opposite*).

For quite some time, both KKR and Blackstone have been changing from traditional buy-out investors that buy and sell companies with debt, to large-scale asset managers that invest in everything from hedge funds to real estate, private equity to mezzanine debt. So the foray into energy was simply a logical expansion of that strategy, private equity managers say.

The reason for this sudden private equity renewable energy bonanza is mainly to be found in a repricing of the assets that made them more attractive for such return-hungry investors.

In the run-up to the financial crisis, Europe's giant utility companies had created a bubble by snapping up a lot of renewable energy assets at high prices. At that time, infrastructure and private equity funds steered clear of the sector because they considered it overvalued. When utilities turned from cash-rich buyers to austere sellers during the credit crunch, those investors came to the fore.

**Something in the air: by the end of 2011, private equity and infrastructure funds will have invested almost €2bn in renewable projects**



PHOTOS GETTY

**'Unlike other infrastructure assets, renewable energy is largely immune to economic cycles'**

Mr Murley from HgCapital says private equity funds have started to understand the sector better. They also consider it to be less cyclical than other sources of energy production.

"One reason why renewable energy is attractive is that unlike a lot of other infrastructure assets, it is largely immune to economic cycles. Wind and solar energy stand first in the queue in the electricity chain, so they don't take the same demand risk as nuclear power, coal and gas," says Mr Murley, who is also chairman of the British Private Equity and Venture Capital Association's energy, environment and technology board, a group of leading UK-based investment practitioners in the low-carbon sector.

HgCapital was one of the first private equity groups to become involved in the renewable energy sector, and today it is the largest European player when measured by the amount of capital it has raised. It raised a €300m fund five years ago and is currently vying for another €500m renewable power fund.

"We started researching the sector in 2001, and in the end decided to operate it separately from the buy-out team to reflect its infrastructure-like characteristics," says Mr Murley.

At the moment, banks are still willing to lend for renewable energy projects. That distinguishes such assets from many other infrastructure projects, where debt is now harder to come by.

"Renewable energy has become mainstream power generation for a number of years now. Solar energy is still a bit further away in terms of cost, but it is heading in a similar direction," says Francesco Giuliani, director at US-based First Reserve Corporation, the biggest private equity firm specialising in energy.

But Mr Giuliani also says: "It still requires government subsidies and a higher amount of debt than traditional power production to make it work for investors."

He says that for traditional power production such as coal or gas, a takeover where 60 per cent of the price is paid with debt would suffice to create attractive returns; this ratio would be 85 per cent for wind and solar energy projects.

Industry insiders say the biggest momentum in the sector currently comes from generalist infrastructure funds moving into the space. One example is Deutsche Bank's RREEF infrastructure fund, which recently struck several solar power deals. Another is Barclays Infrastructure, which this year invested £300m ($470m) in a fund that installs solar panels on the roofs of social houses and is run by Eaga, the green services group.

"We expect private equity groups will move towards the supply chain of that sector, whereas infrastructure funds are going to invest into power generation," says Mr Giuliani.

He is beating the drum for First Reserve's approach of concentrating solely on the energy sector. "I think there needs to be a space for specialist investors. You cannot transform yourself from a consumer investor to an energy investor."

### Germany powers ahead

IF ONE PROJECT WERE TO EPITOMISE private equity's hunger for deals in the renewable energy sector, it would be Blackstone's €2.5bn ($3.3bn) bet on the offshore wind sector in Germany's North Sea.

With the help of a semi-retired senior energy manager, the US buy-out group is pouring a huge amount of equity and debt into the construction of two wind farms with 146 turbines, the largest such projects in Germany to date. The deals also mark one of the biggest ever investments in renewable energy by a global buy-out group.

The first of the two projects, called Meerwind (sea wind), is planned to go live by 2013 and will then produce enough power to service 400,000 households. The second one is expected to be completed by 2016.

"This is very different from an onshore project that can be done by a couple of guys with a ladder and some money. This is a much bigger scale, with different risks, but also with the opportunity for much better returns," says Sean Klimczak, Blackstone's managing director.

Peter Giller, the 69-year-old German-born former chief executive of International Power, the UK utility group, is the main driving force behind the projects. The director, who knew the private equity group from being on the board of one of their portfolio companies, had been instrumental in planning the investments.

In summer 2008, Blackstone and Mr Giller met with suppliers of turbines, the government, regulators and owners of permits for offshore wind farms in an attempt to kick-start the project.

But it took three years for it to become reality, as the increase in subsidies and a government pledge to invest in the connection of the offshore farms to the onshore grid were essential to make it viable. The German government, under Chancellor Angela Merkel (below), has since decided to subsidise wind energy heavily in line with its ambition to phase out nuclear power by 2022.

First, the government has increased the feed-in tariffs from €95 per megawatt hour, to up to €190/MWh in several steps. Second, it has set up a €5bn loan programme through KfW, the German state development bank, to fund such renewable energy projects.

This addressed one big issue that hampered the projects in the first three years: the availability of finance, as commercial banks had not dared to dip their toes into the stormy waters of a risky offshore wind-farm project.

The ice was broken when the feed-in tariffs were changed; the government set up the loan programme, which is based on the state bank matching the loan terms of commercial banks; and it became clear that EKF, the Danish export credit agency, would also provide financing.

Mr Klimczak said the investment environment for such a project had been the most favourable in Germany.

"A lot of other countries are still behind the UK and Germany when it comes to investing in offshore wind energy." *Daniel Schäfer*