

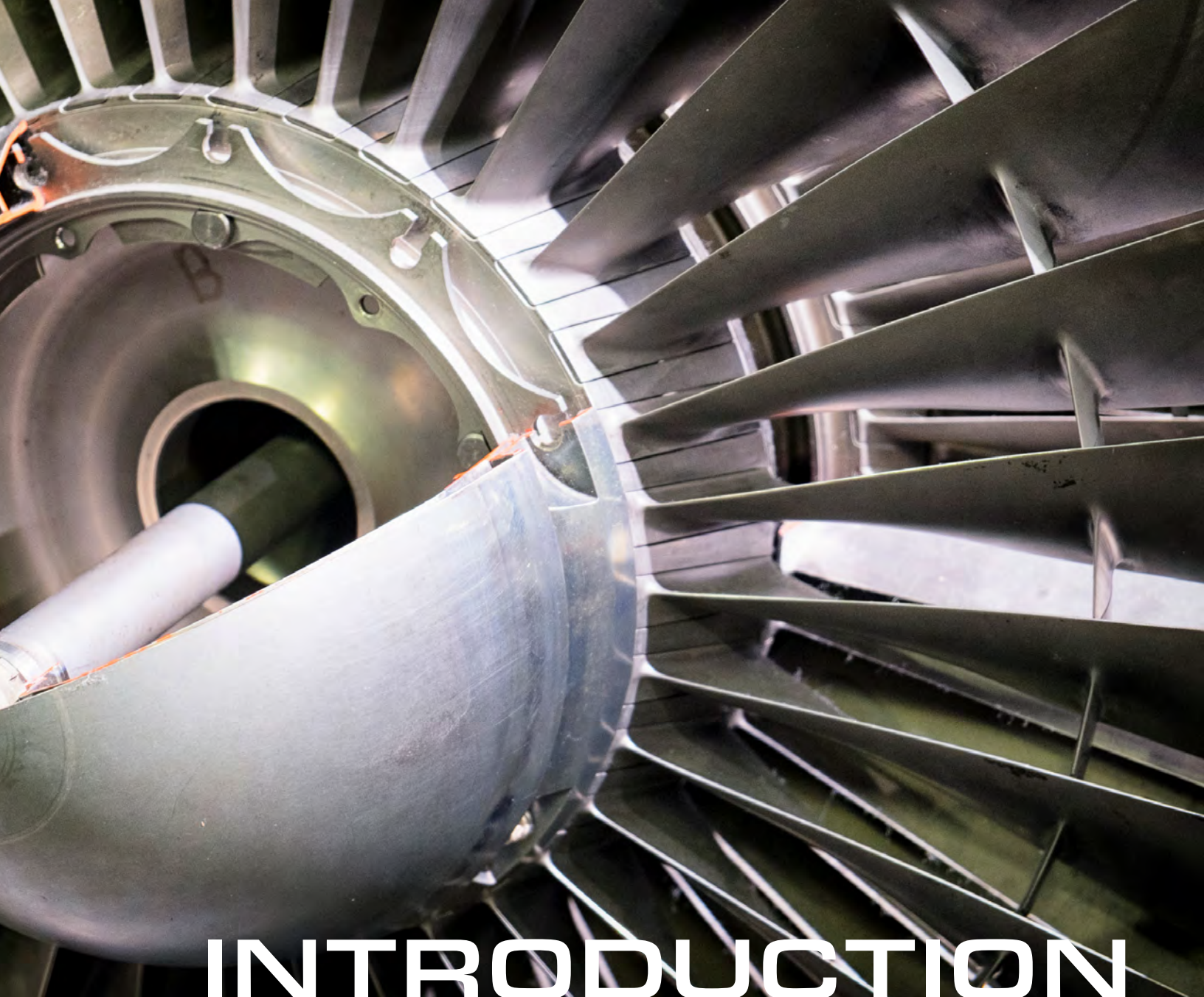


8-pitfalls to Avoid When Buying a Power Generation Asset

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INTRODUCTION

It is a new age in the energy marketplace, particularly for those firms considering acquiring electric power generation assets. Today the electric market fundamentals are influenced by historically low natural gas prices, changing environmental rules forcing the retirements of many coal units, along with the emergence of more lower-cost renewables coming on-line.

In addition to complicated underlying market forces, there is increased competition, with more players entering the marketplace looking to acquire power assets. The resulting competition for quality assets is driving available yields down while increasing the prices for “winning” bidders. This landscape has some private equity firms considering acquiring more challenging, often risky assets.

While the tradeoffs of risk and reward always remain in any transaction, evaluating a power asset becomes increasingly difficult without a sound understanding of power operations and fundamental asset management optimization capabilities.

The following are 8-pitfalls to avoid when considering acquiring a power generation asset:



Only relying on Independent Engineering Reports

1 Independent Engineering (“IE”) Reports are needed to provide an outside, unbiased expert assessment of the underlying assets. The project finance lenders require these assessments as part of their underwriting of the potential acquisition. Independent Engineers confirm the technology employed at the facility, general commercial viability of the project including compliance with permits and other approvals. Unfortunately, these reports can be generic in nature referring to fleet wide observation on generating technology and not very detailed reporting on the specifics of the potentially acquired facility. IE reports are produced by subject matter experts typically from large engineering firms whose primary business in the power generation industry is typically the design and construction of new power plants.

Power plant operations and maintenance (O&M) are a critical component of the facility’s safety, reliability and ultimate profitability. Most IE firms do not have power O&M affiliates and do not consider this aspect as a core competency of their business. Thus when considering a potential investment; it is critically important to evaluate the specifics of each plant and its unique O&M history and future requirements.

Beyond the initial due diligence, it is important to have an O&M partner throughout all phases of the acquisition process, all the way through the takeover date. Working with an O&M provider to assess a facility’s operations and maintenance needs will create a realistic, actionable game plan for the future.

With this approach, there are fewer surprises and the buyer has a solid foundation to optimize.



Failing to account for existing corporate support and its replacement cost

2 If an asset was part of a larger portfolio of an IPP or electric utility, there can be significant corporate costs associated with the owner's overhead and infrastructure providing corporate support services to the plant and its personnel. These corporate support costs may not be included in the Seller's model since the individual asset is a part of a larger fleet that and the corporate support will not be conveyed to the potential asset being acquired. If these corporate support costs are included, these are often estimated with many simplifying assumptions made.

It is in the Seller's interest to show as low of costs as possible. For example, there could be significant regulatory support involved ensuring compliance with various NERC and other requirements that need to be properly accounted for when developing a proforma budget for the potentially acquired facility. The Seller will often make generic assumptions about the costs of providing these services in their model. This simplification based on assumption can leave the potential buyer with a potentially significant surprise in increased costs after the facility is acquired.



Not developing a customized operating (O&M) budget

3 Rather than only accepting what is in-place as part of the data room and making relative adjustments, it is helpful to begin a budget from the ground up, looking at each line item in the operating budget. Questioning the appropriateness of the line item and the amounts of each. Similar generating technologies can have markedly different costs profiles depending on market dynamics and geographic influences.

The plant location and specific regional factors need to be carefully investigated to see if. For example, are labor costs adequately captured due to local economic conditions?

Real-world practical experiences can be factored in to create the most realistic budget. A true, experienced based budget, yield more accuracy and less variability for the project going forward.

Does your O&M provider require you to pay them a bonus for them providing O&M services to your facility? Will they forgo this more costly structure instead for a flat-rate type compensation arrangement?



Not considering additional revenue opportunities

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Creating a detailed customized budget improves the accuracy of the buyer's bid model, ensuring fewer surprises in the future. While controlling costs is a major differentiator in a power plant's profitability, investigating and pursuing additional revenue opportunities are prudent ways to optimize your resource further.

A few areas to consider are as follows:

- Are the electrical interconnections and corresponding agreements appropriately sized to reflect the actual output of the facility? MW's translate into millions of dollars. Are there contractual inconsistencies that prevent the plant from capturing its full value in the marketplace?
- What about the land on which the Project is built? Often developers sized the power project to allow for expansion or other purposes. This excess land may no longer be needed and could be sold for additional value.
- Surplus materials – spare parts: Is there unused inventory that could be liquidated from additional revenue?



Not Evaluating Plant Staff and Personnel

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"The strength of the team is each individual member. The strength of each member is the team." – Phil Jackson
It takes a team of dedicated, knowledgeable professionals to make a power generator hum along.

Unfortunately most independent engineering reports focus only on the equipment and do not consider the impact of the personnel on the performance of the plant. During due diligence site visits, discussions with current plant staff can be informative and provide insight into operations and plant issues that may otherwise not be captured in any of the data room or reports. Many sellers/deal brokers do not want you as the potential buyer to have interaction with the plant staff during site visits — Insist on it!

Maybe the plant's dispatch or other requirements have changed, and a new staffing regime is required. What is the optimal staffing plan to ensure safe, reliable operations at the facility based on current/future operating requirements?



Assuming property tax evaluation is accurate

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Power plants are incredibly costly to construct and involve complex operations. As a result of their initial capital costs, power facilities provide potentially significant revenue to the local taxing authority.

Given the many special tax abatements and other grants that could apply to the taxable value, it is extremely important to validate the assessment and explore ways to improve the value.



Failing to consider Information Technology requirements

7 Power generation facilities require extensive IT connections and equipment. In addition, Cyber-security requirements, telemetry, systems control, emissions, fuel monitoring, RTO/ ISO communications and software licensing all need to be accounted for.

Many assets were once part of a larger portfolio and were supported by companies with immense IT departments and budgets. In addition, the seller frequently does not highlight specific software programs that will not convey. A comprehensive audit should be performed on inherited systems and devices as it is typical for a seller to not upgrade aging equipment when a facility is for sale.

Completing an IT audit will prevent unforeseen security and reliability issues and will help develop a good IT process.



No Support After the Sale

8 Congratulations you just bought a \$500 million dollar power plant. An important consideration is whether the team of experts that helped advise you during the sales process are now ready to support you during the transition and ultimately into the ownership of the project. You paid the advisory fees, now what? Do you have a team of experts available to assist you with whatever issue or opportunity may arise in the future? Or, did your consultants conduct specific Due Diligence, send you a bill, collect their money, or disappear?

Acquiring a power generation asset is a team effort that takes many months of hard work. Realizing the full potential of your investment takes a team of experts able to optimize all aspects of the resource and the marketplace.

If you would like to see how CAMS can help you please contact;

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